CREDIT CARD FAIR FEE ACT OF 2008

HEARING

BEFORE THE

TASK FORCE ON COMPETITION POLICY AND ANTITRUST LAWS

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

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CREDIT CARD FAIR FEE ACT OF 2008

THURSDAY, MAY 15, 2008

HOUSE OF REPRESENTATIVES,
TASK FORCE ON COMPETITION POLICY
AND ANTITRUST LAWS
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Task Force met, pursuant to notice, at 11:02 a.m., in Room 2141, Rayburn House Office Building, the Honorable John Conyers, Jr. (Chairman of the Task Force) presiding.

Present: Representatives Conyers, Lofgren, Jackson Lee, Cohen, Sutton, Smith, Sensenbrenner, Chabot, Cannon, Keller, Issa, and Feeney.

Staff present: Stacey Dansky, Majority Counsel; Perry Apelbaum, Majority Staff Director and Chief Counsel; Stewart Jeffries, Minority Counsel; Sean McLaughlin, Minority Chief of Staff and General Counsel; and Brandon Johns, Majority Staff Assistant.

Mr. CONYERS. We are going to start the hearing even though the Ranking Member of Antitrust isn't here. But since I have the former Chairman and the Ranking Member here, I think it is safe to begin. And I know he is on the way.

But I am glad that everyone has come together this morning to examine together the Credit Card Fair Fee Act, which is H.R. 5546.

Last year, there was a hearing on the topic of credit card interchange fees. And I was surprised by the depth of the problem facing merchants. Members on both sides of the aisle seemed equally concerned about these fees and the effects they ultimately have on consumers.

And so, after deliberation with Chris Cannon, we have brought together a bill to be examined this morning. We hope it will go a long way toward restoring some balance between retailers and the credit card companies.

Now, just a couple of things, and then I am going to yield to some other Members for any remarks.

We do not think that this is regulation of the industry. We think that this measure we are examining addresses potential anti-competitive aspects of interchange fees. We think that lower interchange fees will help merchants and consumers and lower prices.

And, with that in mind, we want to hear what you all think about it.

I would like to yield to the Chairman emeritus, Jim Sensenbrenner, for anything he might want to say.

Mr. SENSENBRENNER. Thank you very much, Mr. Chairman.

First of all, I would like to ask unanimous consent that a statement by the Electronic Payments Coalition be placed in the record at this point.

Mr. CONYERS. Without objection.

[The information referred to follows:]

Electronic Payments Coalition: Statement on H.R. 5546

The Electronic Payments Coalition is pleased that the House Judiciary Committee Antitrust Task Force is holding a hearing today to take a closer look at H.R. 5546, the "Credit Card Fair Fee Act." Members of the Task Force will be given an opportunity to learn quite explicitly that this ill-conceived legislation is nothing short of price controls – action that would result in less competition, fewer consumer choices, and reduced access to affordable credit and debit options.

Developed in this country, the global electronic payments system today connects more than 16,600 banks and credit unions to more than 29 million merchant locations accepting more than 1.9 billion cards – and processes more than 10,000 transactions per second. The success and functionality of this market is evident in the ongoing innovation, improving convenience, new entrants to the marketplace, and the ever-growing presence of credit and debit cards – which are now being used by more than 90 percent of American households.

We strongly oppose this bill, or any other bill that places price controls on this functioning free market. The legislation's proposed panel of politically-appointed bureaucrats who would "determine rates and fees" for this highly complex and vast system could never replicate the delicate balance currently established by the free market. Such policy would bring harm to consumers, to the community banks and credit unions that receive interchange revenue, and to the viability of the worldwide electronic payments system. Ultimately, merchants would also feel the pain of such an economic disaster – ironically, the very entities that are seeking price controls for their own financial gain.

In Australia, where regulators forced down interchange fees, price controls resulted in higher cost of credit and fewer benefits for cardholders. A recent study by CRA International reveals that Australian consumers are now paying approximately AU$480 million more in additional fees for credit cards each year. Meanwhile, the value of reward points for four-party cards has declined by approximately 23 percent, while annual fees for those cards have risen 47 to 77 percent. Moreover, consumers experienced no corresponding decline in merchandise prices as a result of the caps.

We at the Electronic Payments Coalition are optimistic that Congress, with the testimony provided today, will arrive at the correct and obvious conclusion: that this price control legislation is short on workable substance and fatally flawed.

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About Electronic Payments Coalition
The Electronic Payments Coalition is dedicated to protecting consumer value, choice, and competition in electronic payments systems. The coalition is a broad-based group of payment card networks, financial services companies, and financial services trade associations whose primary goal is to educate policy-makers, consumers, and the media about the value of electronic payments systems — including economic growth, convenience, speed, reliability, and security — and to ensure the continued growth of global commerce by promoting consumer choice and the stability of the vast payment networks that connect millions of consumers with millions of retailers each and every day.

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Mr. SENSENBRENNER. Mr. Chairman, I am going to be very brief. Let me say I think this bill is a very ill-advised bill. It is going to have a lot of unintended consequences in the eyes of the Chairman and its supporters.

One of the things that plastic has done to benefit merchants is that they don't have accounts receivable of their own. They get paid right away when people use a credit card to pay for their purchases. And the credit card company basically assumes the risk of somebody not paying their bill.

When I started out practicing law, I represented a mom-and-pop grocery store, and there were a number of folks in town that never seemed to want to pay their bills. And, as a result, I had to try to collect the money and really wasn't very successful in doing so. And, as a result, the small-business operator ended up having to absorb the loss by basically being good people and extending credit to folks in town.

The credit cards, in the way this is set up now, insures the small-business operator from having to deal with those kinds of losses. But nothing in life comes free, and part of that is paid for by the interchange fees that merchants that accept credit cards take.

So I think that we are going to have to look at the impact on small business of this legislation, as well as the impact on consumers and on merchants that take the credit cards.

And I think that the current situation is actually a big plus for both consumers who pay their bills as well as small-business operators. And I will talk a little bit more about that later.

Mr. CONYERS. Thank you, Jim.

Could I turn now to the Ranking Member of the full Committee, Lamar Smith?

Mr. SMITH. Thank you, Mr. Chairman.

Mr. Chairman, America has gone through a radical transformation in the way it pays for its goods and services. Ten years ago, almost 80 percent of all financial transactions involved checks or cash. Today, fewer than half of all purchases are conducted that way. And 3 years from now, consumers are projected to use credit and debit cards for over 70 percent of all their purchases.

Properly used, credit cards offer many benefits for consumers and businesses alike. For consumers, they offer fraud protection, payment flexibility, the ability to track purchases and collect airline miles, for example. For merchants, they offer guaranteed faster payment and the opportunity to expand businesses through Internet and phone sales.

Some studies have shown that consumers who use credit or debit cards at the time of purchase are likely to spend more than they would otherwise with cash or checks.

Of course, this growth has not come without its cost. Consumer groups complain about credit card practices that they think are unfair or illegal. Merchants, too, have had their complaints.

In 2005, the 2nd Circuit affirmed a settlement in which Visa and MasterCard paid $3 billion. The settlement arose from a case brought by a group of retailers who claimed that Visa and MasterCard had illegally tied the acceptance of their credit cards to their debit card offerings.

Today, retailers continue to claim that Visa and MasterCard are charging excessive fees for the acceptance of their cards and that these fees are ultimately passed on to consumers. A group of retailers have brought a series of Federal antitrust suits challenging the way that Visa and MasterCard set these interchange fees, and that suit is pending in the Eastern District of New York now.

For their part, the credit card companies maintain that the setting of credit card interchange fees is a necessary part of their business that maximizes the number of consumers who are willing to carry their cards and the number of merchants who are willing to accept them.

In considering this legislation, my primary concern is how it will affect the American consumer. Will the consumer pay less for goods and services if interchange fees are reduced for merchants? Will those lower prices be offset by reduced credit card benefits and higher charges and fees on credit cards?

Retailers have raised some serious questions regarding Visa and MasterCard's business practices. For example, the credit card firms must answer who sets the interchange fee and how is it set. How much competition is there? Do merchants really have options when it comes to accepting Visa and MasterCard?

In the end, though, the ultimate question is how this bill will help the American consumer.

And, Mr. Chairman, I will yield back the balance of my time.

Mr. CONYERS. Thank you.

Darrell Issa of California?

Mr. ISSA. Thank you, Mr. Chairman.

And thank you for this continued process of evaluating what is, for me, a global competitiveness issue. As you know, in the current form I haven't signed on to the bill, but I have signed on to exactly what caused that bill to be brought.

We have two interesting dichotomies here. On one hand, the efficiency of a global and universally accepted card system has benefited us and the rest of the world. On the other hand, the rest of the world has become convinced that the fees were too high and, in most cases, both Europeans and other nations have artifically lowered those rates.

Recognizing that when we look at competition, if my Visa card represents 1 percent in Spain and 4 percent in the United States, American competitiveness is at stake.

I deny no one—I repeat, no one—the ability to make as much profit as they can justify. But when you have, by definition, a monopoly—and I don't say that in a perjorative way; in fact, we need a universal system, we need a system that, in fact, is so complete as to have that kind of reach and power—you have a situation in which the United States government has an obligation to assert sufficient control to ensure that America is not put at an unfair disadvantage.

To that end, I believe that the bill's attempt to have transparency is critical, to deal with competitiveness on a global basis is critical. I also believe that although it is well-intended, that there may need to be additional safeguards for two reasons: one, to make sure that this is an American solution and not simply an attempt to get to a global rate quickly; secondly, I believe that if

Visa's rates, by an arm's length relationship equivalent, are to be lowered, as I am sure many of the authors would hope them to be, that it be a soft landing.

So at the appropriate time, when this bill is mature, I intend on offering some input for amendments. But today I look forward to hearing from all the parties about how, in fact, we can find a situation in which countries are paying dramatically less for the same service with my same credit card.

And last but not least, quite frankly, I will be asking one critical question, and that is, why is it that when I have discount rates of perhaps double between the highest and lowest, I cannot pass that on in any way, shape or form to the consumer? It is an all-or-nothing. I think that, in fact, has allowed competitiveness but not competitiveness that the consumer truly understands is being paid for by the merchant that he or she does business with.

Mr. Chairman, thank you again. And I yield back and appreciate the time.

Mr. CONYERS. Thank you very much, Darrell Issa.

Congresswoman Zoe Lofgren, Chair of Immigration.

Ms. LOFGREN. I don't have an opening statement, but when we are ready, I would like to introduce my constituent who is a witness.

Mr. CONYERS. All right.

I turn now to the Ranking Member of the Antitrust Task Force, Steve Chabot of Ohio.

Mr. CHABOT. Thank you, Mr. Chairman.

And I, first of all, want to apologize for being a couple minutes late. I am also the Ranking Member of the Small Business Committee and just came from a hearing there. A very interesting hearing, we were talking about the high price that the grocers, the restaurants, snack foods, you name it, how that is related to energy, how it is related to ethanol and requirements that a certain amount of ethanol be utilized nowadays. And very interesting hearing, but I do apologize for being late for this. That is why I was late.

And I want to thank the Chairman, the very distinguished gentleman from Michigan, for holding this important hearing.

And we have an expert panel of witnesses with us, and I know we all look forward to their perspectives. And, therefore, I am going to keep my remarks very brief.

The hearing this Task Force held last year and the resulting bill that we are examining today demonstrate how technology has changed the way individuals, businesses and the markets interact with one another. Credit cards have brought consumers and merchants together in ways never thought possible.

There are more than 14,000 card issuers in the United States today, with 1 billion cards in use. Experts predict that, by 2009, U.S. consumers will spend more than $5 trillion using electronic payment systems.

In my district, in Cincinnati, I have heard from all sides—banks and credit unions and retailers and grocers and merchants of all types. So I know this is an issue that is of great interest to an awful lot of people and affects many Americans. So I know that all Members are interested in hearing all sides to this issue.

As I have said in these hearings over the last year, in my view, Government intervention is not always the best remedy, and we must be very careful not to do more harm than good. Today's hearing is about whether the market for credit cards is flawed to the extent that Government intervention is warranted.

And, again, as I mentioned, I have been trying to listen to every different party, individual, business that has an opinion about this, to make sure that, when this Member ultimately acts, will do so having considered all points of view.

So, again, Mr. Chairman, I want to thank you very much for holding this hearing. And I will yield back the balance of my time.

Mr. CONYERS. Thanks, Steve.

Go ahead, Zoe.

Ms. LOFGREN. Thank you, Mr. Chairman.

I appreciate the opportunity to introduce two of our witnesses today, both from my part of California.

First is Mr. Tom Robinson, who I have known for many, many years. He is the CEO of the San Jose, California-based Robinson Oil Corporation and has been with the company since 1974.

Last year, Tom was named vice chairman of government relations for the National Association of Convenience Stores, which is the association for conveniece and petroleum retailing.

He earned his bachelor's degree in economics from Santa Clara University at home. He is the past president of the Society of Independent Gasoline Marketers of America and is active in the California Independent Oil Marketers Association. He is also a member of the 25-Year Club at the Petroleum Industry.

And he and his wife Lynn reside in Los Gatos. They have two adult daughters and an adult son, all of whom have followed him in the family business.

And it is a pleasure to see Tom here in Washington.

I also would like to introduce Josh Floum, who is also a native Californian and serves as the executive officer and general counsel of Visa, Incorporated, which is based in Foster City, California.

Mr. Floum helped lead Visa through its recent merger, creating a global company and its IPO in March of this year. And that was the most successful IPO in U.S. history, despite a down economy.

Mr. Floum is a former antitrust trial attorney. He is a graduate of the University of California at Berkeley. He earned his J.D. from Harvard Law School.

He is a longstanding member of the Lawyers' Committee for Civil Rights and a senior legal advisor to Earth Island Institute, a nonprofit conservation organization.

I am really very happy that these two individuals are here from California. They don't agree with each other on this subject, which just shows the value of our diverse community at home.

So I yield back, Mr. Chairman.

Mr. CONYERS. Thank you.

Welcome, gentlemen.

Mr. Robinson, why don't you begin our discussion?

TESTIMONY OF THOMAS L. ROBINSON, VICE PRESIDENT OF REGULATIONS, NATIONAL ASSOCIATION OF CONVENIENCE STORES

Mr. ROBINSON. Chairman Conyers, Ranking Member Chabot, and Members of the Committee, thank you for the opportunity to provide my views regarding the Credit Card Fair Fee Act, H.R. 5546.

My name is Tom Robinson, and I am president of Robinson Oil Corporation. Robinson Oil operates 34 Rotten Robbie gas stations and convenience stores in northern California.

I am here today representing the National Association of Convenience Stores, NACS, which represents an industry of more than 145,000 stores, of which more than 60 percent are owned by one-store operators.

I want to thank you for holding this hearing today.

Let me start by stating clearly: NACS fully supports this legislation and urges you to move swiftly toward enactment.

Credit card interchange fees hurt my customers, who, in the end, pay for them and hurt my business. In today's market, many convenience stores will not survive without the action of this critical issue. The Credit Card Fair Fee Act will help fix this problem.

Right now, there is no market for interchange fees. The fees are fixed by the banks, hidden from the public and forced on merchants in a take-it-or-leave-it offer. Right now, the banks act collectively but merchants cannot.

The Credit Card Fair Fee Act would create a market for interchange fees for the first time by allowing merchants and the card associations to negotiate on equal footing.

The card associations claim there is no problem with the current system. If I were able to fix prices with my competitors and make more than $40 billion per year doing it, I suppose I wouldn't think there was a problem either. Of course, just because the price fixers want to keep doing business the same way doesn't make it right.

I am not an antitrust attorney; I am a businessman. But I know I cannot agree with my competitors to charge the same price. Yet that is precisely what the banks that issue credit cards have done for years.

From my perspective, the best way to understand the antitrust problem is looking at what would happen if the same situation prevailed in my industry.

NACS does not, and never has, set the prices or terms for which member companies charge the public. But let's just say that we set a default price for a gallon of gasoline at $9 and that every member of NACS across the country charged that default price.

The speed with which this Committee and the Justice Department would haul us in front of them for agreeing to a default price would be dizzying. I would fully expect someone to fit me for a not-very-fashionable yellow jumpsuit.

Yet that is precisely what Visa does with its banks and, separately, what MasterCard does with its banks. All these banks that are supposed to compete with each other charge the same default interchange fees, and the rest of us have no choice but to pay them because of the huge combined market power Visa and MasterCard wield with their banks.

And don't just take my word for it. The Kansas City Federal Reserve has found that merchants like me have no realistic but to accept Visa and MasterCard.

The impact on my industry is incredible. And, in fact, I think there are slides up there on the board. If you take a look at these charts, you will see that in 2006 the industry paid more to accept cards than it made in pre-tax profits, $6.6 billion to $4.8 billion.

The 2007 figures are simply incomprehensible. My entire industry made pre-tax profits of $3.4 billion. Note that our profits went down by more than $1 billion at the same time card fees increased by $1 billion, to $7.6 billion. And we received nothing more for this additional $1 billion or for the billions of additional dollars these fees increased in prior years.

Processing the card swipe probably cost Visa and MasterCard less than before, but now we are paying far more than double our profits simply to accept cards. It is clear that the price for the cashless society is way too high if you let the credit card industry set the rate.

Every time you buy gasoline, I ask you to remember this: The station you are buying it from is likely paying more than twice in much in fees than it is making, and every time gas prices go up, the card fees go up right with them.

If you are concerned about prices at the pump, you need to be concerned about interchange fees. These fees have simply taken over our industry. My business is more for them than it is for me.

I don't even time to describe the ways that Visa and MasterCard create anti-competitive and abusive rules to make the situation even more difficult for businesses like mine, but I am happy to answer questions regarding these abuses.

The bottom line is that we need legislation to at least make this playing field level. The Credit Card Fair Fee Act is a critical first step to bringing market fundamentals to this nonexistant market.

Critics of this bill say it is a Government price-fixing proposal. Nothing could be further from the truth. The bill provides merchants an opportunity to negotiate reasonable terms with the card associations. However, if a deal cannot be reached, there must be a way to resolve the differences.

In the event a deal is not reached, each side will present a final offer. The bill simply identifies a decisionmaker to pick the offer that is closest to what is happening in the competitive market. At no point does this bill allow judges to independently come up with the price of interchange. They do the minimum necessary to say which side has the better offer, and that is chosen.

This is just the type of approach that appeals to me as a businessman. I negotiate the prices and terms of nearly everything that happens in my business. This is the way American businesses operate. What I need is the ability to present myself to the card associations and to the banks in the same way they present themselves to me, as a group. The card associations should not be afraid to negotiate on an equal footing with merchants.

Thank you for your time, and I would be happy to answer questions.

[The prepared statement of Mr. Robinson follows:]

PREPARED STATEMENT OF THOMAS L. ROBINSON

NACS®

Tom Robinson

President

Robinson Oil Corporation

On Behalf of

The National Association of Convenience Stores

Before the

U.S. House Committee on the Judiciary

Antitrust Task Force

H.R. 5546, The Credit Card Fair Fee Act of 2008

May 15, 2008

The Association for Convenience & Petroleum Retailing

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Chairman Conyers, Ranking Member Chabot, and Members of the Committee, thank you for the opportunity to provide you with my views regarding the Credit Card Fair Fee Act, H.R. 5546. My name is Tom Robinson and I am President of Robinson Oil Corporation. My company, which is headquartered in San Jose, California, operates 34 gas stations and convenience stores throughout the San Francisco and Monterey Bay area of Northern California under the name Rotten Robbie. Robinson Oil is a privately owned family business. I am the third generation to operate the business and the fourth generation is active in the company as well.

I am here today representing the National Association of Convenience Stores ("NACS"). NACS is an international trade association representing the convenience store industry. The industry as a whole includes about 145,000 stores in the United States, generated $577.4 billion in sales in 2007, sells nearly 80 percent of the gasoline in the nation, and employs about 1.7 million workers. It is truly an industry for small businesses; more than 60 percent of convenience stores are owned by one-store operators. NACS also helped found the Merchants Payments Coalition, which includes about 20 national and 80 state trade associations from diverse industries, to help promote a more competitive and transparent system of credit card interchange fees.

I am also a past President and active member of the Society of Independent Gasoline Marketers of America ("SIGMA"). SIGMA is a member of the Merchants Payments Coalition and subscribes to the views expressed in this testimony regarding the interchange fee system.

I want to thank you for holding this hearing today. Credit card interchange fees hurt my customers – who, in the end, pay for them – and hurt my business. I would like to first talk about why the interchange fee system as it exists today is an antitrust and economic problem as well as a problem for consumers and businesses. Then I'd like to give you my views as to why the Credit Card Fair Fee Act is a helpful solution to those problems.

Problems with Interchange Fees

The American credit card interchange fee system has several enormous problems that are perniciously hidden from consumers. First, the way the fees are set represents an ongoing antitrust violation. Second, Visa and MasterCard have organized the system such that there is no functioning market for interchange fees and therefore market forces do not create downward pressure on the cost of interchange as would happen in a functioning market. Third, the system hurts consumers and businesses – with lower income consumers and smaller businesses shouldering a disproportionate share of the burden of the system.

The Antitrust Problem

I am not an antitrust lawyer. I am a businessman. Given my background, however, I can understand when there is an antitrust problem. I cannot agree with my competitors to charge the same prices. If we did that it would deprive consumers of the benefits of price competition and we would justifiably face civil and/or criminal charges. And we could not agree to charge the same prices even if we did so while meeting together as board members of our trade association, NACS. Yet that is precisely what the banks that issue credit cards have done for years.

Until recently, both Visa and MasterCard were associations – much like NACS – and under their umbrella banks that should compete with one another on the prices of their services

agreed to charge the same interchange fee. Despite the Visa and MasterCard initial public offerings, the situation is just as bad. While they have reached for a fig leaf to cover their illegal activity (and collectively set aside more than $3.5 billion for litigation exposure), the same banks continue to agree to charge the same interchange fees and refuse to compete. I'm sure lawyers can explain this better than I can, but in my view this is simple. Banks, using the cover of Visa or MasterCard, agree to charge the same interchange fees. That is against the law and something must be done.

From my perspective, the best way to understand the antitrust problem is by looking at what would happen if the same situation prevailed in my industry. As I said, I am a member of NACS and its structure is not much different than Visa's and MasterCard's. NACS is governed by a group of its retailer members and others in the industry and it sets policy for the trade association. NACS does not and never has set the prices or terms by which its member companies charge and deal with the public. But let's say that it did and that NACS decided that its "default" price for a gallon of gasoline would be $9 and that every independent member of NACS across the country charged that "default" price. The speed at which this Committee – and, by the way, the Justice Department – would haul us in front of them would be dizzying. I would fully expect someone to fit me with a nice orange jumpsuit after I'd finished explaining what we had done.

But that is precisely what Visa does with its banks and, separately, what MasterCard does with its banks. All these banks that are supposed to compete with each other charge the same "default" interchange fees and the rest of us have no choice but to pay them. Now, let's think about their arguments in light of this clear analogy. Visa and MasterCard say this isn't a problem because, after all, we don't have to accept their cards if we don't like how they price

them. In the hypothetical scenario of NACS setting gas prices, I could just as easily say that if anyone didn't like it they could choose not to buy gasoline. And Visa and MasterCard even have the audacity to argue that the fact that we accept cards proves they deliver a valuable service and that we think it's worth it. Would I get out of this room alive if I made the same argument about price-fixing by independent retailers of gasoline?

Let's take another argument that the small banks put forward. They argue that they have higher costs than large banks for issuing cards and that without centralized price-fixing they could no longer offer this card-issuing service to their customers. I could make the same argument in the hypothetical gasoline situation. The majority of my industry, more than 60 percent, are single-store operators. There is no doubt that these small businesses struggle to keep their expenses low enough to compete with their larger competitors. They would have a much easier time if there were price-fixing in the industry and no doubt they would be hurt if that price-fixing scheme were later taken away. But again, I don't think anyone on this Committee would be particularly sympathetic to the small gasoline retailers arguing that their businesses would be hurt if they weren't allowed to fix prices. It is ironic that businesses in my industry are sometimes accused of price gouging when the real gouging is being done to us by the banks that collude to fix prices.

If small banks are too inefficient to offer card-issuing services without price-fixing in the industry, then the answer that a competitive American economy should give to them is the same one it gives to competitors in every industry across the nation – find a way to be more efficient or get out of that particular portion of the business. It may be a tough message, but that is how our economy works for everyone except the small banks that issue cards.

No Functioning Market

The antitrust problem created by this price-fixing activity has an enormous impact in the marketplace. Visa and MasterCard have market power such that I have no choice whether to accept their cards. Given their place in the market, if I don't take Visa or MasterCard my competitors will take them – and will take my customers. But don't just take my word for it. The Kansas City Federal Reserve has found that retailers like me have no realistic choice but to accept Visa and MasterCard.[1]

The banks present themselves collectively to retailers as Visa or MasterCard and present us with a take it or leave it offer – accept all our cards on all our terms at our collectively set prices or you can't accept any cards. That is abusive. Other companies that provide services to my stores negotiate with me. This happens on a daily basis. Virtually everything I purchase is the result of a competitive negotiation. I negotiate with suppliers, service providers and others. But interchange is not negotiable. Interchange fees are so significant that at six of my locations card fees are my #1 operating expense. Just at my stores, the fees went from $3.5 million in 2006 to more than $4 million in 2007 and my sales were flat or slightly down. That is a dramatic increase and it mirrors the dramatic increases we have faced industry wide.

Visa and MasterCard sometimes try to confuse the interchange fees with something they call the "merchant discount." The merchant discount is the full amount by which the money I receive is less than the sale I made to the consumer. Most of that discount – perhaps 80 to 90 percent – is the interchange fee. There are some other fees imposed by my bank and processor, but those are minimal. I can also shop around or negotiate to get a better deal on those other fees. Many contracts call for merchants to pay the processing cost plus interchange. I can't shop

[1] F. Hayashi, "A Puzzle of Payment Card Pricing: Why Are Merchants Still Accepting Card Payments?" *Review of Network Economics* at 172 (March 2006).

around or negotiate on interchange because every bank adheres to the collectively set default fees. Visa and MasterCard want to pretend there is no problem because I have some options on the small percentage of other fees making up the merchant discount. The fact that I can negotiate a penny or two off of the processing costs of a transaction has no bearing on the fact that I still have to pay the credit card companies 6 to 8 cents or more when selling a gallon of gasoline. In my experience interchange is always a full pass through to the retailer and competition on other fees cannot make up for the antitrust problem and lack of a market on interchange.

I have a chart showing the annual profits of my industry and the amounts paid to accept cards. A few years ago we were paying almost as much as we earned – and these are pre-tax numbers. In 2006, those figures flipped and we paid $6.6 billion and only made $4.8 billion. The 2007 figures are simply incomprehensible. My entire industry made pre-tax profits of $3.4 billion. Note that our profits went down by more than $1 billion. At the same time, card fees increased by $1 billion to $7.6 billion. Now we are paying far more than double our profits simply to accept cards. It is clear that the price for the cashless society is way too high if you let the credit card industry set the rate.

Every time you buy gasoline I ask you to remember this – the station you are buying it from is likely paying more than twice as much money to accept cards as it is making. Given the price of gasoline today an average retailer is paying between 6 and 8 cents in interchange fees (and some are paying more) on every gallon paid for with a credit card – and every time gas prices go up the card fees go right up with them. If you are concerned about prices at the pump you need to be concerned about interchange fees. These fees have simply taken over our industry. Some days I think I should just take down my "Rotten Robbie" signs and put up Visa and MasterCard signs. My business is more for them than it is for me.

It is impossible for anyone to look at this and credibly say that we don't have to accept cards. If we could stop accepting cards, we would. Cards are a huge drain on my business. Visa and MasterCard like to talk about the service they provide – and it does provide convenience – but it does not give me additional sales as they like to claim. I have never seen one of my customers' gas tanks grow because they got a credit card. My customers buy the amount of gas they need.

Visa and MasterCard Create These Problems

I wish I could stop taking cards. But not only is the market power of Visa and MasterCard so great that I have no choice, they put a legal straitjacket on me to make sure I can't refuse their cards. Visa has a rule, for example, requiring that if I want to take cards at one location I have to take cards at all of my locations. Think about that. Let's say that there were really only one or two of my locations where the competition was such that I had to accept cards to stay in business. That is not true for me, but let's assume it were. Visa would make me choose to accept cards at all thirty four locations – or lose those one or two locations. Or, put another way, now that I and most other retailers take cards, what is my realistic choice? Visa says I could decide not to take cards, but what retailer makes a dramatic change in its operations throughout a chain without testing it first. That would be suicide. If I had the ability to refuse cards, I or any reasonable businessperson would want to try it at one or two locations and see how well it worked. Visa prohibits me from doing that. They require that it is an all-or-nothing, take-it-or-leave-it choice. I can't put an entire business that has been in my family for four generations at risk that way – and Visa knows it. That is precisely why they have this rule. And for them to testify before you that I can simply choose whether or not to take their cards is shameless. They do everything they can to make that an impossible choice.

The card associations also have an honor all cards rule which severely limits my ability to make market decisions. This rule provides that if I want to take any of their cards I must take all of them – no matter how expensive they make their interchange fees on some of these premium cards. One aspect of this rule is understandable – part of the value of the Visa and MasterCard brands is that merchants like me will not discriminate based on which bank issued a particular consumer's card. That means consumers do not have to worry where they get their card because it will be treated in the same way. I don't take issue with that. But notice what they have done. Rather than an honor all issuers rule, Visa and MasterCard impose an honor all cards rule. And they have exploited that rule to a painful extent. They push more and more cards every year that carry higher interchange fees. Platinum cards, rewards cards, corporate cards and other offerings can carry with them much higher interchange rates than standard cards. By pushing these cards to consumers (often to existing consumers who have not even asked for a different type of card), Visa and MasterCard change the mix of cards consumers use and that results in dramatic price increases on interchange – even when the announced price changes are relatively modest. They don't need to make many individual categories of cards more expensive if they convert more people to higher interchange fee cards. Once again, there is nothing I can do. If I am concerned about the high price of some of their most expensive cards my only choice is to not take any of their cards at any of my locations – or I can pay these abusive, exorbitant fees that often result in my selling gasoline at a loss. They know that as bad as these fees are I just can't risk losing my customers by refusing to take Visa and MasterCard.

Frankly, Visa and MasterCard are much like telephones in the days when AT&T was a monopoly. They are essential for most everyone to do business. It is no more realistic for Visa and MasterCard to claim that their actions are OK because if merchants have the choice not to

accept cards than it would have been for AT&T to say their actions were OK because no one has to have a telephone. That is just not a real choice.

The card associations also like to say that they let me discount for cash. Very kindly of them in light of the fact that federal law won't let them prohibit me from discounting for cash. The problem here is that they do everything in their power to make it difficult to discount for cash. For example, they require that the credit price be treated as the full price and retailers have been instructed numerous times by their acquiring banks that the credit price must be more prominently displayed. Many types of retailers have so many different products in their stores that the double price marking this requires is just not a practical option. That is why you don't see cash discounts within stores. About the only place you see cash discounts is gasoline retailing because at the pump we tend to offer only a few products – regular, mid-grade, and premium gasoline. But Visa in particular has undertaken aggressive actions against gasoline retailers who try to discount for cash. In my state of California, for example, Visa threatened multiple retailers with fines of $5,000 per day for offering cash discounts. These retailers simply posted two sets of prices – one for cash and one for credit. But Visa didn't like the higher price being called the "credit" price. I don't understand why because that is exactly what it was and gasoline retailers have displayed cash discounts that way for a long time. Visa, however, insisted that the higher price had to be called the "regular" price or the "full" price. The state of California, on the other hand, told retailers that we couldn't call that price "regular" or "full" because we offer "regular" as a grade of gasoline and full service as opposed to self-service. The state said that these labels would be confusing to consumers and violate consumer protection laws. But Visa still insisted on these changes being made – or they would impose $5,000 per day in fines. Thankfully, some Members of Congress got involved and Visa backed off – in

California – but Visa has taken similar actions in other states and successfully intimidated many retailers so that they no longer offer cash discounts.

I want to emphasize the coercive power that Visa and MasterCard have in these situations and how they use it. In my industry, a single store in 2007 made an average pre-tax profit of about $23,000 per year. As I said, Visa in California was threatening stores – including at least one individual who only owned a single store and used what he made from that single store to support his family – with fines of $5,000 per DAY. How do you think a retailer reacts to this kind of threat? Predictably, most of them are not willing to risk bankruptcy for a fight with Visa and they back down. So, Visa says we can choose not to take cards or discount for cash and that takes care of the interchange problem. But because of their market power and their aggressive actions, both of those possibilities can threaten the existence of merchants' businesses. The card associations know this and that is why they pile the pressure on us. They know we have no realistic choice but to agree to any terms that they dictate.

In fact, they know we have no choice but to let them dictate the terms because they do it from day one of the commercial relationship. Merchants like me sign a short contract with our bank or processor that allows us to accept Visa and MasterCard. My contract is about 15 pages. But the contract incorporates by reference more than 1,000 pages of rules that govern the contractual relationship. I didn't get to see those rules before I had to sign a contract and agree to them. We have complained about this for years. Even people who normally are supportive of the card associations seem to recognize the unfairness in making merchants agree to and comply with rules that they cannot see.

Thankfully, due to the attention of the Members of this Task Force and others in the Congress we are starting to see a little change. Visa has announced that today – the day of this

hearing – they will allow us to see their rules without having to sign a nondisclosure agreement. While it is long overdue, I applaud them for finally disclosing their rules. I am still a little skeptical, however, because we have heard similar announcements in the past. More than two years ago when a House Energy and Commerce Subcommittee had a hearing on this issue the card companies said they made all their rules available on their website. That, of course, was false. When the Senate Judiciary Committee had a hearing in 2006, Visa announced that they were making their rules available. Unfortunately, at that point they only allowed merchants to see the rules AFTER the merchant signed a contract agreeing to abide by them and only AFTER the merchant signed the non-disclosure agreement. I hope the change announced by Visa is what they claim and that all the rules will be available to merchants without conditions and before they have to sign an agreement. Past experience shows that when they say they are making rules available we need to watch out for the exceptions they aren't telling us.

That, however, leaves MasterCard. Just recently, MasterCard released about 500 pages of its rules in addition to the excerpts it previously made available to merchants. MasterCard claimed these, at long last, were all the rules that were relevant to merchants. But their claim is plainly wrong. There are multiple examples of information that is very important to merchants but does not appear in the rules that MasterCard makes available. It is somewhere in the rules that we are not allowed to see. One clear example is the issue of fines. I already mentioned that Visa threatened California retailers with fines of $5,000 per day for having the temerity to offer cash discounts. Retailers are threatened with fines from the card associations on a regular basis for different types of violations of the voluminous rules. The information that MasterCard makes available, however, does not include anything indicating the amount of fines that can be imposed for different types of violations, how those fines are determined and the like. I can't

think of a merchant who wouldn't consider that important information to know. Visa, by the way, has never made information about fines available before today either but perhaps we can all learn something when we look at their website this afternoon. For MasterCard to claim that it gives merchants everything they need to know and then not tell us how much we will be fined for different violations is completely disingenuous. The fines aren't the only thing missing, but they are egregious. MasterCard has no excuse for not making its entire set of rules available.

I should be clear though – making the rules available is not enough. Many of the rules are anticompetitive and abusive and need to be changed or eliminated. I have already briefly touched on the single entity rule, the honor all cards rule, and the abusive use of the no surcharge rule to stop discounting for cash. Walking through all of the problems of which we are aware in the rules would take a long time, but the area of chargebacks deserves special mention.

Chargebacks are the term used by the card associations to refer to situations in which they take the retailer's money. In some situations they can take the entire amount of a transaction out of the retailer's pocket and in other situations they only take part of it, but either way they are taking our money.

It is important to understand that the card associations justify interchange on the basis that they are taking the credit risk and guaranteeing the retailer payment. Except the card associations do not deliver on this supposed promise. Instead, they push the credit risk onto the retailers and do not guarantee payment. Their actions belie their justifications for interchange.

The card associations take our money for many different reasons. Importantly, they take our money for many transactions that they determine are fraudulent or result from unauthorized use of a card. Remember we get an authorization at the pump and the card associations justify their fees based on taking this risk – and justify high interest rates charged to consumers the

same way – but we end up paying for a great many transactions this way. The card associations don't mention that too often. But the one that has really harmed my industry is referred to in Visa's rules as "reason code 96." If Visa has really put its rules on its website, then maybe today I can actually find out what reason codes 1 through 95 are, but this particular one is number 96 and MasterCard has a similar rule.

Reason code 96 provides that when a credit card is swiped at the pump prior to a fill-up, Visa and MasterCard put a $75 limit on the transaction. Until last month Visa's limit was $50, but they changed it following years of complaints. When gas prices rose and people started paying more than $50 or $75 for a tank of gas in significant numbers, my industry started losing big money on these transactions. That is because if a transaction exceeds that limit, Visa claimed the right to chargeback the entire amount of the transaction – not the amount over $50 but the entire amount of the transaction. Visa just recently changed that practice and now treats these like MasterCard by only charging back the amount by which the transaction exceeds $75. While that is still unfair, it is far better than the practice Visa employed for years.

Consider for a moment the fact that some folks in my industry sell diesel fuel to truckers. Many of those stations no longer allow truckers to use card readers to pay at the pump, but for quite some time they did and those fill-ups can be as much as $800 or more in some cases. That means when the transaction is made at the pump the retailer can lose $725 on a single sale. To understand how much money that is to a retailer it helps to know something about margins in our industry. In good years, retailers tend to sell with a margin of 10-15 cents per gallon above the cost they pay for gasoline at wholesale. And that margin is before the interchange fees are deducted from the retailers' revenues. Right now most retailers are operating at margins significantly less than 10-15 cents, but assume retailers are having an absolutely great year and

selling at a margin of 15 cents. Interchange fees are between 6 and 8 cents per gallon now so the real margin even if this were a great year for the industry (which it isn't) would be about 7 cents per gallon. That means to make back the $725 that Visa has taken from some retailers on a single diesel sale, the retailer needs to sell another 10,357 gallons. The truth is we never really make up for those losses and the chart demonstrates graphically that we just keep losing more money.

How often do these reason code 96 chargebacks happen? They don't happen every time a transaction exceeds the limits – different card issuing banks treat these situations differently – but we have seen individual months in which the total dollars taken from retailers due to these chargebacks exceeded $100 million. I'm afraid to find out how many gallons of gasoline retailers would have to sell to make back the money taken from them in just one of those months. My calculator doesn't have that many digits so I don't know the answer.

Public Policy Problems with the System

The antitrust violations by Visa and MasterCard and the problems created in the business relationship and the marketplace are, of course, severe public policy problems. But the anti-consumer effects of the system Visa and MasterCard have created are additional policy problems that may not be as obvious at first glance. The costs that Visa and MasterCard impose are, in the end, borne by consumers. These consumers, however, get no notice or disclosure about interchange fees. They, just like the merchants they frequent, have no idea how much interchange is charged for their cards – and many don't know that interchange is charged at all. In fact, the Visa and MasterCard rules constraining how retailers can list their prices are designed to make interchange invisible to consumers. That means consumers cannot make rational economic decisions about whether using their cards is worth the cost it imposes on the

transaction. Not only does it look like using the card is free for the consumer, many consumers are offered so-called rewards of airline miles or other things as an inducement to use their cards. They don't know that they are paying far more through the inflated cost of goods and services than they will ever get back in the form of rewards. That is the deception inherent in the way that Visa and MasterCard have designed the system.

Another problem is that because of the way the rules require the cost of interchange to be buried in the cost of goods and services sold, all of us pay more for our goods to cover the cost of interchange – even if we don't use credit cards at all. That means people who don't have good credit and can only use cash pay extra to cover interchange. It also means that people who, for example, use food stamps pay more to cover interchange. This is a massive transfer of value in which lower income people pay more for their goods and services and a piece of their money goes out the door to pay for airline miles and rewards – particularly for people at the highest end of the income brackets who get the most generous rewards programs with their cards.

Not only that, Americans pay about 60 percent of all of the interchange paid throughout the entire world. Some of that is because there are more transactions here than in other countries, but a lot of it is because interchange rates are far higher here than in other countries. Our rates are about three times higher than the European rate, more than twice the British rate, and nearly four times the Australian rate. And Europe's Competition Commissioner has said even their much lower rate is unjustified and must be reduced because it currently violates their antitrust laws. What does this mean? I can only conclude that American consumers are getting the short end of the stick as Visa and MasterCard do just fine in other countries with far lower interchange fee levels.

Smaller businesses also pay higher fees. Some of the card associations' fee schedules are openly weighted to provide that larger businesses pay less. That is a questionable practice because this is not like some businesses in which certain fixed costs (delivery trucks for example) are lower on a per unit basis when more units are ordered. The infrastructure of the system is the same for me as it is for some of the giants in my industry. To the extent that my locations require their own hardware and software – and they do – that is an expense that I pay. Keep that in mind. The card associations tend to like talking about the investments they have made in the system and I don't dispute that they have made those investments. But I never hear them talk about the very large investments that merchants across the country have made in card readers, software systems and the like. Those investments are huge and benefit Visa and MasterCard tremendously – and those investments are a disproportionate burden on smaller businesses.

The Solution – H.R. 5546

What do we do about all of these problems? Chairman Conyers, Congressman Cannon and other Members on and off this Committee have given us a good answer to a multi-faceted problem. The Credit Card Fair Fee Act, H.R. 5546, seeks to create a competitive marketplace where none exists today. The bill would move us toward a competitive market by allowing for transparency and negotiation. It would allow merchants like me to negotiate as a group with Visa and its banks, on the one hand, and MasterCard and its banks on the other. This will simply help balance the scales of market power so that we can have negotiations about both the rates charged for interchange and the many pages of anti-competitive and abusive rules that are imposed on merchants.

This is just the type of approach that appeals to me as a businessman. I negotiate the prices and terms of nearly everything that happens with my business. This is the way that American businesses operate and I am comfortable with it.

The truth of the matter is that there are only three basic ways to deal with an antitrust problem like the one we have here. One way is to break up the card associations like the courts broke up AT&T in the 1980s. Another way is to have a regulator oversee the card associations like utilities and set their prices. The third way is to create a competitive marketplace where none exists today. H.R. 5546 opts for that third way and I think that is appropriate. Competitive markets are what make the American economy great – both for business and for consumers. Allowing for a negotiation with similar market power on each side of the table is a great way to create that competitive market.

Visa and its banks and, separately, MasterCard and its banks already deal with each individual retailer this way. They mass their market power and present us with their deals – take-it-or-leave-it – and each merchant deals with that individually. H.R. 5546 should be welcomed by the card associations because it would allow them to continue to act in just that way. It is hard to understand why huge financial institutions like Bank of America, Citibank, Wachovia, JP Morgan Chase, and others feel the need to combine their market power and agree with each other (through the card associations) to charge exactly the same rates and impose exactly the same terms, but they seem to believe this activity is essential. H.R. 5546 accepts that situation even though there are many reasons to think that these huge combinations are in themselves a problem and that the associations should be broken up like AT&T. We agree with the decision of Chairman Conyers, Congressman Cannon and the other cosponsors of the bill to

take a narrower approach – accept the card associations as they have organized themselves but allow merchants a similar right.

Frankly, it is baffling to me that the card associations and banks object to negotiating on equal terms. It makes me wonder what exactly scares them. This is how business is done in most industries in the United States everyday – just without the combination of competitors acting together (as happens on the card side of the equation already). If they believe that their fees are so inflated that negotiating on equal terms will be a disaster for them, then that is all the more reason to require it. It simply proves my point about the problems in the system today. If they don't believe their fees are over-inflated, then they should welcome this type of negotiation. It allows their model to continue, makes their customers happy, and brings needed transparency to the system.

Of course, there must be some way to deal with the situation if no deal is reached in negotiations. The card associations would have no reason to bargain in good faith to change a system that is unfairly slanted to their own advantage without some provision about what happens when negotiations fail. The sponsors of the Credit Card Fair Fee Act have devised a good solution to that issue. They provide that the two sides would each submit their best, final offers to a panel of judges and those judges would review the facts and pick the one that was closest to what would happen in a competitive market. The judges would be extremely constrained in their discretion and would not have the ability to set interchange rates or terms. They would not be allowed to pick some terms from offer "A" and others from offer "B." They would only be allowed to choose one offer or the other. This process is a minimal and necessary protection and this Committee has passed and amended a similar process to allow group negotiations in the licensing of music. This definitively is not price controls.

This process for dealing with a failed negotiation is what the card associations complain about – at least publicly. They say it amounts to government price controls. That may be a good, focus-group tested label for them to slap on this idea – it just isn't an accurate one. Government price controls occur when a regulator collects the necessary information and uses its discretion to set the price. It is not something that follows a market negotiation but is the only process at work and the regulator is the only decision-maker. The Credit Card Fair Fee Act, by contrast, allows the businesses involved to control their own destiny. They can negotiate a deal in any way they choose. And even if they don't reach a deal, no regulator compiles and sets a price. The parties each compile an offer and one is simply accepted.

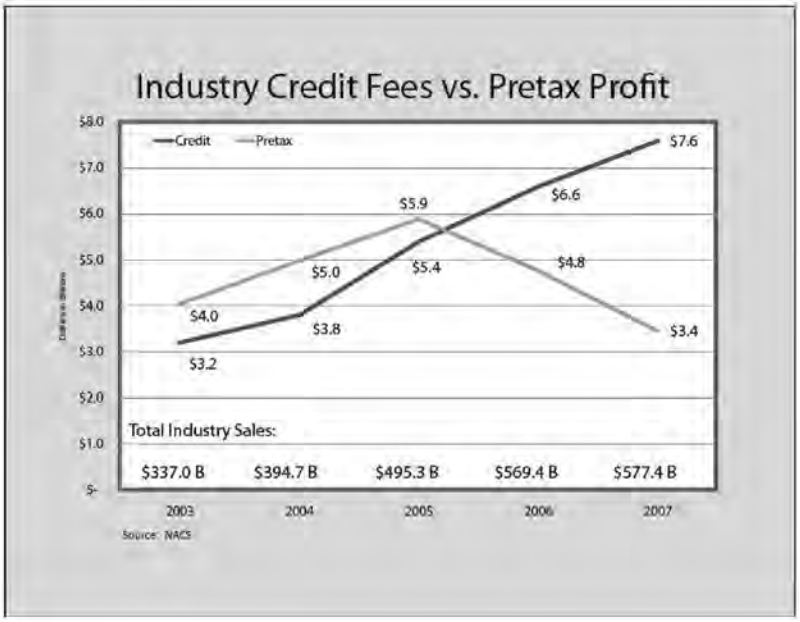
The bottom line is that under this bill there will be a negotiated, agreed upon interchange system or whichever party comes up with a more reasonable offer will get that offer implemented. No government decision-maker will set interchange in any fashion. Calling this price controls is a mischaracterization and an insult to every one of the bipartisan group of sponsors of this carefully balanced legislation.

The bottom line for me is that I just want a seat at the negotiating table. If I get that, then I am willing to take my chances – just like I do in every other part of my business. If Visa and MasterCard are right in what they say about interchange, then interchange might get more expensive after this bill passes. I am happy to take that chance. Of course, if Visa and MasterCard really believed what they say, I doubt they would be fighting this hard just to avoid sitting at a balanced negotiating table.

* * *

Members of the Committee can make their own evaluations of that – and of the other issues at stake in this debate. Regardless of the evaluations you make, I want to express to all of

you my appreciation for your willingness to seriously examine the interchange fee system. This is a problem that has remained in the shadows of secrecy for far too long and your colleagues and the public need to know about it and hear about these concerns. Thank you for giving me the opportunity to provide you with my views. I welcome your questions.


Industry Credit Fees vs. Pretax Profit
Credit
Pretax
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$7.0
$6.0
$5.0
$4.0
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$2.0
$1.0
$-
$7.6
$6.6
$5.9
$5.0
$5.4
$4.8
$4.0
$3.8
$3.4
$3.2
Total Industry Sales:
$337.0 B
$394.7 B
$495.3 B
$569.4 B
$577.4 B
2003
2004
2005
2006
2007
Source: NACS

Mr. CONYERS. Thank you very much.

Attorney Floum, welcome.

TESTIMONY OF JOSHUA R. FLOUM, GENERAL COUNSEL AND CORPORATE SECRETARY, VISA, INC.

Mr. FLOUM. Thank you, Mr. Chairman and distinguished Members of the Committee. My name is Josh Floum. I am an executive officer and the general counsel of Visa. I have prepared some written testimony, which I would request be submitted for the record.

Mr. CONYERS. Yes, yours and everyone else's as well, without objection.

[The prepared statement of Mr. Floum follows:]

PREPARED STATEMENT OF JOSHUA R. FLOUM

Joshua R. Floum,
General Counsel, Visa Inc.

Written Testimony

Before the

House Committee on the Judiciary
Task Force on Competition Policy and Antitrust Laws

May 15, 2008

Chairman Conyers and Members of the distinguished committee, my name is Josh Floum, and I am an Executive Officer and General Counsel for Visa Inc. I want to thank the Antitrust Task Force for the opportunity to participate in this important hearing and explain why Visa's interchange-setting methodology is a highly efficient and pro-consumer way to manage its payment network and why regulated interchange fees would leave the vast majority of participants in the Visa payment system worse off than they are today.

It is important to start out by recognizing the enormous benefits that payment cards deliver to both cardholders and merchants — benefits that are available only because of interchange fees. Cardholders are able to avoid the risks of carrying cash, can make payments by telephone or over the Internet, and have the right to a "chargeback" if the goods or services they receive are not as promised. And by accepting Visa cards, retailers can receive reliable, convenient, secure and safe payment from any of hundreds of millions of cardholders throughout the world. Retailers without the resources to operate their own financing business can also attract consumers who wish to buy on credit. This can dramatically expand the markets available to such retailers. Retailers also gain access to new customers who either prefer to pay with a Visa card or who are not carrying cash, checks, or other payment methods accepted by the retailer.

The payments market is an exceptionally dynamic, ever-evolving space characterized by shifting market shares, efficiency-enhancing innovations in products and processing, and frequent entry of new players. To be a viable competitive alternative at the point-of-sale, Visa must provide value both to issuers, so that they will choose to provide Visa cards to consumers and encourage cardholders to pay with them, and to acquirers, so that they can negotiate with and sign retailers to accept Visa cards. This is the essence of a two-sided market: balancing the push

and pull of demand between the system's two groups of customers, making the system appealing to both.

In seeking that balance, Visa considers the effects on *both* sides of the payments market and sets its default interchange rates so that retailers will accept Visa products for payment and contribute to the costs and incentives of developing the system, recognizing that issuers impose fees on cardholders for their use of Visa cards on the other side of the ledger. Interchange, however, is not set simply to reflect or exchange these costs. Visa sets interchange to optimize total participation in its network, provide high quality data and other processing incentives to strengthen network performance for the benefit of all participants, and ultimately maximize the number of transactions processed securely through the Visa network.

Visa's default interchange rates also foster competition and innovation. Visa has every incentive to maximize its card transaction volume, which it does by setting interchange rates that provide incentives for banks to issue Visa cards that cardholders desire to use and for retailers to accept Visa cards. Because interchange is paid by acquirers to issuers and is not Visa revenue, Visa's primary interest in interchange fees is setting them at a level that balances demand on both sides of the network. If retailers do not accept Visa, cardholders will not carry Visa cards, banks will not issue Visa cards, and Visa will suffer competitively. Visa, therefore, fosters robust competition on both sides of the market through the mechanism of interchange. This competition benefits consumers, retailers, and the economy by providing thousands of choices for payment services.

Visa's use of interchange to maximize system output takes a variety of forms. Default interchange rates can be set to encourage issuers to fund rewards programs, increase acceptance among merchants in historically under-penetrated market segments, or simply to reflect the value

of payment cards in enabling remote transactions in electronic commerce. Visa also has made its products more attractive to participants in its payment system by creating incentives through reduced interchange rates to encourage marketplace behaviors that reduce fraud and improve the timeliness and accuracy of the Visa system to the benefit of all participants.

The proposed regulation of interchange — a system functioning efficiently and competitively today — would harm competition and innovation. Government regulators would do a worse job setting interchange rates to maximize output and encourage innovation than Visa does. A non-market driven reduction in Visa's interchange rates would drive issuers and cardholders to American Express, or other potentially more expensive and lesser utility networks, and thereby simply re-allocate output on the Visa system to another network. Price controls would thus have the perverse effect of driving transactions to a payment network that is generally *more expensive* for retailers. The harmful effects of interchange regulation are evident from the recent experience in Australia. There, interchange regulation has led to higher prices and reduced rewards for cardholders, all without any reduction in the prices that consumers pay when they make a purchase from a retailer, let alone a reduction sufficient to offset the higher costs and reduced rewards.

Interchange regulation would also skew competition in the banking sector. Interchange enables the over 13,000 local and community banks, credit unions, savings and loans, and thrifts to offer payment products and reduces their disadvantages in competing with larger banks. Even if the largest players in banking might find a way to adapt to the regulation of Visa's interchange rates (either by moving their card portfolios to American Express or by creating customized card programs to attract consumers), smaller financial institutions would be particularly vulnerable if interchange were artificially suppressed. Interchange regulation would thus tip the competitive

scale in favor of the largest banks and have broader impacts on banking competition, likely accelerating the trend towards bank consolidation. This harm to smaller local financial institutions would have a deeply-felt impact on every community that depends upon the vital role played by community banks, thrifts, and credit unions.

Moreover, much of the criticism of interchange reflects a misunderstanding of payment markets. Arguments that interchange has high "social costs" because it encourages "overuse" of payment cards are based on the flawed belief that cash and checks come at no cost. Comparison shows that PIN-debit, signature-debit, and credit are actually cheaper than cash and checks. Criticisms concerning the cost of interchange to retailers are similarly unfounded. The dramatic increase in payment card volume has benefited retailers, and an increase in the *total* cost of payment-card acceptance reflects primarily increased system volume. Visa's average interchange on a per-transaction basis has *decreased* over the last thirty years and has remained steady over the last ten years. Retailers, in fact, have many options with regard to accepting Visa, including determining not to accept Visa at all. That over seven million U.S. retailer locations accept Visa clearly indicates that the benefits of accepting Visa exceed the cost to most retailers. More than 1,600 acquirers compete for the business of these retailers, and retailers can and do use this competition to their advantage. Groups of retailers, including the National Association of Convenience Stores, have negotiated favorable merchant discount rates for their members. And retailers that are not happy with their rates can switch acquirers — more than 500,000 retailers switch to a new acquirer every year. Retailers, just like car buyers, need not pay the "sticker price."

Finally, as I will discuss, any claim that Visa violates the antitrust laws by setting default interchange rates is equally baseless, and the courts have consistently rejected such claims in

every case in which they have been presented. And while retailers' prior unsuccessful challenges have been based on Visa's membership structure and incorrect claims that Visa's rules and practices result from horizontal agreements between Visa's member financial institutions, Visa is no longer majority owned or otherwise controlled by its customer banks.

I. Background

Visa competes in the vibrantly competitive payments market, which has included general-purpose payment cards since Diners Club introduced the first card in 1950. This market also includes cash, checks, ACH, PIN-debit cards, signature-debit cards, prepaid/gift cards, and store-branded cards, among other payment forms. From the Diners Club system, which had fewer than twenty thousand cardholders and charged retailers 7% for accepting the card in 1950, the payments marketplace has grown to the point at which, by 2007, 81% of American households owned at least one credit card, and the average merchant discount charged on a Visa transaction by the banks engaged in retailer acquiring — across credit, signature-debit, and PIN-debit — is roughly 2%.

Competition in the payments market takes place not only among different firms, but also among different payment types. General-purpose payment cards must compete aggressively with two forms of payment that have existed for centuries: cash and checks. In 2005 cash and checks accounted for more than 44% of consumer payments at the point-of-sale (33% for cash, 11% for check), versus 19% for credit cards, 4% for gift/prepaid cards, 19% for PIN-debit, and 14% for signature-debit.[1] The fastest growth in payments (over the last five years, and

[1] *See* Nasreen Quibria, Federal Reserve Bank of Boston, *Understanding Emerging Payments - Moving Towards a Cashless Society?*, at 10 (May 8, 2007) (citing a Dove/ABA study), *available at* http://www.bos.frb.org/economic/eprg/presentations/quibria050807.pdf.

anticipated for the next five years) is coming from automated clearinghouse (ACH) payments and debit cards, with credit card transactions growing at a slower rate.

Even within the electronic payments segment, consumers can choose to pay with, and retailers can choose to accept, an enormous variety of charge and credit cards, along with PIN-debit, signature-debit, and prepaid cards. A number of established players in addition to Visa, including MasterCard, Discover, American Express, and First Data/STAR, offer a variety of products in multiple payment segments. These established players also compete with a variety of more recent entrants. Firms including PayPal, Google, and Bill Me Later are offering new payment services for electronic commerce and Internet retail. Tempo has entered the market with a number of other products, including decoupled debit, PIN-debit, and stored-value cards. Revolution Money, another recent entrant, is marketing its RevolutionCard, a PIN-secured credit card, as well as an Internet-based solution for transferring money between account holders. Not only are these new entrants motivating continued innovation across the entire payments industry, they also are growing rapidly in transaction volume, retailer acceptance locations, and consumer accounts.

II. Interchange

A. The Role of Interchange in a Two-Sided Market

Any discussion of payment card interchange must take into account the two-sided market in which payment cards compete. Sellers in a two-sided market serve two distinct groups of customers, and the number of participants on one side of the market affects the demand on the other side. Payment systems are a classic example of a two-sided market because they bring together two distinct groups of customers: cardholders and retailers. The demand for payment cards by cardholders and retailers is interdependent — the greater the number of consumers who use payment cards, the more valuable the network is to retailers, and the greater the number of

retailers that accept payment cards, the more cardholders value those cards. Payment networks use interchange to balance demand between the two sides of the market, promoting growth of the total system.

The two types of payment network systems — "open" and "closed" systems — both use a form of interchange to balance the two sides of the market. A closed system, sometimes called a three-party system, prices directly to retailers and cardholders, and operates without the use of independent issuers or acquirers. Today, American Express and Discover generally follow this model, as do newer payment systems like PayPal. Payment networks operating a closed system balance acceptance and cardholder usage by directly setting the retailer's cost for card acceptance, which is called the merchant discount rate.

Visa's payment system is more complex than the closed three-party system. In a four-party payment system (also called an "open-loop" system), issuing financial institutions provide payment cards to consumers, and acquiring institutions provide payment card transaction services to retailers. In addition to Visa, MasterCard, STAR, NYCE, PULSE, and other debit networks operate similar four-party systems.[2] Operators of open-loop systems do not issue cards, establish cardholder fees, or set the interest rates that cardholders pay, nor do they typically contract with retailers or set merchant discount rates. Instead, the network facilitates the transaction between the issuer and the acquirer, each of which is, in turn, responsible for establishing these rates and fees in contract with their respective cardholders and retailers. When a cardholder uses his or her credit card with a retailer, the retailer transfers the billing

[2] In more recent years, both American Express and Discover also have begun to emulate the four-party model by opening their network to other acquirers and issuers. In doing so, American Express and Discover apply acceptance charges and offer an "issuer rate" or yield on volume that serves the same function as interchange from the perspective of an issuing bank, in an effort to attract issuers.

information to its acquirer, which transfers the billing request to the cardholder's issuer. The acquirer then credits the transaction amount charged to the retailer's account, less the merchant discount rate that it charges to the retailer. Accordingly, the retailer receives prompt payment. The issuer subsequently pays the acquirer the amount of the transaction less the interchange fee, which (absent a bilateral agreement) is set in default form by the open-loop system, and posts the transaction to the cardholder's account. The cardholder thereafter pays the issuer the transaction amount.

In order for an open system to operate efficiently, it must have an interchange mechanism that establishes a default rate of exchange between the issuer of the card and the acquirer that contracts with the retailer. While issuers and acquirers are free to negotiate bilateral interchange agreements, default interchange rates promote efficiency by ensuring that both the issuer and the acquirer know the exact financial terms that will apply to any given transaction between any two participants in the system absent a bilateral agreement. While closed payment systems balance demand between cardholders and retailers directly by setting discounts to the retailers and card fees, interest rates, and rewards to consumers, open payment networks do not control issuers or acquirers. Issuers and acquirers in an open system set their own prices and provide their own benefits to cardholders and retailers. Thus, to balance the demand between cardholders and retailers, networks in open systems must establish an interchange rate.

B. Visa Uses Interchange to Foster Competition and Innovation

Visa sets default interchange to maximize network card volume by balancing demand between retailers and cardholders. Visa also sets interchange fees to ensure that participants in the Visa network have the proper incentives to innovate and invest in new technologies. Without the proper incentives, which result from the stimulus of interchange, payment networks would be less competitive and, therefore, less innovative.

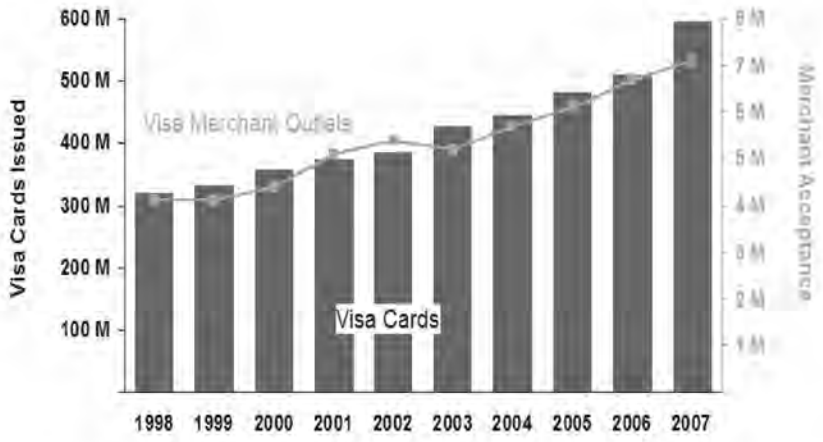
Visa's interest in setting default interchange rates is to maximize the volume of transactions on Visa's system because that is the way Visa maximizes its own revenue. Visa earns revenue from fees charged to the banks that issue Visa cards and acquire Visa transactions that are based upon these banks' transaction and sales volumes. Visa does not earn revenue from interchange paid on U.S. transactions, which is paid by acquiring banks to issuing banks (except on ATM transactions, where interchange is paid by issuers to the acquirers who operate ATMs). Thus, Visa has no stake in setting a "high" interchange rate or a "low" interchange rate; its interest is solely in setting the optimum interchange rate to maximize the level of Visa transactions and sales volume.

Visa's financial institution customers play no role in setting Visa's U.S. interchange rates. The minority of Visa directors affiliated with Visa financial institution customers (although they owe fiduciary duties to Visa when acting as Visa directors) have played no role in reviewing Visa's interchange strategy or setting or recommending rate levels since Visa U.S.A. added independent directors to its board in 2006. Rather, interchange today is solely in the hands of Visa's management.

In order to maximize transaction volume, Visa sets interchange rates to balance issuance and card usage with retailer acceptance. On the issuance and card usage side of the system, given the highly competitive business of issuing credit cards in the U.S., increases in interchange benefit cardholders by resulting in reduced cardholder costs and increased cardholder benefits. This leads to greater transaction volume and revenue for Visa. Issuers also use these benefits to encourage consumers to use electronic payments instead of cash and checks. Increased cardholder demand to use a Visa card also makes it more attractive for banks to issue Visa cards instead of cards from MasterCard, American Express, and Discover. By the same token, Visa's

failure to respond appropriately to interchange rates set by its competitors can lead to a reduction in transaction volume on the Visa network, as cardholders shift their purchases to cards that offer superior rewards or other valuable card benefits funded by interchange, and as issuers switch their portfolios to competing networks in order to be able to offer cardholders the competitive terms and card benefits they demand.

Visa, however, must use interchange to balance *both* sides of the two-sided market. Visa must set default interchange rates that not only avoid the loss of existing retailer acceptance, but also to win acceptance at retailers that have not previously accepted Visa cards. To the extent increases in interchange inform the acquirer's pricing to the retailer, higher interchange makes it less attractive for retailers to accept Visa cards. If retailers stop accepting or exhibit less preference for Visa cards, Visa not only loses transactions at those retailers (which results in a loss of Visa revenue from processing transactions), but this loss of acceptance also makes Visa cards less attractive to consumers (resulting in a loss of transaction volume and Visa revenue as consumers switch purchases to competing cards) and less attractive to issuers (resulting in a loss of transaction volume as issuers switch their portfolios to competing networks). As the chart below shows, Visa has been successful in setting default interchange to balance merchant acceptance and cardholder participation. Visa has added acceptance at 1.5 million merchant locations in the last two years, and both acceptance and cards issued are growing at roughly 7%/year.



Retailers make a choice about both the costs and benefits of accepting Visa cards, and while the merchant discount is a cost of accepting Visa cards, those costs are balanced against the benefits that Visa acceptance provides. By accepting Visa cards, retailers can receive reliable, convenient, secure and safe payment from any of hundreds of millions of cardholders throughout the world. Retailers without the resources to operate their own financing business can attract consumers who wish to buy on credit. Accepting Visa cards can dramatically expand the sales channels — such as mail order and/or Internet shopping — available to retailers. Retailers also gain access to customers who either prefer to pay with a Visa card or who are not carrying cash, checks, or other payment methods accepted by the retailer. Where Visa offers an attractive value proposition given these and other benefits, it is able to win acceptance at new retailers (and avoid losing acceptance with existing retailers), gaining not only increased revenue from new transactions at those retailers but also new transactions at other retailers as it increases the value of issuing and holding Visa cards.

In an effort to further maximize system output by setting interchange rates that reflect the costs and benefits of a Visa transaction, Visa sets default interchange rates at different levels depending upon the type of transaction, merchant category, and type of payment card. Visa uses interchange to create incentives to implement technologies that make the Visa network more valuable to all participants. As an example, by using interchange rates to create incentives for retailers to implement technologies that reduce fraud rates, Visa makes its network more attractive to issuers (who generally bear the cost of fraud), to retailers (who bear the cost of fraud in some circumstances), and to cardholders (for whom dealing with fraud is troubling and time-consuming, even if their direct financial exposure is limited). For example, Visa transactions at some retailers can qualify for lower interchange rates if the retailer implements Payment Card Industry Data Security Standard (PCI DSS) compliance, which requires the retailer to encrypt sensitive cardholder data and prohibits storage of sensitive data (such as magnetic stripe data or CVV2 security codes).

Visa has also successfully created incentives for electronic authorization of transactions in lieu of manually looking up card numbers in a book listing stolen or otherwise unauthorized cards by offering favorable interchange rates for electronically authorized transactions. Although implementing electronic authorization imposed costs on retailers in the form of new card terminals and telecommunications charges, the percentage of Visa transactions processed electronically rapidly increased after the introduction of favorable interchange rates for electronic transactions in 1980. Within ten years the percentage of Visa transactions processed electronically grew from 5% of sales volume to 80%. Today over 99% of Visa retail transactions are processed electronically. Retailers and cardholders alike have benefited from the increased security and reduced fraud that these innovations brought to the system.

Visa also provides incentives to retailers to improve fraud performance and customer satisfaction by setting higher interchange rates for transactions at retailers that have high chargeback rates (which reflect either high fraud rates or a large number of customers dissatisfied with the retailer's product or service performance). Visa has successfully lowered fraud rates by 20% in the past 10 years. At the other end of the spectrum, Visa has established preferred interchange rates for "high-quality" transactions that are submitted to cardholders quickly, include enhanced data, or have undergone supplemental validation by the retailer. The faster clearing times, extra data, and additional validation benefit cardholders and retailers alike by reducing fraud and increasing security.

In addition, because interchange is a significant component of the costs that acquirers face when they charge a merchant discount to retailers, Visa has set lower interchange rates in some merchant categories to enable acquirers to enroll additional retailers in historically under-penetrated segments (such as quick-service restaurants, department stores, and supermarkets) to accept Visa cards, while it sets higher interchange rates in merchant categories where the cards deliver more value to retailers (such as travel and entertainment).

By the same token, to encourage issuers to invest in and promote rewards programs (such as frequent-flier miles or cash back), interchange rates on rewards credit cards generally are higher than interchange rates on cards that do not offer rewards. These rewards programs deliver benefits to retailers as well as consumers by encouraging higher spend on cards and acting as a discount on card purchases. (In other words, when a cardholder receives a 1% cash rebate, it is indistinguishable in effect for the cardholder from a 1% reduction in the retailer's price to the cardholder.) Visa also sets higher interchange rates on rewards cards to compete with American

Express (whose products target higher-income customers that value rewards) for banks' issuance decisions.

Most fundamentally, Visa uses interchange to enable it to deliver new types of products that offer new benefits. Visa created the debit card, but without interchange banks would have had no incentive to issue debit cards and promote their use to the extent that there are now more Visa debit transactions in the U.S. than Visa credit transactions. Visa prepaid cards are attractive to governments as a lower cost way of delivering benefits like social security and child support payments, while also helping benefit recipients avoid the cost and burden of cashing checks and the risks of carrying cash. But without interchange, banks would have no incentive to compete for the government's business to issue these cards, or would do so only by charging the government far higher fees. Mobile payments from cell phones have the potential to be the "next big thing" — allowing consumers to make payments without carrying a wallet or a card. But without interchange revenue, banks will have no interest in enabling it. Without interchange, the electronic payments revolution could never have occurred. And if interchange is regulated, consumers will miss out on the benefits that Visa's substantial investment in innovation is poised to deliver.

III. Interchange Price Controls and Government Regulation of Visa's Rules Will Harm Competition and Innovation

Retailers are seeking comprehensive government regulation that would prevent Visa from using its independent, marketplace-driven judgment to determine core business functions, namely the rate and terms of exchange between its customers. Specifically, retailers want Congress to reject the free market and to impose price controls and regulatory micro-management on Visa's payments business.

Legislation recently introduced in the House of Representatives would create a panel of three "Electronic Payment System Judges" with the power to set not only the price that retailers pay for Visa (and MasterCard) transactions, but also all of the rules and terms that govern retailers' participation in the Visa network.[3] Under the proposed legislation, the rates and terms would be the same for all retailers regardless of merchant category or volume of transactions.[4] In other words, the pending legislation would introduce price controls and regulate terms of service on Visa and MasterCard, but not on other payment networks. This proposed legislation is as misguided as it is extreme and unprecedented.

Given that Visa uses interchange to foster competition and innovation, it naturally follows that interchange price controls such as those contemplated by the House bill will harm competition and reduce the pace of innovation. Indeed, the experience in Australia, which has experimented with interchange price controls, demonstrates that consumers are *worse off*, and that price controls have failed to accomplish the goals that their proponents claimed.

A. Price Controls Are Bad Policy

Americans know from experience that price controls do not work. Price controls inherently misallocate resources, create inefficiencies, and retard innovation, without providing consumer benefits. A shining example of the folly of price controls is the price caps imposed on gasoline in 1973 and again in 1979. These efforts resulted in massive inefficiencies, including

[3] *See* Credit Card Fair Fee Act of 2008, H.R. 5546, 110th Cong. (2008).

[4] *Id.* at § 2(d)(2) ("For any given covered electronic payment system, such rates and terms shall be the same for all merchants, regardless of merchant category or volume of transactions (either in number or dollar value) generated.").

huge lines of consumers waiting to purchase gasoline, and consumer harm that swamped any possible benefits.[5]

It has been the consistent policy of the United States in both Democratic and Republican Administrations to oppose unjustified regulation, and particularly to oppose price controls in competitive markets.[6] As the Antitrust Modernization Commission ("AMC") created by Congress[7] recognized in its recent report, "[i]n the vast majority of cases, competition is more likely to benefit consumers than economic regulation."[8] The AMC specifically warned that "[i]n general, Congress should be skeptical of claims that economic regulation can achieve an important societal interest that competition cannot achieve," for "in many instances, regulation reflects successful rent-seeking by private economic interests and generally reduces consumer welfare by restricting output."[9] That describes precisely the efforts of the proponents of interchange price controls.

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[5] William Simon, the administrator of the Nixon price control program, concluded in retrospect that, "the kindest thing I can say about it is that it was a disaster. The normal market distribution system is so complex, yet so smooth, that no government mechanism could simulate it." William E. Simon, *A Time for Truth* (1978), quoted in Michael R. Baye, Director, Bureau of Economics, Federal Trade Commission, Remarks for Breakfast with the Federal Trade Commission Bureau Directors: Is There a Doctor in the House? The Value of Economic Expertise in Antitrust, Consumer Protection, and Public Policy (Mar. 28, 2008), *available at* http://www.ftc.gov/speeches/baye/080328aba.pdf.

[6] *See, e.g.*, Exec. Order 12,866, 58 Fed. Reg. 51,735 (Sept. 30, 1993), *available at* http://www.whitehouse.gov/omb/inforeg/riaguide.html (stating a presumption against regulatory actions such as price controls); *see also* Exec. Order 13,422, 72 Fed. Reg. 2763 (Jan. 18, 2007) (amending Executive Order 12,866 to clarify the description of market failures that justify regulation but retaining the language quoted above).

[7] The members of the Commission were appointed by the President and the respective majority and minority leadership with the goal of ensuring "fair and equitable representation of various points of view in the Commission." Antitrust Modernization Commission Act of 2002, Pub. L. No. 107-273, §11054(h), 116 Stat. 1856, 1857 (2002).

[8] Antitrust Modernization Commission, *Report and Recommendations* 337-38 (2007).

[9] *Id.* at 337-38.

B. Price Controls Would Harm Competition By Interfering With Visa's Ability to Maximize Output

Price controls are particularly unworkable for a system as complex as open-loop card networks and the interchange rates that enable them to function. Artificially capping interchange rates — and particularly requiring that the same interchange rates apply to all transactions — would disturb the balance Visa establishes when it sets interchange at levels that maximize issuance, acceptance, and cardholder usage of Visa cards. While a reduction in interchange might in theory lead to increased retailer acceptance in the short term, Visa cards are already accepted at more than seven million locations, and it is implausible that the added transactions from retailers that might begin to accept Visa would outweigh the loss of transactions stemming from the reduction in Visa issuance and card usage that are the inevitable result of any mandated artificial reduction in interchange. At any interchange level, if there were a drop in the level of Visa card issuance, retailer demand for Visa products would likely fall as well. Indeed, if reducing interchange would cause Visa to gain more transactions than it would lose, Visa would have every incentive to reduce its interchange rates today.

The proposed regulation of Visa's interchange rates would have the perverse effect of driving issuers and consumers to American Express, which without similar constraints would be able to continue to offer cards that provide elevated cardholder benefits funded through merchant discount revenues. These transactions would move to American Express's network, even though retailers pay significantly more on average when their customers pay with Amex than with Visa. Evidence from interchange regulation in Australia (where the Reserve Bank of Australia capped Visa's7 and MasterCard's interchange rates but left Amex's and Diners Club's rates unregulated) bears this out: American Express gained share even though the merchant discount on American

Express transactions is about 2.5 times higher than the merchant discount on Visa transactions in Australia.[10]

If Congress regulates Visa like a public utility, we all will end up with significantly less competition, slower growth, and reduced innovation. The payments industry is simply too dynamic and complex to regulate as a public utility. It is the lifeblood of the modern economy. As the Commerce Department has recognized, "Electronic payments expand the consumer market, increase banking access to the unbanked, improve macroeconomic efficiency, and encourage entrepreneurial activity."[11]

Provisions of the proposed legislation requiring Visa to set the same interchange rate for all transactions at all retailers would have particularly pernicious effects. Because Visa would lose the ability to offer reduced interchange to gain acceptance in new merchant categories, the legislation would raise costs to some retailers rather than reduce them. The legislation also would impede Visa's ability to create strong incentives via reduced interchange for retailers to implement technologies that reduce fraud or otherwise improve the quality of transactions processed on VisaNet, reducing network quality to the detriment of all participants: issuers, acquirers, consumers, and retailers.

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[10] *See* Reserve Bank of Australia Payments System Board, *Reform of Australia's Payments System: Preliminary Conclusions of the 2007/08 Review* 20 ("RBA 2007/08 Review"), *available at* http://www.rba.gov.au/PaymentsSystem/Reforms/RevCardPaySys/Pdf/preliminary_conclusions_2007_2008_review.pdf.

[11] Department of Commerce, International Trade Administration, *Credit Card Market: Economic Benefits and Industry Trends* (March 2008), at 2, *available at* http://www.ita.doc.gov/td/finance/publications/creditcards.pdf.

C. Interchange Regulation Would Lead to Higher Prices for Consumers

The harm to consumers from interchange regulation is evident in Australia, where credit card fees have increased substantially since interchange regulation was imposed and if any retailer cost savings were realized, they have not been passed on to consumers in the form of lower prices. In a recent study of Australia's rate regulation, economists estimated that cardholders had seen their annual fees and finance charges increase by AU$148 million.[12] Another analyst estimates that consumers have faced increases in card-related fees of about 40%.[13] Lest there were any doubts, in a report released earlier this month, Australia's interchange regulator, the Reserve Bank of Australia ("RBA") itself concluded that "[l]ower interchange fees in the MasterCard and Visa credit card systems have resulted in a reduction in the value of reward points and higher annual fees, increasing the effective price of credit card transactions facing many consumers."[14] Consumers must now spend over 30 percent more to receive the same rewards they did prior to the imposition of interchange caps.[15] Not only do cardholders face higher fees on the regulated networks, but American Express and Diners Club

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[12] Howard H. Chang et al., *An Assessment of the Reserve Bank of Australia's Interchange Fee Regulation*, The Federal Reserve Bank of New York Conference: Antitrust Activity in Card-Based Payment Systems: Causes and Consequences (Sept. 15-16, 2005). Some economists estimate the increase in fees to Visa and MasterCard cardholders as high as AU$ 480 million. *See* Robert Stillman et al., *Regulatory Intervention in the Payment Card Industry by the Reserve Bank of Australia: An Analysis of the Evidence* 13 (Apr. 28, 2008), *available at* http://www.crai.com/ecp/assets/Regulatory_Intervention.pdf.

[13] *See* Mercator Advisory Group, *Australian Interchange Regulation: Credit Card Issuer Effects* 17 (Dec. 2007) (including annual fees, over-limit fees, and cash advance fees).

[14] *See RBA 2007/08 Review*, *supra* note 10, at 17; *see also* Stillman, *supra* note 12, at 15-16 (noting that cardholder rewards have been reduced by approximately 23% since 2003).

[15] *See* Reserve Bank of Australia Payments System Board, *Annual Report 2007* 27, *available at* http://www.rba.gov.au/PublicationsAndResearch/PSBAnnualReports/2007/Pdf/2007_psb_annual_report.pdf.

have taken the opportunity to raise their annual fees on rewards-based charge cards at similar rates as increases on rewards-based Visa and MasterCard cards.[16]

What did consumers get in return for these higher prices for the use of payment cards? As the RBA conceded earlier this month, in the five years since interchange was regulated "no concrete evidence has been presented to the Board regarding the pass-through of [retailers' interchange] savings."[17] Indeed, the vast majority of retailers that reported a reduction in the merchant discount applicable to their transactions did not reduce prices to consumers.[18] In short, the Australian experiment with interchange regulation has brought consumers higher prices with no demonstrable benefits.

Indeed, there is every reason to believe that regulation of Visa's rules and interchange rates would subject consumers to three different types of harm: (1) artificially suppressed interchange would lead to a reduction in cardholder rewards (such as cash back), which operate as a discount on card transactions; (2) evidence suggests retailers would not reduce their prices to offset reduced merchant discount; and (3) elimination of Visa's no-surcharge rule could result in retailers surcharging Visa transactions at the point-of-sale.[19] In all three ways, consumers stand to lose at the hands of retailers.

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[16] *See* Stillman, *supra* note 12, at 12.

[17] *RBA 2007/08 Review*, *supra* note 10, at 23.

[18] David S. Evans, *Turbulent Times: Recent Developments in the Payment Card Business in the United States, European Community, and Japan*, Modern Bankers Bankcard Seminar, Beijing, China (June 29, 2006) ("No change in relevant prices at point of sale to consumer"); Howard Chang et al., *The Effect of Regulatory Intervention in Two-Sided Markets: An Assessment of Interchange-Fee Capping in Australia*, AEI-Brookings Joint Center for Regulatory Studies 18 (Dec. 2005).

[19] *See e.g.*, Bi-Lo Complaint at ¶12(G); Kroger Complaint at ¶23(G); Meijer Complaint at ¶12(G); Publix Complaint at ¶ 12(G); QVC Complaint at ¶12(G); Raley's Complaint at ¶12(G); Rite Aid Complaint at ¶12(G); Supervalu Complaint at ¶12(G); Wakefern Complaint at

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D. Interchange Regulation Would Have a Disproportionate Impact on Smaller Banks, Thrifts, and Credit Unions and the Communities They Serve

Interchange (and Visa's establishment of a default interchange rate that applies absent individual negotiation between issuers and acquirers) enables the over 13,000 local and community banks, credit unions, savings and loans, and thrifts to offer payment products and reduces their disadvantages in competing with larger banks. Even if the largest financial institutions might find a way to adapt to the regulation of Visa's interchange rates (either by moving their card portfolios to American Express or by creating customized card programs to attract consumers), smaller banks would be particularly vulnerable if interchange were artificially suppressed or Visa could not establish default interchange fees. Community banks and credit unions lack both the resources and the leverage to negotiate rates with thousands of acquirers. They also are far less attractive as issuers to American Express and lack the scale to create customized card offerings that would allow them to compete with larger financial institutions.

Smaller financial institutions often act as acquirers for small businesses in their communities, and absent a default interchange rate established by Visa would be unable to continue in this role because it would be impracticable for them to negotiate agreements with thousands of other Visa issuers. Interchange regulation would harm local merchants that prefer to do business with local community bank acquirers instead of the large national acquirers.

Because community banks and credit unions have less diversified revenue sources than larger banks, they are more dependent upon interchange revenues, and regulation of interchange

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¶12(G) ("The 'No Surcharge Rule" forbids retail merchants from charging cardholders a surcharge on their cards to reflect cost differences among various payment methods."); First Amended Consolidated Complaint ¶ 154.

would have a disproportionate impact on their revenues and profitability, as well as the benefits that credit unions provide to their members. Interchange regulation would thus tip the competitive scale in favor of the largest institutions and have broader impacts on banking competition, likely accelerating the trend towards bank consolidation.

Harm to community banks raises concerns far beyond competition in the banking sector. Small banks, thrifts, and credit unions play an essential role in local communities, focusing on the needs of local families, police and firefighter associations, and farmers, and remaining deeply involved in local community affairs. Regulation of interchange rates would thus have deeply-felt impacts not only in the payments industry and among community banks, but also in every community that depends upon the vital role played by community banks.

E. There Is No Evidence That Interchange Regulation Increases Overall Efficiency

Interchange rate regulation leads to reduced output of the regulated card system, higher card usage costs for consumers, and no reduction in the prices that retailers charge to consumers. All of these effects represent harm to competition and a reduction in market efficiency. Absent any basis to allege a reduction in output — the classical measure of harm to competition or an anticompetitive effect — critics of interchange are left to argue either that interchange harms consumers because it encourages over-usage of payment cards, or that it forces consumers who pay with cash to subsidize those who pay with credit cards. Both of these arguments demonstrate a fundamental misunderstanding of payment networks.

Discussions of the "high" cost of payment cards and claims that consumers "over-consume" payment cards are based on the erroneous assumption that other payment forms, such as cash and check, come at no cost. In fact, cash and check also have costs, and comparison shows that PIN-debit, signature-debit, and credit are actually cheaper than cash and checks.

When only retailer per-transaction processing costs are included, payment cards seem more expensive relative to cash or checks, and cash seems the cheapest payment instrument.[20] But proper assessment of the overall costs of a payment mechanism measures costs across all participants in the system, and should account for the benefits as well as additional private and social costs of the payment instrument. These include consumer costs (processing time and queue time, both in terms of opportunity cost; explicit price, such as ATM fees and the price of a paper check; and implicit price, such as time spent going to the ATM), central bank costs (production, as in the cost of maintaining high-quality currency; and processing), and commercial bank costs (ATM maintenance; production, for example of payment cards; processing, including float; and reward costs, such as payment of airline miles and cash back).

Accounting for these costs in addition to retailer processing costs reveals that cash is not the least expensive way of paying when all costs to the economy are considered. Signature-debit transactions are cheapest, followed by PIN-debit and credit.[21] Paper instruments, especially cash and non-verified checks, are more costly than Visa's electronic payment offerings. As the Department of Commerce noted in a report last month, "[e]lectronic payment networks have the potential to provide cost savings of at least 1 percent of GDP annually over paper-based systems through increased velocity, reduced friction, and lower costs."[22]

Proponents of interchange regulation sometimes claim that customers who pay with cash are forced to subsidize consumers that pay with credit cards. As an initial matter, this argument portrays a group of cash spenders and a separate group of card users. In fact, most consumers

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[20] *See* Daniel D. Garcia-Swartz *et al.*, *The Move Toward a Cashless Society: Calculating the Costs and Benefits*, 5 Rev. of Network Econ. 199 (2006).

[21] *Id.*

[22] Department of Commerce, International Trade Administration, *supra* note 11, at 2.

have ready access to multiple credit cards of different brands, debit cards, personal checks, and cash and coins. This, therefore, is not a case of one set of consumers subsidizing another; it is a case of individuals exercising an option to choose one payment method over another. From a consumer perspective, welfare is being enhanced by the availability of these options. Retailers benefit as well when the consumer has the option to utilize a number of different methods of payment. And common sense and experience tells us that, for example, if acceptance of credit cards speeds up the checkout line at the grocery store, as it does, all shoppers benefit — those paying with cash as well as those paying with cards.

In addition, nearly every U.S. consumer has access to a payment card,[23] and to the extent that there are under-served portions of the population, Visa is making efforts to expand access to electronic payment products and increase the financial literacy of these individuals. And even the "unbanked" are, to a greater and greater extent, using payment cards that operate on Visa's and MasterCard's debit networks to receive payroll distributions and government benefits.[24] Use of prepaid debit cards allows the unbanked to avoid high check-cashing fees and provides protection from loss or theft of checks or cash because Visa cardholders have zero liability for unauthorized card usage. It also saves time and money by, for example, allowing people without a checking account to make household payments (such as utility payments) online, rather than

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[23] According to TNS's Consumer Card Strategies Research Program, 90.4% of the households in their survey (English-speaking only) had a credit or debit card. This is consistent with data in an ABA/Dove consulting study, which showed that of consumers that pay with cash, only 11% reported doing so because they lacked access to another payment method.

[24] *See* Marianne Crowe, Federal Reserve Bank of Boston, *Emerging Payments — The Changing Landscape*, at 16 (Apr. 15, 2008), *available at* http://www.bos.frb.org/economic/eprg/presentations/2008/crowe04151708.pdf. The federal government and more than 30 states, including the two largest states (California and Texas), are using or are in the process of implementing Visa prepaid cards to disburse child support, unemployment, and other social benefits.

making cash payments in person.[25] These cards also save the government money — more than $125 million by switching to prepaid cards from checks (which cost 89 cents each to issue and mail).[26]

In all events, if there is any "subsidization," the subsidy flows in the opposite direction from what the retailers contend because electronic payments have lower total costs to society than cash and checks. Indeed, while signature-debit transactions usually have lowest total societal costs, followed by PIN-debit and credit,[27] because Visa sets different interchange rates for different types of retailers and different categories for payments, credit cards sometimes have even lower societal net costs than debit cards (and cash and checks). For example, the chart below, reproduced from a presentation by a vice president of the Minneapolis Federal Reserve Bank, shows that credit card transactions have the lowest societal cost net of benefits for a typical grocery store transaction, closely followed by signature-debit transactions.[28] Cash and check remain the most expensive forms of payment for grocery transactions when total societal costs are considered.

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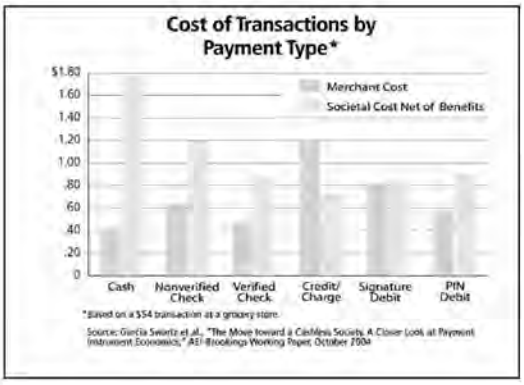
[25] According to the Federal Reserve Bank of Boston, almost 4% of payments by unbanked prepaid cardholders were online payments for household expenses — the most common use for the cards after purchases at grocery stores, restaurants, and gas stations. *Id.* at16.

[26] *See Banks Compete To Issue Debit Cards for Treasury*, ATM & Debit News (Oct. 11, 2007); *see also* U.S. Department of the Treasury, *U.S. Treasury to Launch Prepaid Cards for Unbanked Social Security, SSI Benefit Recipients* (Jan. 4, 2008) (Treasury to launch "a new initiative to give millions of unbanked Americans the option of using a prepaid debit card for receiving Social Security and other federal benefit payments," which could save taxpayers up to $44 million/year), *available at* http://www.fms.treas.gov/news/press/financial_agent.html.

[27] *See* Garcia-Swartz *et al.*, *supra* note 20.

[28] *See* James M. Lyon, First Vice President, Federal Reserve Bank of Minneapolis, *The Interchange Fee Debate: Issues and Economics* (June 2006), *available at* http://www.minneapolisfed.org/pubs/region/06-06/interchange.cfm.



Finally, there is no good evidence that interchange regulation is effective at steering consumers to forms of payment that reduce even the costs that retailers pay, let alone total societal costs. While the costs of interchange regulation are clear — higher costs for consumers with no offsetting reduction in retail prices — after the imposition of interchange regulation in Australia the more expensive payment systems of American Express and Diners Club have taken share from Visa and MasterCard.

F. Retailer Complaints About Interchange Are Unjustified

While many retailers recognize the enormous benefit they receive from payment cards — including enabling online transactions and allowing customers to buy on credit without the retailer creating a financing program — it is perhaps human nature to want more for less. Regardless, a close evaluation of retailers' critiques of interchange shows that they are unjustified.

First, it is essential to distinguish interchange fees from merchant discount fees. Acquirers negotiate their merchant discount rates and any other fees they agree to with their retailer customers without Visa's involvement. In doing so, acquirers compete for business with

other Visa acquirers, other payment card systems, and other forms of payment. As a result of this competition, the largest retailers tend to accept payment cards under "interchange plus" contracts that provide for a markup on the interchange fee charged to the acquirer. Smaller and medium-sized retailers, on the other hand, usually accept cards at "blended" merchant discount rates offered by their acquirers that are the same regardless of the network that processes the transaction. All retailers, however, can and do switch among acquirers in order to ensure they are paying the most competitive rates.

According to a recent study, 82% of retailers pay a blended merchant discount rate.[29] These retailers are less directly impacted by Visa's changes in interchange rates and may see no change in their cost of accepting Visa cards even if interchange rates are regulated. This can be seen starkly in the aftermath of Visa's settlement of the *Wal-Mart* litigation, in which Visa agreed to reduce its interchange rates on Visa debit transactions by 48 basis points for most retailers between August 1 and December 31, 2003. Retailers that did not have interchange-plus contracts (where the retailer pays a merchant discount linked directly to the interchange paid by its acquirer), but rather had committed to a fixed merchant discount with their acquirer, received none of the benefit of this rate reduction.

Even ignoring the substantial benefits retailers gain from accepting payment cards, retailers have focused on the fact that their total cost of accepting payment cards has increased in recent years. This increase, however, primarily reflects an increase in payment card transaction volume, rather than any increase in Visa's interchange rates, which on average have scarcely changed in recent years, as can be seen in the chart below.

[29] Aite Group, *The State of the Merchant Acquiring Industry*, at 11 (Nov. 2007).

Cardholders have shifted their payments to cards from other payment forms because of the increased speed and convenience of paying with plastic, as well as the rewards and improved recordkeeping that electronic payments provide. A purchase made with a card instead of cash or a check also means the retailer avoids the costs associated with payment by cash and checks. Visa has also seen a shift in product mix, as cardholders have shifted their usage toward cards that offer rewards, rather than Visa's basic card offerings. Reflecting the robust competition in the payment card segment, Visa has responded to American Express's premium card offerings by increasing the interchange rates on its highest-end cards to allow its issuers to offer their cardholders a product that is attractive and to discourage issuers from switching their premium card portfolios to American Express. While Visa's average interchange rate has been flat, Visa has responded to competition and consumer demands with rewards offerings.

Further, retailer complaints that technological changes that have reduced costs of processing transactions have not been reflected in reduced interchange rates to retailers are the result of a misunderstanding of role of interchange. Interchange is not a price for transaction processing, but the means by which the card networks seek to maximize system output by

balancing demand between retailers and cardholders. Visa's scale efficiencies and the cost reductions enabled by technology are reflected in the prices that Visa charges *its* customers — issuers and acquirers — for processing Visa transactions.

Moreover any retailer criticism of Visa's transparency falls well short of the mark. Visa has answered calls for transparency, and has been — and continues to be — as transparent as possible while protecting the security of its system to the benefit of cardholders *and* retailers. Ten years ago, Visa began making a summary of the rules that affect retailers publicly available on its website.[30] Visa's default interchange fees have been publicly available on the Visa website since October 2006.[31] In September 2006, Visa made its operating regulations available to retailers that are willing to keep them confidential. As of today Visa has gone one step further and eliminated the non-disclosure agreement, making the actual text of its rules, with the exception of rules relating to data security and rules that contain competitive information, available on its website with no strings attached.

Finally, retailers claiming that they have no choice but to accept payment cards are wrong. While more than seven million U.S. retailer locations accept Visa cards because they find that the value of acceptance exceeds its cost, retailers such as Costco, Neiman Marcus, and ARCO do not accept Visa credit or signature-debit cards (though Costco and Nieman Marcus accept Visa for Internet purchases). In addition to these high-profile retailers, many smaller and medium-sized retailers across the country have chosen not to accept some or all forms of

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[30] *See* http://usa.visa.com/download/merchants/rules_for_visa_merchants.pdf?it=c|/merchants/|Rules%20for%20Visa%20Merchants.

[31] *See* http://usa.visa.com/download/merchants/visa-usa-interchange-rates.pdf.

electronic payment. For these retailers, apparently, the perceived costs of accepting payment cards outweigh the benefits.

Contrary to retailers' claims, retailers can influence their cost of accepting Visa cards. All retailers can also choose among more than 1,600 different acquirers who offer a range of pricing models. Indeed, according to a recent study, between 500 thousand and 600 thousand retailers change their acquirer every year.[32] A number of larger retailers have used the threat of dropping Visa acceptance to negotiate custom interchange rates with Visa that apply to their transactions, resulting in a reduced cost of acceptance because they have interchange-plus contracts with their acquirers.

Retailers have also banded together to negotiate preferred rates from their acquirers. For example, the National Association of Convenience Stores ("NACS") has created the NACS Card Processing Program with acquirer First Financial Bank (a subsidiary of First Data). All NACS members are eligible to participate in the program, which allows retailers to pay about 6 cents per transaction above Visa's interchange rates.[33] NACS estimates that the average convenience store could reduce its card-acceptance costs by more than $5,500 per year by participating in the program.[34] Organizations ranging from the National Restaurant Association[35] to the Vermont

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[32] Marc Abbey, *The Addressable Market in U.S. Acquiring*, First Annapolis Navigator, Sept. 2007, *available at* http://www.firstannapolis.com/get_navigator.cfm?navigator_id=72.

[33] *See* NACS Card Processing Program, *available at* http://www.nacsonline.com/nacs/resource/creditcards/nacscpp_details.htm.

[34] *Id.*

[35] *See* National Restaurant Association Take Charge Program, *available at* http://www.restaurant.org/business/takecharge.cfm.

Grocers' Association[36] have negotiated similar discounted group merchant discount rates with acquirers.

Moreover, Visa's rules are explicit that a "[r]etailer may request or encourage a Cardholder to use a means of payment other than a Visa Card." Retailers regularly and successfully "prompt for PIN" when a customer presents a debit card to steer transactions from Visa's signature-debit network to a PIN-debit network. Retailers are completely free to provide discounts to consumers who pay with cash, check, PIN-debit cards, and private label (*i.e.*, store brand) credit cards that are not general purpose cards. Retailers may also offer discounts to customers that use so-called "affinity cards" (general purpose cards that are co-branded with the retailer's name), which may offer a reduced cost of acceptance to the retailer, or they may offer free merchandise, services or other benefits as an incentive to customers not to use a Visa card.

IV. Visa Does Not Violate the Antitrust Laws By Setting Default Interchange Rates

The same retailers pushing to enact price controls are also pursuing an antitrust case challenging interchange and certain Visa Operating Regulations in the Eastern District of New York. The retailers' arguments are not new. Over the course of more than two decades, every direct challenge to the legality of Visa's interchange rates has been firmly rejected by the courts. These decisions have upheld interchange as a legal, procompetitive, and efficient means of maintaining Visa's open payment network.

The leading case addressing interchange is *NaBanco*, which rejected a claim by a third-party processor of Visa transactions that Visa violated Section 1 of the Sherman Act by setting

[36] *See* RBS Lynk - Vermont Grocers' Association's Preferred Payment Processor, *available at* http://rbslynkpartner.com/Pages/VermontGrocersAssociation.aspx.

default interchange rates.[37] The trial court held that Visa's default interchange fees were not per se illegal price-fixing and did not unreasonably restrain trade.[38] *NaBanco* clearly recognized and established the procompetitive and efficiency-enhancing aspects of interchange. The Eleventh Circuit affirmed the trial court's findings that interchange is procompetitive "because it was necessary to achieve stability and thus ensure the one element vital to the survival of the V[isa] system — universality of acceptance."[39] Default interchange "acts as an internal control mechanism that yields procompetitive effects that its members could not create acting alone, and helps create a product that its members could not produce singly."[40] In its absence, "individual price negotiations are impractical," which would "produce instability and higher fees," possibly resulting in "the demise of the produce offered."[41]

NaBanco does not stand alone in its rejection of challenges to interchange. Just two months ago, the Ninth Circuit affirmed a district court's rejection of retailers' claims that interchange is anticompetitive.[42] *Kendall* was a putative class action filed by retailers against Visa, MasterCard, and several banks belonging to their payment card networks that alleged that the setting of interchange and merchant discount fees amount to horizontal price fixing.[43] The court held that the plaintiffs' allegations failed to describe a price fixing conspiracy or that the

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[37] *Nat'l Bancard Corp. v. Visa U.S.A., Inc.*, 596 F. Supp. 1231 (S.D. Fla. 1984), *aff'd*, 779 F.2d 592, 595 (11th Cir. 1986).

[38] *Nat'l Bancard Corp.*, 596 F. Supp. at 1260.

[39] *Id.*

[40] *Id.*

[41] *Id.*

[42] *Kendall v. Visa U.S.A., Inc.*, No. C 04-04276 JSW, 2005 U.S. Dist. LEXIS 21449 (N.D. Cal. July 25, 2005), *aff'd*, 518 F.3d 1042 (9th Cir. 2008).

[43] *Kendall*, 2005 U.S. Dist. LEXIS 21449 at *3-4.

banks had knowingly, intentionally, and actively participated in a scheme to fix interchange fees.[44] In affirming the trial court's decision earlier this year, the Ninth Circuit directly addressed the retailers' claims that interchange unlawfully set a "floor" for the acquiring banks' independent determination of their merchant discount fees.[45] The court concluded that it was not unlawful for the networks to set interchange fees that "indirectly establish the merchant discount fee, much as the cost of eggs sets a floor for the price of an omelet on a menu. Just like the restaurateur, the banks charge the merchant a higher price than their cost of business to make a profit."[46] Rather, the acquiring banks' conduct was suggestive of "a rational business decision, not a conspiracy."[47] The holdings in *NaBanco* and *Kendall* are further supported by two Northern District of California decisions rejecting challenges to interchange fees as per se illegal.[48]

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[44] *Id.* at *8.

[45] *Kendall*, 518 F.3d at 1042.

[46] *Id.* at 1049.

[47] *Id.*

[48] In *Reyn's Pasta Bella, LLC v. Visa U.S.A., Inc.*, the district court rejected claims by retailers that Visa and MasterCard member banks had agreed to abide by uniform interchange fees throughout the payment systems, as opposed to individually negotiating varying fee rates among themselves. 259 F. Supp. 2d 992 (N.D. Cal. 2003). The court held that the rule of reason should apply because "the uniform interchange fee does *not* appear to be one of the few types of restraints exhibiting a 'predictable and pernicious anticompetitive effect' without potential for procompetitive benefit." *Id.* at 1000 (quoting *State Oil Co. v. Kahn*, 522 U.S. 3, 10 (1997)) (emphasis added). On the contrary, the retailers admitted that the existence of payment card networks had procompetitive benefits for them. *Id.* And, the Northern District for California similarly held that a Section 1 challenge to the interchange fees charged by the STAR ATM network on ATM transactions should be evaluated under the rule of reason. *In re ATM Fee Antitrust Litigation*, 2008 WL 793876 at *1, *9 (N.D. Cal., Mar. 24, 2008). The district court recognized the essential role played by interchange, echoing the Eleventh Circuit's decision twenty-four years earlier in *NaBanco* that individual negotiations would be too numerous to be feasible because, "[a]s in *NaBanco*, there are too many potential entities involved in the transaction that all efficiencies would be lost," and "the fee promotes cooperation between the venture's members and *cannot* be set individually." *Id.* (emphasis in original).

The courts' consistent rejection of attacks on the legality of interchange establishes the essential procompetitive and efficiency-enhancing role that default interchange fees play in open payment networks. Both the holding and analysis in *NaBanco* were correct and remain correct today. Default interchange is necessary to the functioning of the Visa system and no court has held otherwise in the twenty-four years that have elapsed since the *NaBanco* holding. Visa enables financial institutions to issue cards under a common brand and sign retailers to a common network. This has dramatically reduced the costs of participation in the payments industry and has made possible a payment system of unsurpassed utility and breadth.

Further, while retailers' prior unsuccessful challenges have been based on Visa's membership structure and claims that Visa's rules and practices result from horizontal agreements between Visa's member financial institutions, Visa is no longer majority owned or otherwise controlled by its customer financial institutions. After Visa's initial public offering in March 2008, Visa's financial institution members became common stockholders that control only a minority of Visa's stock. Indeed, the minority equity stake held by such financial institutions is in the form of a class of shares that are entitled to very limited voting rights. Visa's board of directors and management answer to Visa's public shareholders, not Visa's financial institution customers. As such, Visa's actions can no longer be alleged to be those of a joint venture or otherwise concerted conduct within the scope of Section 1 of the Sherman Act.

V. Conclusion.

Imposing government price controls on an efficient and highly competitive payments market is unjustified. Visa's interchange rates enable it to balance the two sides of its payments system and to create incentives for the implementation of technologies and practices that make Visa's payment network more useful and more valuable by reducing fraud, speeding transactions, and otherwise improving cardholder and retailer satisfaction.

Because consumers' use of payment cards is of great value to retailers, they do not want the Visa network to be impaired or to be eliminated; they want to continue to realize the exceptional benefits of this highly functional payments network, but at a lower cost. The proposed price controls will impede this balancing, leading to higher costs, reduced output, higher fraud rates, and a payments network that is less attractive to issuers, to cardholders, and ultimately to the very retailers that are seeking price controls.

Mr. FLOUM. Thank you, Mr. Chairman.

There was also a report released just today from the GAO entitled, "Credit and Debit Cards." May I also request that that be submitted for the record?

Mr. CONYERS. Without objection, it will be.*

Mr. FLOUM. Thank you.

I appreciate the opportunity to appear before this Committee. And what I would like to focus on today are interchange fees. I am sure that this Committee will deliberate and take action based on the facts and only the facts, so let's get right to them.

Electronic payments provide extraordinary value to retailers, to consumers and to the economy. Visa connects over 29 million retailers, over a billion cardholders, and over 16,000 large, small and very small financial institutions.

What we do, what Visa does, is provide the backbone or provide a platform for innovation in electronic payments, products and services. What we do not do is issue cards; we don't extend credit. We don't set the rates and the fees to retailers and consumers, which have been the subjects of other hearings. That is not our function.

What is interchange? And this is widely misunderstood. Interchange is a transfer fee from one back to another that enables millions of stakeholders to participate in the system.

Interchange is not revenue to Visa. Interchange is not a fee to retailers. Visa has no incentive to set interchange fees too high or too low. It is not our revenue.

The reason that we set interchange fees are to drive growth in electronic payments, which replace legacy systems such as cash and check, and we think that electronic payments are much more efficient and beneficial to consumers, retailers and the economy in general. That is why we set interchange rates; it is not our revenue.

Now, let's dispell a rumor that we have heard a lot about interchange rates increasing. They are not increasing. They have remained flat for 10 years, even though today's payment services are much more valuable than they have ever been in the past.

And, finally, our rates and processes are wholly transparent. We have answered all the calls for transparency. All of our rates, all of our rules, there are telephone books thick of them. They are available on the Internet. And we have done that largely in response to the merchants saying that they would like to look at them. We have made them all available.

Now, I mentioned that our services have improved and become much more valuable. The chart up here depicts, on the bottom left, what we call the old knuckle-buster. Remember? That is how credit cards used to work. They were metal, you dragged it, you had carbon paper.

And even though the rates have remained flat for all of this time, we have innovated into incredible new categories: Debit cards, they don't carry interest rates or late fees. They are an electronic access to your checking account. Debit is bigger for us now than credit.

*The May 2008 GAO report, "Credit and Debit Cards," has been made a permanent part of this record and is archived at the Committee on the Judiciary. The report may also be viewed on the Internet at the following address: *http://www.gao.gov/new.items/d08558.pdf.*

We have gotten into community cards: local universities, firemen's credit union cards, et cetera.

All of that enabled by Visa. E-commerce couldn't exist at all without electronic payments. And we are going into mobile and contactless into the future.

So our products are more valuable. The electronification of the point of sale—over 99 percent of transactions at the point of sale now are electronic instead of cash and check. We have reduced fraud rates. We have increased acceptance. And we have lowered cost relative to cash and check.

Just today's GAO report, released today, the Government found that with respect to the Government, the Government has paid $380 million in acceptance fees for electronic payments in 2006, and they have saved $1.7 billion. I am not saying this; this is the GAO. So you can see the cost savings by using electronic payments.

We provide retailers with guaranteed payment. And, as some of you have commented, it is the card issuers who bear the credit risk, not the retailers.

Now, let's just dispell this rumor once and for all, if we can. These are our rates; these are our interchange rates. And you can see, from 1998 to 2007, on an average blended basis, they have remained relatively stable at about 1.6 percent. So the rates have not been going up.

What has been going up is the use of electronic payments, which, yes, it costs more in paying electronic payments acceptance fees, but retailers save more not having to handle cash and checks. And it is indisputable that the economy, as a whole, benefits from this efficiency.

Now, what the price-control legislation—and it is price control. It takes rate-making out of the hands of the marketplace. It would give it to three judges. There are subpoenas and depositions. And it would take the free market and turn it into a regulatory proceeding.

And we believe that that poses a triple threat to consumers. And I spoke to Mr. Mierzwinski about this yesterday. I want to have continuing discussions with the consumer groups. Because this is an anti-consumer bill, with all respect, Mr. Chairman. And I know you care greatly about consumers in your district. But what happens when interchange is artificially suppressed?

We have seen it now twice in other jurisdictions. The retailers don't lower their retail prices. They simply keep the revenue at the expense of the local community banks. So that is threat number one to consumers.

Threat number two to consumers is they pay more for cards, and they get fewer rewards. The Reserve Bank of Australia, there is a quote—they are the regulators. They found that themselves. And in today's GAO report, just released, on page 36, the GAO concluded that lowering interchange in Australia meant that—this is a quote—"cardholders have experienced a decline in the value of credit cards, reward points for most cards, and an increase in annual and other consumer credit card fees." So consumers pay more; that is the second problem.

And third, the retailers, they have sued us 54 times. And in their lawsuit, they want to impose additional checkout fees on consumers who use cards.

So that is a triple hit to consumers.

Now——

Mr. CONYERS. How much longer will you need?

Mr. FLOUM. Two minutes, Mr. Chairman, if I may?

Mr. CONYERS. All right, without objection.

Mr. FLOUM. Thank you.

Retailers can and should negotiate their merchant discounts. And they should not pay the sticker price. There are 16,000 financial institutions within the Visa system that would love to do business with Mr. Robinson, and they compete with each other to provide merchant discount rates in a very, very competitive marketplace.

Now, I have up on here a Web page from Mr. Robinson's group, the National Association of Convenience Stores, telling gas station owners how to negotiate their merchant discount rates. And it says right on here that they offer interchange plus 6 cents. That would bring his rate from $2.50 down to $1.75. So I am not sure why they are not taking advantage of it.

Finally—and we do have Mr. Blum from the community banks and credit unions here—default interchange provides very important protections for the 13,000 local community banks and credit unions who are able to issue cards in competition with the larger banks. Suppressing interchange would harm these very small local financial institutions.

Thank you, Mr. Chairman.

Mr. CONYERS. Thank you, sir.

We now turn to Mr. Joshua Peirez of MasterCard Worldwide. He has served as group executive for global public policy and associate general counsel, and formerly was a partner with Clifford, Chance, Rogers and Wells.

Welcome to our hearing, sir.

TESTIMONY OF JOSHUA PEIREZ, CHIEF PAYMENT SYSTEM INTEGRITY OFFICER, MASTERCARD WORLDWIDE

Mr. PEIREZ. Good morning, Chairman Conyers, Ranking Member Chabot, and Members of the Task Force. My name is Joshua Peirez, and it is my pleasure to appear before you today on behalf of MasterCard to discuss H.R. 5546.

We are brought together by a basic commercial dispute. There are some merchants who would like to pay less to accept payment cards. We fully understand the desire to reduce the cost of doing business, and we have attempted to help them achieve this objective.

Merchants are an essential part of our system, and we are deeply committed to addressing their needs. Let me repeat that: Without merchants, there is no payment system. And as a result, we have attempted to address all the issues raised by the merchants in this dispute.

Merchants said that they did not have access to the interchange rates set by MasterCard. In response, we now public interchange

rates on our Web site. These rates provide an extraordinary tool for merchants to use when negotiating with their banks.

It is our hope that merchant groups will be encouraged to use this tool to better educate themselves and their members on the full range of negotiating opportunities that exist today, rather than seeking to arbitrarily lower merchant discount fees through Government intervention.

Merchants have also said that they wanted to see our rules. In response, we posted all of the rules that apply to merchants on our Web site a few years ago, and we continue to publish more and more rules so that all of our operating rules will be available soon.

Almost 2 years ago, gas station owners said that rising gas prices were adversely affecting their profits when they accepted our payment cards. In response, we have capped interchange fees on gas sales. In addition, MasterCard has lower rates for supermarkets, utilities and convenience purchases to encourage acceptance by these types of merchants.

Merchants can use all of these tools to negotiate better terms. We would like to work with the Task Force to ensure a deeper understanding of the opportunities for negotiation.

Our interchange cap for gas sales provides a good example. We announced the cap in September of 2006. We expected gas retailers to use this information to negotiate lower fees and to point to our initiative to lower the fees from our competitors. We have been disappointed that most gas merchants have not taken advantage of this opportunity.

The merchant lobbying groups have made other statements that are patently false. For example, they have been saying that merchants cannot discount for cash. This is simply not true. Under our rules, merchants are permitted to discount for cash, and each merchant is free to choose the manner in which the discount is offered.

They also state that merchants cannot tell card holders the fees they pay when they choose to accept a payment card. Again, this is not true. MasterCard permits any merchant to disclose its merchant discount fees to consumers. MasterCard also permits merchants to disclose their interchange fees to consumers.

The merchant lobbyists have even claimed that MasterCard has a rule that requires a merchant that accepts MasterCard to accept it at every one of its retail locations. There is no such rule.

We are concerned that the opportunities to negotiate are being cast aside for litigation and legislation. While the merchants seek legislation claiming that existing antitrust laws are inadequate, they are telling a different story in their litigation on these same issues.

I would like to offer a quote from Craig Wildfang, the lead attorney representing the merchants in their litigation against MasterCard. He said in November of 2007, just recently, "I actually don't think that the antitrust laws are in need of much reform. Although the Antitrust Modernization Commission considered many proposals and proposed a few, I don't think that anyone has really made a persuasive case that the U.S. antitrust laws are not working well to achieve their goals of enhancing and preserving competitive markets." We agree.

And so did the Antitrust Modernization Commission, on which two of the merchant representatives sat, when it concluded that antitrust exemptions, like proposed here, should be strongly disfavored, as they "undermine, rather than upgrade, the competitiveness and efficiency of the U.S. economy."

As the Task Force considers these important issues, please note that the parties in the litigation have agreed to mediation, which began last month. If a resolution is achieved through mediation, it will resolve the litigation and all the issues raised in this basic commercial dispute.

In closing, Mr. Chairman, we deeply appreciate your concerns about this issue. We are committed to working together to fully address your concerns and resolve this commercial dispute without the need to move forward with legislation.

While we agree with you that free-market negotiation provides the best way forward, we have concerns about price controls and the antitrust exemptions in the legislation that would enable the merchants to negotiate in ways that violate the antitrust laws today, rather than negotiating in a free market with the antitrust laws in place to protect consumers.

I am prepared to answer any questions you may have. Thank you.

[The prepared statement of Mr. Peirez follows:]

PREPARED STATEMENT OF JOSHUA PEIREZ

WRITTEN STATEMENT

JOSHUA PEIREZ

CHIEF PAYMENT SYSTEM INTEGRITY OFFICER
MASTERCARD WORLDWIDE

BEFORE THE

TASK FORCE ON COMPETITION POLICY AND ANTITRUST LAWS
OF THE
HOUSE COMMITTEE ON THE JUDICIARY

MAY 15, 2008

Good morning Chairman Conyers, Ranking Member Chabot, and members of the Task Force. My name is Joshua Peirez, and I am the Chief Payment System Integrity Officer for MasterCard Worldwide in Purchase, New York. It is my pleasure to appear before you today to discuss H.R. 5546.

MasterCard is a driving force at the heart of commerce, enabling global transactions and striving to make commerce faster, more secure, and more valuable to everyone involved. We are brought together at this hearing today by a commercial dispute. In short, there are many merchants who would like to pay less than they currently do for the payment card acceptance services they receive from their local banks. We at MasterCard fully respect and understand the desire to reduce the costs of doing business. As I will discuss in a minute, merchants have the ability to negotiate today to reduce their costs. In our view, there is every opportunity outside of legislation to achieve common ground between merchants and payments providers and MasterCard is committed to finding that common ground.

At the outset, I would like to discuss some of the steps MasterCard has taken to address key concerns expressed by merchants as part of this debate. For example, a number of years ago, merchant representatives expressed concern that acquirers were requiring merchants by contract to comply with applicable MasterCard rules but were not disclosing those rules to the merchants. The MasterCard rules were specifically designed to address this issue by requiring acquirers to include in their merchant agreements the substance of any rule the merchant was obligated to comply with. This requirement was designed to ensure that merchants understood the MasterCard rules with which they were bound to comply. Nonetheless, in response to merchant requests, MasterCard began publishing on our website the portions of our rules that apply to merchants. These rules can be found at www.mastercard.com.

More recently, merchant representatives indicated that it would be helpful to also have ready access to the MasterCard chargeback rules. These rules govern the rights and responsibilities of issuers and acquirers when a cardholder disputes a transaction and the issuer grants a credit to the cardholder and "charges back" the transaction to the acquirer. Although those rules do not govern the relationship between acquirers and merchants, merchant representatives expressed interest in accessing the rules because acquirers typically require the merchant to provide reimbursement for the "chargeback." In order to accommodate these merchant requests, MasterCard now publicizes the chargeback rules on our website. The Merchants Payments Coalition ("MPC") has now come forward and indicated that they would like to see other rules as well. I would like to take this opportunity to inform the Task Force that MasterCard will make its entire set of operating rules available to the public in the near future. This will give merchants and anyone else who is interested the ability to review all of MasterCard's rules.

We also heard concerns from merchants that they did not have access to the default interchange rates paid by their acquiring banks to issuing banks. Although merchants do not pay the interchange fee, MasterCard recognized that publication of the interchange fees would give merchants additional information for them to use when negotiating the price of MasterCard acceptance with their acquirers. To assist merchants in negotiating the merchant discount fees they pay, MasterCard has published the default interchange rates for our systems. These rates, which are readily accessible on our website at www.mastercard.com, provide an extraordinary tool for merchants which enables them to understand the interchange fee costs of an acquirer

when negotiating the merchant discount fee with the acquirer. It is our hope that merchant groups such as the MPC will be encouraged to use this tool to better educate themselves and their members on the full range of negotiating opportunities that exist today rather than seeking to lower merchant discount fees through government intervention.

MasterCard management has also responded to market forces in efforts to increase merchant demand for our cards. MasterCard management independently sets default interchange rates in order to maximize the value of the system as a whole. This requires a careful balance, which takes into account the interests of cardholders *and* merchants. For example, we set lower default interchange rates for supermarkets, utilities, and convenience purchases to encourage acceptance by these merchants and maximize the value of the system. We also capped default interchange rates on petroleum sales, based on concerns that rising gas prices were disproportionately affecting gas stations when they accepted payment cards and to maintain the balance of value in the system.

These developments are part of our efforts to address merchants' concerns about their ability to negotiate for the cost of MasterCard acceptance. It is important for me to raise our efforts with the Task Force because, although the MPC states that its only desire is for merchants to have the ability to negotiate, what you are not hearing from the MPC is that merchants have that ability today. We would like to work with the Task Force to ensure a better understanding of those opportunities for negotiation. And, frankly, the merchants could improve their use of those opportunities. Let me provide some examples of where the merchants have not taken advantage of the tools we have provided.

As I noted, MasterCard has capped the default interchange rates on petroleum sales. We announced this change in September 2006, and it became effective in April 2007. We expected petroleum retailers to use this information to negotiate lower merchant discount rates with their acquiring banks and to point to our initiative to leverage lower fees from our competitors. We have been disappointed to learn, however, that most petroleum merchants have not taken advantage of this opportunity to negotiate better rates for MasterCard acceptance based on the reduced default interchange rate and we see no evidence they are using it to reduce what they pay to accept payment cards on competing networks.

Furthermore, the publication of MasterCard's rules and default interchange rates was also designed to allow merchants to enhance their ability to negotiate the terms of MasterCard acceptance, including their merchant discount fees. Merchants are given valuable information regarding the rules that would apply to them, and the costs their acquiring banks pay to issuing banks in default interchange rates. With this information merchants have the ability to negotiate with hundreds of acquiring banks to get the best rates and terms they can. And, I may note, this cost information is far more than merchants give consumers when consumers are shopping in a store. For example, merchants do not display their cost on an item alongside the price they are charging. Yet what MasterCard has done is to provide to merchants the acquirers' interchange costs so that merchants can be fully informed of those costs when negotiating their merchant discount fees with the acquirers.

Although we agree that negotiation is the best way forward, we are concerned that the MPC is really not pursuing negotiation as a solution. Merchants negotiate merchant discount fees every day when they seek to accept American Express cards. Throughout the debate, we

have never heard a single merchant claim that they "must" accept American Express cards, and indeed many merchants do not (just as many merchants do not accept MasterCard). Yet the merchant discount fees that merchants agree to pay when they choose to accept American Express cards are higher on average than the fees they pay when they choose to accept MasterCard cards. This begs the question if merchants are willing to pay more for American Express when they readily admit they do not have to accept the American Express card, how can they claim that our system which involves interchange fees and results in average merchant discount fees that are lower raises an issue that must be addressed by Congress? We think the answer to this question is clear—the MPC's initiative is not really targeted at addressing a competition law issue, but instead is an effort to artificially reduce merchant discount fees through governmental intervention.

In short, the MPC claims that there is a competition law problem but seeks to resolve its complaint in anticompetitive ways. As the congressionally created Antitrust Modernization Commission noted, "[v]igorous competition, protected by the antitrust laws, does the best job of promoting consumer welfare and a vibrant, growing economy." If a particular practice raises antitrust concerns, its disposition is best left to the judicial enforcement of existing law as opposed to legislating toward a specific outcome. Not only is the MPC seeking legislation, but the merchants have already sought judicial intervention through use of the antitrust laws as the way to resolve this issue. In fact, well before coming to Congress, trial lawyers seeking to represent all U.S. merchants as a class commenced litigations against MasterCard and Visa and their customer banks on the very same issues covered by H.R. 5546. The MPC appears reluctant to note that while they are asserting to the Congress that the current antitrust laws will not solve their problems, their attorneys are claiming the ability to solve those problems through litigation under the very same antitrust laws. I would like to offer a quote from one of the attorneys representing the merchants in their litigation against MasterCard. This is the statement of K. Craig Wildfang, lead counsel to the merchants, as it appeared in Competition Law 360 on November 2, 2007: "I actually don't think that the antitrust laws are in need of much reform. Although the Antitrust Modernization Commission considered many proposals and proposed a few, I don't think that anyone has really made a persuasive case that the U.S. antitrust laws are not working well to achieve their goals of enhancing and preserving competitive markets." If Mr. Wildfang is unaware of a persuasive case to reform our existing antitrust solutions to competition concerns, that would suggest H.R. 5546 is unnecessary.

The MPC also appears reluctant to highlight that just prior to the introduction of H.R. 5546 the parties in that litigation agreed to mediation which began last month. The mediation is being overseen by an outside mediator, and if a resolution is achieved through mediation, it will be presented to the court for purposes of resolving the litigation. This mediation is yet another example of how the MPC's efforts to secure legislative action are entirely unnecessary to achieve their stated objective of negotiating their concerns.

Before I close, I would like to dispel a number of other myths that have been created by the MPC during this debate. For example, the MPC says that MasterCard makes it difficult or impossible for merchants to discount for cash. This is simply not true. The MasterCard rules simply and clearly state that: "A merchant may provide a discount to its customers for cash payments." These rules, which are publicly available on our website, impose no restriction on how a merchant offers a cash discount. This means that the merchant can post two prices, can simply post a sign offering "X% off for cash," or can choose any other method the merchant

believes is best for the merchant and its customers. Any interpretation of MasterCard's rules to the contrary is false.

The MPC also states that merchants cannot disclose to cardholders the merchant discount merchants pay when cardholders pay with a payment card. MasterCard does not restrict any merchant from disclosing its merchant discount fees to consumers. For example, merchants can post their merchant discount rates on signs throughout their stores, or could disclose the rates on each payment card receipt along with the dollar amount of the merchant discount fee for each transaction. Merchants are also free to disclose interchange fees to consumers as well.

It has also come to my attention that the MPC has even gone so far as to claim that MasterCard has a rule that requires a merchant that accepts MasterCard to accept it at every retail location. The MPC refers to this mythical rule as the "single entity rule." There is no such rule. A merchant that would like to accept MasterCard at one of its several locations is not required by MasterCard rules to accept it at other locations. Whether a merchant accepts MasterCard at one, some, or all of its locations is strictly a matter to be negotiated between the merchant and its acquiring bank.

The last myth I would like to address relates to the benefits merchants receive when they pay a merchant discount fee. The MPC believes that the merchant discount should cover the cost of processing a payment card transaction, plus a profit margin acceptable to the MPC. In other words, the MPC seeks to obtain for merchants <u>all</u> of the benefits of card acceptance, while paying only for the small portion of those benefits that relate to "processing." This is roughly analogous to requiring merchants to sell their products for the cost of shipping and accounting without regard to all of the other costs, or any of the value or other factors that go into determining the price of a product.

Merchants receive enormous benefits when they choose to accept payment cards. These benefits include increased sales from accessing the vast purchasing power of millions of cardholders around the globe. Merchants are able to access these global payment systems and financing without undertaking any of the operational costs and burdens involved when merchants operated their own payment card systems. In the MasterCard system, for example, our customer financial institutions: market the cards; process the applications; grow the customer base; underwrite the credit; comply with the complex and growing body of payment card law; perform all of the accounting functions; and collect the debts. Moreover, payment cards provide the extraordinary benefit of enabling a merchant to sell goods and services on credit without taking any credit risk—the merchant gets paid even if the card issuer is unable to collect anything from the cardholder. By accepting cards, merchants also avoid or reduce costs associated with other forms of payment like the costs of bounced checks and check verification services and the costs of paying employees to handle, count, and safeguard cash as well as the significant costs of cash theft.

Under the MPC's approach, merchants would pay nothing for these benefits and, instead, would receive all of those benefits at roughly the processing costs incurred to deliver the benefits to the merchant. This begs the question as to who pays the costs when merchants take benefits from the system without paying for them. Unfortunately, the answer is that consumers would pay.

Mr. Chairman, we deeply appreciate your concerns about this issue. It is our hope that we can work together to address fully your concerns without the need to move forward with legislation. We are concerned that H.R. 5546 would impose price controls that would disproportionately harm community financial institutions and, as we have seen in other contexts, price controls have significant negative consequences for consumers. We fully believe that negotiation provides the best way forward, but we have concerns about granting antitrust exemptions that would enable the merchants to negotiate in ways that violate the antitrust laws today.

With respect to legislation attempting to regulate the costs of payment card acceptance, we can look to Australia for evidence of how consumers are harmed when the government regulates interchange. A few years ago, the Reserve Bank of Australia ("RBA") decided to reduce interchange by approximately 50% for the MasterCard and Visa systems in Australia. MasterCard recently commissioned a study on the effects of the RBA's intervention.[1] What did the study find? The merchants benefited from reduced costs of accepting cards while consumers paid the price. Cardholders in Australia now pay higher fees and rates for their cards and receive fewer benefits. Australian consumers are now paying 22 percent more in annual fees for standard credit cards, and as much as 77 percent more for rewards cards. Not surprisingly, there is no evidence that merchants passed their windfall on to consumers in the form of lower retail prices. In order to ensure that U.S. consumers are protected against the same fate, we must ensure that price controls are not part of any resolution of the commercial dispute between merchants and payment systems. We would hope that the Members of the Task Force would encourage the MPC to utilize the tools we have provided to take advantage of the negotiating opportunities available to them before seeking legislative intervention.

I also urge the Task Force to consider the findings of the Antitrust Modernization Commission, on which two representatives from the MPC served, as those findings relate to creating exemptions to antitrust laws. For example, the Commission noted that "[a]ntitrust exemptions can harm the U.S. economy and, in the long run, reduce the competitiveness of the industries that have sought antitrust exemptions." Furthermore, the Commission stated flatly that "statutory antitrust exemptions should be disfavored as likely to harm both U.S. consumers and the U.S. economy." Why does the Commission come to these conclusions? The Commission stated that "[w]hile the beneficiaries of an exemption likely appreciate reduced market pressures, consumers…and the U.S. economy generally bear the harm from the loss of competitive forces." Such a result does not appear to be the intent of the legislation, but the Commission's statements raise issues that should give the Task Force significant pause.

Mr. Chairman, this concludes my testimony. MasterCard is fully committed to working with you and the Task Force to address these important issues. I am prepared to answer any questions you or others on the Task Force may have.

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[1] A copy of the study and its transmittal letter are attached to this statement. These documents can also be found at http://www.crai.com/ecp/assets/Stillman_et_al_cover_letter_(28_Apr_2008).pdf and http://www.crai.com/ecp/assets/Regulatory_Intervention.pdf.

Mr. CONYERS. Thank you very much.

We have been called to the floor for—all right, we will try to get in one more witness.

Mr. John Blum, vice president of operations for Chartway Federal Credit Union. He has 20 years of experience managing operations, both in retail and within the military.

We have your statement, and we would like to hear from you now.

TESTIMONY OF JOHN BLUM, VICE PRESIDENT OF OPERATIONS, CHARTWAY FEDERAL CREDIT UNION

Mr. BLUM. Thank you. Good morning, Chairman Conyers, Ranking Member Chabot and Members of the Committee. My name is John Blum, and I am testifying on behalf of the National Association of Federal Credit Unions.

I serve as the vice president of operations for Chartway Federal Credit Union, headquartered in Virginia Beach, Virginia. Chartway has more than $1.2 billion in assets and serves over 160,000 members.

NAFCU and the entire credit union community appreciate the opportunity to participate in this hearing.

The electronic payment system has proven to be one of the most important advances in the financial services marketplace and is tremendously beneficial to consumers as well as merchants. Retailers reap tremendous benefits in the form of increased sales, reduced costs for overhead, substantially fewer fraud losses, and immediate payment for goods and services.

I would like to focus today on the benefits of the current system, specific to the credit union community, and our concerns with H.R. 5546.

The electronic payment system is incredibly important to the credit union community. The system allows us to compete with the largest financial institutions. Credit and debit card products are important tools in developing and fostering relationships with our members. And interchange fee revenue helps cover the considerable cost of maintaining this system.

Capping interchange fees would provide an advantage to large financial institutions at the expense of credit unions. We are much smaller than national banks. Consequently, the credit union community will find it more difficult to offset the losses from a cap on interchange fees. In contrast, large banks will be able to internalize the loss.

H.R. 5546 authorizes a three-judge panel to set a single rate for a payment system. Credit unions have a higher per-transaction cost for processing card payments. Further, credit unions make up an extremely small percentage of the financial services market. This panel may be compelled to set the rate based on the cost for larger institutions, as they process significantly more transactions. Smaller institutions would then receive the lower cap rate even though their actual costs are much higher.

And it will be doubly painful for credit unions. First, it will be more difficult to provide our members a credit or debit card without increasing costs elsewhere. Credit unions have a number of restrictions on their activities, as well as stricter capital require-

ments. As a result, credit unions have fewer avenues to offset any losses created by a cap on interchange fee income.

Second, if credit unions cannot afford to offer card services to their members, they will lose an incredibly important relationship-building tool.

For many financial institutions, interchange fees are not a huge income-generating engine. Last year, Chartway processed over 14 million transactions. The fees generated by each transaction are not pure profit. The system does not simply run itself. Chartway employs 11 people for debit card support, and we contract with a large service provider for our credit card portfolio.

Interchange fees help offset the significant fraud losses associated with plastic cards. In 2006, there was over $1.1 billion in plastic card fraud losses. In nearly all situations, the financial institution covers these losses. Chartway reimburses all members in full for any fraudulent transactions.

We spend nearly $425,000 a year to cover fraud losses and related insurance. These statistics do not account for a number of other costs associated with each instance of fraud, including issuing new cards and time spent working with members who have been victims of fraud.

It is important to note that debit cards and some credit cards generate little income outside of interchange. At Chartway, 34 percent of our active credit card accounts are paid in full at the end of every month. We do not receive any interest income on these accounts. In fact, Chartway is essentially providing these customers a short-term, unsecured loan at no interest. Interchange fees help cover these costs.

In conclusion, NAFCU opposed H.R. 5546. The electronic payment system has been incredibly beneficial to merchants. We understand why retailers would like price controls. However, we are wary of the Government interfering with a valued product that is used by millions on a daily basis. Further, we do not think the Government should dictate prices between private parties.

A cap on interchange fees will harm credit unions. As not-for-profit cooperatives, we will suffer, finding it more difficult to offer credit and debit card services to our members. Those credit unions that remain in the card business will have to adjust, by either raising interest rates, decreasing dividends or reducing services.

As financial cooperatives, the ultimate cost of this proposal will be shouldered by the 90 million Americans who are member owners of their credit union.

Thank you. And I would be happy to answer any questions the Committee may have.

[The prepared statement of Mr. Blum follows:]

PREPARED STATEMENT OF JOHN BLUM

Testimony of

John Blum
Vice President of Operations of Chartway Federal Credit Union

on Behalf of

The National Association of Federal Credit Unions

H.R. 5546, the "Credit Card Fair Fee Act of 2008"

Before the

House Judiciary Committee, Antitrust Task Force

United States House of Representatives

May 15, 2008

Introduction

My name is John Blum and I am submitting this testimony on behalf of the National Association of Federal Credit Unions (NAFCU). I serve as the Vice President of Operations for Chartway Federal Credit Union, headquartered in Virginia Beach, Virginia. Chartway FCU was founded in 1959 by seven civilian employees of Norfolk Naval Air Base. Since then, Chartway has grown substantially and we now have more than $1.2 billion in assets and operate 49 branch locations in 9 states. Chartway serves 160,000 members and provides financial services to our members across the globe.

For the past six years my responsibilities at Chartway FCU have included the operational performance of our credit and debit card portfolios, including card issuance, card activation, transaction authorization and processing, reversals, as well as funds verification, settlement, fraud/compromise analysis and fraud protection of member funds. Prior to joining Chartway, I spent ten years in senior management positions for two big box retailers; The Home Depot and Haynes Furniture, preceded by thirteen years as an officer in the United States Army.

I am testifying today on behalf of NAFCU, the only national organization exclusively representing the interests of the nation's federally chartered credit unions. The organization is comprised of member-owned financial institutions representing approximately 30 million individual credit union members. NAFCU–member credit unions collectively account for approximately 55 percent of the assets of all federally insured credit unions. NAFCU and the entire credit union community appreciate the opportunity to participate in this discussion regarding credit card interchange fees.

The electronic payments system has proven to be one of the most important advances in the financial services marketplace in the last century. The system is tremendously beneficial to consumers, as well as merchants.

Consumers can travel the globe without worrying about having access to cash or exchange currency. Everything from a trip to the supermarket or gas station is made simpler and more convenient thanks to credit and debit cards.

The system has been equally beneficial for merchants. Retailers reap tremendous benefits in the form of increased sales, reduced costs for overhead such as accounting for, and transporting cash, substantially fewer fraud losses and ***immediate*** payment for goods and services. Indeed, credit and debit card sales helped Wal-Mart ring up more than $375 billion in sales last year. It is also instructive to note that Exxon-Mobil, Chevron and ConocoPhilips were the first, seventh and eighth most profitable companies in 2007 according to Forbes Magazine. Based on the profits of the largest gasoline manufacturers, perhaps gas station operators should look to cut costs by negotiating a cheaper wholesale price for gasoline rather than advocating for price controls on interchange fees. Further, the explosion in internet commerce would have been virtually impossible absent the electronic payment system. In 2007, the Census Bureau estimated there was $136.4 billion in online sales.

The proof of the system's success lies in its popularity among consumers and merchants. Last year, there were more than 40 billion electronic payment transactions. Plastic is quickly growing more and more popular with consumers. Likewise, more and more merchants are also signing on to use the Visa and MasterCard networks. The system is working exceedingly well. Introducing price controls into the electronic payments system is unnecessary and potentially very harmful.

H.R. 5546 directs the three judge interchange panel it would create to "establish rates and terms that most closely represent the rates and terms that would be negotiated in a hypothetical perfectly competitive marketplace for access to an electronic payment system between a willing buyer with no market power and a willing seller with no market power." Given the clear, concise precision of the language, it is clear that this is, indeed, a price control bill.

With that in mind, this testimony focuses on the benefits of the current system specific to the credit union industry and NAFCU's concerns regarding how H.R. 5546 would affect the industry. I conclude with a brief response to some of the most common – and in my mind inaccurate – complaints about the current fee structure.

The Importance of Interchange to the Credit Union Industry

The electronic payment system and the interchange fee structure that supports the system are incredibly important to the credit union industry. The electronic payment system is integral in allowing credit unions to compete with the largest financial institutions. Credit and debit products are important tools in developing and fostering relationships with our members. Finally, interchange fee revenue helps cover the cost of maintaining the system; a cost which, contrary to merchants' arguments, is not negligible.

The current structure allows credit unions to compete with even the largest national banks. Credit union members who use a debit or credit card issued by their credit union know their card is substantially the same as what they would receive at Citibank, Wells Fargo or any of the other industry giants. Given the ubiquity of plastic cards, it is vital that credit unions and other small financial institutions continue to be able to compete in this important market.

Capping interchange fees, however, would ultimately provide an advantage to large financial institutions at the expense of credit unions and other small financial services providers. The average size of a federal credit union, for example, is $81.7 million, compared with $1.4779 billion for banks. Over 3,600 credit unions have less than $10 million in assets. The credit union share of total household financial assets is also relatively small, just 1.1 percent as of September 2007. Given Chartway's relatively modest gross profit per transaction, coupled with our customer base – which is smaller than typical commercial banks – we will find it more difficult than larger institutions to offset the losses from a cap on interchange fees. By comparison, large banks with economies of scale, and large credit and debit card portfolios would be able to internalize the loss much easier as a simple consequence of the fact that they have more customers.

Further, credit unions also have a number of restrictions on the businesses they can engage in, as well as stricter capital requirements. Consequently, credit unions have fewer avenues to offset any losses created by a cap on interchange fee income.

This issue is particularly troubling as H.R. 5546 clearly states that the three judge panel will set a ***single rate that is operative for all institutions*** and merchants using the respective payment systems. The legislation directs judges to "consider the costs necessary to provide and access an electronic payment system for processing credit and/or debit card transactions as well as a normal rate of return" when determining prices. Credit unions, being much smaller than banks, and lacking economies of scale, have a higher per transaction cost for processing card payments. However, credit unions make up a very small percentage of the financial services market. Consequently, in determining the one rate for the entire system, the three judge panel might – indeed the panel could arguably be compelled to – set the rate based on the cost for larger institutions as they process significantly more transactions. Smaller institutions consequently, will receive the lower, capped fee even as their actual costs are higher. Ironically, it is some of these larger institutions that other Committees in Congress are examining for questionable credit card practices that harm consumers. Certainly many credit unions will be able to continue operating their portfolio even with a capped fee. Just as certainly, however, some credit unions will either exit the plastic card market and/or merge with larger credit unions. Given the consolidation from 20,000 credit unions to the approximately 8,900 that exist today, any measure that will lead to further consolidation should be carefully considered.

Further, it is important for Chartway FCU – and all other credit unions – as a brand, to have our members carrying our cards in their wallet. In today's financial services marketplace, it is not uncommon for a consumer to have their primary checking account at one institution, a credit card from another institution, a mortgage from a third and money market or retirement account somewhere else. Indeed, there is no limit to the combinations available today for consumers who wish to shop for their financial service products. By providing these most fundamental products, we help build our relationship

with our members so that we can continue to serve them when they are looking for other financial services.

If interchange fee income is capped, it is doubly painful for credit unions and other small financial institutions. First, it will be more difficult to provide our members a credit or debit card without increasing costs elsewhere. Second, if the institution finds it no longer can offer these products they will lose an incredibly important relationship building tool. In this day and age, it would be literally impossible for a credit union to grow and continue operating if it cannot offer its members this most basic product.

For many financial institutions, interchange fee income is not the huge income generating engine that the merchants make it out to be. In 2007, Chartway processed over 14 million transactions for more than 43,000 credit card users and 85,000 debit card holders. On average, Chartway made 24 cents on each transaction it processed last year. This interchange fee income is vital in allowing Chartway to offer credit and debit card services to our members.

In order to understand the importance of interchange fees, it is critical to also understand the costs associated with maintaining the system. Simply put, the 24 cents per transaction that Chartway made in 2007 is not pure profit. Merchants argue interchange fees should be going down to reflect the smaller per transaction cost of clearing a payment. However, simply clearing a payment through the system is only one of a number of costs associated with issuing credit and debit cards and processing payments. First, the system does not simply run itself. Chartway FCU employs 11 people internally for debit card support, and a large service provider externally for credit card support to ensure our debit and credit card portfolio is operating smoothly and that our members are satisfied with their service.

Another significant cost associated with the system is fraud losses. In 2006, there was over $1.1 billion in plastic card fraud losses. In nearly all situations, it is the financial institution that covers those losses. Federal law caps the amount that can be charged to a

consumer if his or her account is fraudulently accessed. Further, Chartway, like most other financial institutions will reimburse members in full for any fraudulent transactions made on their account. On average, Chartway spends nearly $425,000 a year to cover fraud losses and insurance for fraud. Further, this number would be considerably higher, if Chartway had not made an aggressive effort to seek reimbursement for fraud losses.

Importantly the figures above only capture actual fraud losses. There are a number of other costs associated with each instance of fraud, which are not captured by the statistics; nor are they covered by our insurance policy. Employee time must be spent contacting and working with members to resolve problems. Accounts may need to be shut down entirely and new account numbers issued. New plastic cards may need to be printed. In extreme cases, such as with the TJ Maxx data breach, financial institutions may find themselves issuing thousands of new cards and setting up call centers to respond to customer concerns. Interchange fees help offset all of these substantial – and growing – costs.

My colleagues and I in the financial services industry find it particularly troublesome that merchants are seeking to reduce interchange fee income even as we suffer more and more fraud losses at the hands of thieves who access information through poorly protected merchant databases.

In addition, it is important to note that debit cards and some credit card accounts generate little income outside of interchange. Debit cards, for example, have no cost for Chartway's members. Credit cards obviously generate income in the form of interest. However, that interest rate is calculated to reflect the risk of nonpayment or late payment, it does not include the costs of maintaining the account. Further, at Chartway 34% of our active credit card accounts are paid in full at the end of every month. Consequently, for these members, Chartway does not receive any interest income. In fact, quite the opposite, Chartway is essentially providing these customers a short term unsecured loan at no interest. Interchange fees help cover the costs of these products.

This proposal, however well intentioned, would be potentially disastrous for the credit union industry, particularly for smaller credit unions. Credit unions are not-for-profit institutions. Our industry operates on thinner margins, with less income, a smaller customer base and fewer total assets than traditional banks. As not-for-profit institutions, the income that is generated from interchange is reinvested in higher yields for our members, lower interest rates on loans and superior customer service. If fees are set at an artificially low price, it will be smaller institutions that suffer while large banks will be able to internalize the loss in income, and will likely end up with new customers that small institutions no longer can serve. That is not to say the credit union industry will cease to exist if interchange fees are capped. However, price caps will, undoubtedly, have an effect on the industry. Just as certainly, those effects will be felt most directly by the smallest members of our industry.

Common Misconceptions about the Interchange System.

Next, there are several fundamental misconceptions about the interchange fee system that need to be addressed. It is impossible to grasp the consequences of H.R. 5546 without a firm understanding of the system's structure. Merchants have benefited from the system's complexity by making arguments that those well versed with the intricacies of the system know to be untrue. With that in mind, I would like to address a few of the most common arguments regarding the current interchange fee structure.

First, the interchange fee is not a hidden tax or fee on consumers. Just like the cost of labor, electricity, rent or insurance; interchange fees are a cost of doing business. Further, interchange is a cost that retailers can and do pass on to their customers in the final price of the goods and services they sell.

Next, retailers do not pay the interchange fee. Retailers pay a separate fee known as the merchant discount fee. This distinction is vital in understanding the debate regarding interchange fees. The interchange fee is the fee that a merchant's bank pays an issuing institution, such as Chartway FCU, to process a transaction. The merchant, in turn, pays its bank the merchant discount fee on each transaction. The interchange fee is one

component in the merchant discount fee that the merchant pays. This distinction is significant for two reasons.

First, the merchant discount fee – the fee the merchant actually pays – is negotiable. Merchants can and do negotiate with their bank for a lower merchant discount fee. Further, merchants are free to choose a new bank altogether if they can find a better rate elsewhere.

Second, this simple fact that merchants do not pay the interchange fee is integral in understanding why merchants have limited ability to negotiate the fee. In this sense, the interchange fee is one of several costs associated with the final, retail product (the merchant discount fee). This system is no different from any other retail product. For example, consumers do not get to negotiate the price their local diner paid for the eggs in their omelet, even though being able to do so might result in a cheaper breakfast.

The current interchange fee structure is transparent for retailers. Merchants have argued that they do not know what the fees are for each card. A simple search on Google.com for "Visa interchange rates" or "MasterCard interchange rates" will yield information from Visa and MasterCard respectively on what the rate is for each kind of transaction. That said, the rates are complex and they vary depending on the type of card, the type of retailer, whether it is a pin or signature transaction and several other factors. However, to claim that merchants have no information regarding the cost of interchange is simply not true.

That retailers do not know the exact cost of interchange at the point of sale is a necessary consequence of the complexity of the system and the different options available. Further, it is important to keep in mind that merchants do not pay the interchange rate; they pay the merchant discount fee. In some cases, the merchant discount fee is a set percentage of the transaction. Consequently, even if a retailer does not know the price of interchange on a transaction, they do know the price they are actually paying to process the transaction.

Responding to the merchants' arguments has grown more and more daunting as their expressed concerns with the system change from day to day. The ever changing criticism of the system is indicative of the fact that there is nothing wrong with the system. Merchants want little more than a price control for this cost of business. Consequently they have draped this ultimate desire in whatever argument they find expedient or compelling at that particular point in time.

Conclusion

NAFCU strongly opposes H.R. 5546. If caps are imposed on interchange fees it will enrich merchants while harming credit unions and consumers.

The electronic payments system has proven incredibly beneficial to merchants. Retailers, however, want all of the benefits of the system, while at the same time they are asking Congress to simply cut their costs of doing business. As a businessman I certainly understand why retailers would like to cap their costs for processing transactions. However, as a businessman I am fundamentally opposed to the government dictating prices that should be paid between sophisticated parties negotiating in the free market. Further, as a consumer I am weary of the government interfering with a valued product that has been incredibly successful and that I use on a daily basis. Finally, lower interchange fees are not going to be translated into cheaper prices for consumers. Merchants will, almost certainly, pocket the difference with no actual benefit to their customers.

Further, if caps are imposed on interchange fees it will harm credit unions and other small financial institutions. As not-for-profit cooperatives, credit unions, particularly smaller credit unions, will suffer; finding it more difficult to continue offering credit and debit card services to their members. Large institutions meanwhile will be able to use their economies of scale to weather the decreases in revenue. Indeed, larger institutions will likely step in where smaller institutions once stood. While many credit unions will internalize the loss in revenue, smaller institutions will have to begin to consider merger

opportunities. In a market that has already seen considerable consolidation, Congress should carefully consider whether it wants to inadvertently encourage more mergers.

Finally, this proposal will harm consumers. If interchange fees are capped, consumers will almost certainly see no corresponding decrease in the price of the goods and services they purchase, but will likely face fewer options for obtaining credit. Credit unions have been good actors with their members in terms of credit card rates (federal credit unions have a usury ceiling of 18 percent). Driving credit unions out of this market could result in higher interest rates and more predatory practices.

Credit unions that remain in the credit card business will have to adjust to the loss in revenue by increasing interest rates, decreasing the yield on investment products, decreasing services or otherwise cutting costs. I understand that the merchants' arguments regarding the fees may sound persuasive in relation to industry giants such as Citibank or Wells Fargo. However, those industry giants are not the industry norm. Credit unions, being not-for-profit institutions, do not have the deep pockets of our for-profit colleagues. The institutions that comprise our industry cannot issue stock to raise capital. Further, the federal credit union charter imposes significant restrictions on what markets we can enter and what products we can offer. The loss in revenue that would occur if interchange fees were capped must be made up somewhere. Ultimately, those costs and those burdens will fall on consumers.

Mr. CONYERS. Thank you, Mr. Blum.

We have been called to the floor for several votes. I will leave you to the tender mercies of Andrea Culebras, who will—identify herself—so we can go back to the conference room. And if you want to go downstairs to the deli, you can get a quick lunch. And we will reassemble as soon as the votes are over.

And so we stand in recess for a short period of time. Thank you very much.

[Recess.]

Mr. CONYERS. The Committee will come to order.

I would like to welcome Steve Cannon, chairman of the law firm of Constantine Cannon, an experienced antitrust lawyer. Served as senior vice president, general counsel, and secretary for Circuit City stores. Was responsible for FCC/FTC regulatory and antitrust matters.

He was also a partner earlier in a firm where he concentrated in antitrust law. And he has also been chief antitrust counsel for the Senate Judiciary Committee from 1981 to 1984.

So you are familiar with the process.

Mr. CANNON. Just a little bit, sir.

Mr. CONYERS. Welcome.

TESTIMONY OF W. STEPHEN CANNON, CHAIRMAN, CONSTANTINE CANNON, LLP

Mr. CANNON. Thank you.

Mr. Chairman and Members of the Task Force, Ranking Member Chabot, thank you so much for the opportunity to appear before you today to testify on this issue of extreme importance for the millions of merchants in this country and the consumers they serve every day.

We appreciate your leadership, in particular, on this bill. We endorse it enthusiastically and hope that the Committee will pass it at its earliest convenience.

Mr. CONYERS. Could you pull the mike a little closer, please?

Mr. CANNON. Okay. Is that better? Oh, there we go. Do you want me to start over?

Thank you, sir. We very much appreciate this. We represent today millions of merchants and obviously the consumers that they serve in this country every day. It is vitally important to the Merchants Payment Coalition. We applaud the bill. We think it is a terrific solution to a big problem. And we endorse it enthusiastically.

You know, a few minutes ago, Mr. Floum told you that Visa doesn't really care about what the amount of interchange is because they get no revenue. Now, that raises a really important question, which is, who really should be at this table?

And I will tell you, while we are hearing today from the small banks and credit unions, you really should not lose sight of, really, who Visa and MasterCard are. And while there are approximately 14,000 financial institutions of all sizes that issue some sort of payment cards, the top 10—the top 10—banks in this country control 88 percent of credit card receivables.

These banks, Mr. Chairman, do not negotiate with merchants to set interchange rates, as you would expect in a competitive market.

Rather, acting through their agents at Visa and MasterCard, the banks collude to set high rates and onerous terms, and they tell the merchants to take it or leave it.

Governments around the world have scrutinized the conduct that you are looking at today, and their conclusions are the same as ours. Visa and MasterCard's interchange scheme is anti-competitive, it is certainly anti-consumer, and it needs to change. This system truly represents a market failure that needs an immediate fix.

Contrary to what you hear, merchants do not want or need price controls or industry regulation. What they do need is a fair chance to negotiate market-based rates and terms, and that is exactly what H.R. 5546 provides.

Merchants do not object to paying a competitive market price for the ability to conduct payment card transactions. They do, however, object to paying a price set by colluding banks.

We set forth a pretty detailed analysis of your bill. We obviously think that it works, it works well. It is based on something that the Committee has blessed and worked on for many years in Title 17, involving sound recordings. And that is in great detail in my written testimony.

But suffice it to say that this is not a price-control bill. The fate of the parties, under your legislation, is in their hands at all times from beginning to end. They have the ability to negotiate. They have the ability to give a final offer. And it is completely in their hands. So you will hear "price control, price control, price control," but saying it a million times will not make it so.

Let me address something today that everyone is going to focus on, which is the impact of this legislation on all of us as consumers. I can tell you, coming from Circuit City for 10 years, there is no more brutally competitive industry than the retail industry.

I remember when a plasma television at Circuit City sold for $35,000 10 years ago, and today that television sells for $1,000. Technology and competition does wonderful things.

And on the banks' argument, the side of the banks have simply argued that if their cartel-set interchange fees are lowered, the banks will merely raise their fees to their customers. You know, this is a truly remarkable argument. No bank is entitled to the illegal revenues from high cartel prices. Visa and MasterCard banks around the world continue to issue cards even though interchange fees in many countries are significantly lower than they are in the United States.

One more thing I would like to address, with your indulgence, Mr. Chairman, and that is that, listening to the prior panel and seeing Mr. Floum's chart, I would urge you not to be fooled by that chart. As you might note, it is in terms of percantages and not in terms of fees. And while a percentage may or may not go up a certain amount, fees have gone up by billions of dollars for doing exactly the same thing. So I would encourage you to think about this in absolute terms.

And I also note that Mr. Floum said proudly that fees had not gone up much since the days of the knuckle-buster. I thought technology was supposed to drive prices down, not keep prices the same, especially when they have been developed in such an anti-competitive and anti-consumer form.

So I see my time is up. I appreciate the Committee's indulgence and look forward to answering your questions.

[The prepared statement of Mr. Cannon follows:]

PREPARED STATEMENT OF W. STEPHEN CANNON

STATEMENT OF W. STEPHEN CANNON
ON BEHALF OF
THE MERCHANTS PAYMENTS COALITION, INC.

BEFORE THE
UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON THE JUDICIARY
ANTITRUST TASK FORCE

HEARING ON
H.R. 5546, THE "CREDIT CARD FAIR FEE ACT OF 2008"
MAY 15, 2008

I. INTRODUCTION

Chairman Conyers, Ranking Member Chabot, and Members of the Antitrust Task Force, thank you for inviting me to participate as a witness today. I am honored to appear before you on behalf of the Merchants Payments Coalition to discuss H.R. 5546, the "Credit Card Fair Fee Act." The Merchants Payments Coalition fully supports and endorses H.R. 5546 as a remedy to the interchange problem.

Currently, competing banks collude to fix the price of interchange that they charge Americans on millions of transactions every day. These colluding banks may have formed Visa and MasterCard to manage their cartel activities, but make no mistake about it: the $42 billion of interchange fees that Americans paid last year went directly to these banks, not to Visa and MasterCard. This price fixing conduct by otherwise competing banks is anticompetitive under the antitrust laws, as antitrust authorities in other countries have concluded and more than 50 currently pending individual and class action lawsuits allege.

Using their collective market power, the banks affiliated with Visa and MasterCard force merchants to accept these anticompetitive interchange fees as well as rules that, among other things, prevent merchants from offering customers any financial incentives to use other brands of payment cards. In essence, the banks have colluded to design and perpetuate a dysfunctioual marketplace. The banks' use of Visa and MasterCard to manage these two price fixing cartels does not change the fact that their collusive behavior is anticompetitive. Highlighting the current absence of competition, none of these individual banks affiliated with Visa or MasterCard will negotiate interchange rates and terms with any merchant that are different than those established by their cartel.

H.R. 5546 is a market-based remedy that fixes this current anticompetitive behavior. It facilitates voluntary agreements between the parties every three years using both a carrot and a stick. The carrot is limited antitrust immunity so that both sides can negotiate collectively on a level playing field. The stick is that if the parties cannot reach

agreement then judges will pick one of the two sides' final offers using a competitive market standard after a short proceeding. The banks and their cartel managers (Visa and MasterCard) argue without any factual support that such proceedings would constitute "price controls." They would not. What the banks and their allies refuse to acknowledge is that H.R. 5546 limits the discretion of the judges – they can only choose one of the two "final offers" submitted by the parties themselves. No modifications and no other options are allowed.

In short, H.R. 5546 addresses the current anticompetitive and dysfunctional interchange scheme that the banks have designed and perpetuated. Specifically, H.R. 5546 offers a market-based remedy to fix this existing antitrust problem based upon statutory precedent reported out of this committee and enacted into law in 2004.

A. Background on the Merchants Payments Coalition

The Merchants Payments Coalition ("MPC") is a group of 23 trade associations[1] representing retailers, restaurants, supermarkets, drug stores, convenience stores, gasoline stations, theater owners, on-line merchants, and other businesses that accept debit and credit cards. MPC's goal is to create a more competitive and transparent card system that works better for consumers and merchants alike. The coalition's member associations collectively represent about 2.7 million locations and 50 million employees.

By way of background, I am currently Chairman of the law firm Constantine Cannon LLP, and was privileged to serve as Chief Antitrust Counsel to the Senate Judiciary Committee during the 97th and 98th Congresses (1981-1984). In addition, I served as a trial attorney and subsequently as Deputy Assistant Attorney General for Policy and Legislation in the Antitrust Division of the Department of Justice. More recently, I was a Commissioner on the Antitrust Modernization Commission, which concluded its work in 2007. Further, as General Counsel of Circuit City Stores, Inc. from 1994 to 2005, I had numerous opportunities to see the impact of interchange issues, and I can understand the plight of merchants and consumers throughout this country.

B. Leadership of this Task Force on the interchange issue

The MPC congratulates you and your colleagues, Mr. Chairman, for holding this hearing as the next step in your consideration of H.R. 5546, the Credit Card Fair Fee Act. You and Representative Cannon have provided bipartisan leadership on this issue. Twenty-

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[1] MPC's members include the Food Marketing Institute, National Association of Convenience Stores, National Grocers Association, National Retail Federation, National Association of Chain Drug Stores, American Petroleum Institute, Retail Industry Leaders Association, National Restaurant Association Petroleum Marketers Association of America, National Council of Chain Restaurants, National Association of College Stores, National Association of Truck Stop Operators, International Association of Airport Duty Free Stores, International Franchise Association, National Association of Theatre Owners, American Beverage Licensees, Bowling Proprietors Association of America, National Association of Shell Marketers, Interactive Travel Services Association, Society of American Florists, Society of Independent Gasoline Marketers of America, National Franchise Association, and Coalition of Franchisee Associations.

eight additional members (15 Democrats and 13 Republicans) already have expressed their support for your bill. Building upon your successful oversight hearing last year, this legislation provides a market-based solution to the problem of unlawful cartel pricing by payment card systems with market power.

Price fixing of interchange fees by the two dominant electronic payment systems—Visa and MasterCard—cost Americans $42 billion in 2007 alone. These fees, hidden from consumers, are in addition to other fees and practices of individual banks, like universal default. Consumers are only too familiar with those. While other legislative proposals before Congress and even our financial regulators may address those practices, H.R. 5546 is currently the only vehicle that addresses the cartel practices of competing banks that collectively set interchange rates and terms.

C. Visa and MasterCard have a history of antitrust trouble

Visa and MasterCard have become well-known in recent years for anticompetitive behavior. For example, the government successfully challenged Visa's and MasterCard's so-called "exclusionary" rules, which prohibited literally thousands of their affiliated banks from issuing cards of other electronic payment systems. Additionally, Visa and MasterCard paid billions of dollars to settle another antitrust case regarding their longstanding practice of forcing merchants to accept their debit cards as a condition of accepting their credit cards.

Despite this antitrust trouble during the past few years, Visa and MasterCard continue to engage in anticompetitive conduct regarding interchange rates and terms. As described in more detail below, each of these electronic payment systems (and their affiliated banks) has established a cartel to fix the price of interchange and related terms. Each then uses its market power to force merchants to accept these anticompetitive rates and terms. In light of this behavior, Australia decided to have its central bank comprehensively regulate these interchange practices. Moreover, just this past December, the EC found that these interchange practices violated Europe's antitrust laws.

D. The Credit Card Fair Fee Act is a market-based remedy to the interchange problem

Because of the intractable nature of this interchange problem – addressed in detail at the Task Force's hearing last summer – action is necessary. Having analyzed a variety of possible legislative remedies, the Merchants Payments Coalition agrees that the best approach is to have a market-based remedy analogous to an existing statutory framework that this committee approved with respect to music licensing. The Credit Card Fair Fee Act is such a remedy. Under H.R. 5546, parties are encouraged to reach a voluntary agreement on rates and terms that merchants must comply with to access an electronic payment system such as Visa or MasterCard. If they cannot, these parties must participate in a binding proceeding before a judicial panel. The panel would decide which of the parties' "final offers" best approximates the outcome in a competitive marketplace.

My testimony today will focus on three general topics. First, I will provide an overview of the interchange problem and how it harms American merchants and consumers. Second, I will review what MPC believes to be the key aspects of the Credit Card Fair Fee Act. Finally, I will address why H.R. 5546 is a strong pro-consumer, market-based remedy to the interchange problem.

II. OVERVIEW OF THE INTERCHANGE PROBLEM

Visa, MasterCard, and their affiliated banks suggest that the problem raised by merchants regarding interchange is too complex to understand. It is not.

A. Merchants must accept Visa and MasterCard brands of credit and debit cards

In 2006, the dollar value of all U.S. general-purpose payment card transactions exceeded $2.7 trillion. This represents more than 38 billion credit and debit card transactions in the United States alone, which account for more than 40% of all transactions between merchants and consumers. Such widespread use of general-purpose credit and debit cards dictates that most merchants cannot conduct business without accepting at least certain card brands.

More specifically, Visa and MasterCard collectively control approximately 75% of electronic card payments. Given this market power, the competitive nature of the retail market, and consumer demand for electronic card payments, merchants effectively are compelled to accept Visa and MasterCard as a matter of economic necessity.

B. To accept these cards, merchants must accept interchange fees and related rules without negotiation

A merchant that wants to accept a specific brand of general-purpose credit or debit cards must have access to that brand's electronic payment system. This access, however, is conditioned upon the merchant paying interchange fees and following certain rules (*e.g.*, merchants accepting any Visa credit cards must accept all Visa credit cards from every bank that issues them).

Thousands of banks issue branded cards for specific electronic payment systems (*e.g.*, Visa and MasterCard). Each of these competing banks charges a fee, called an interchange fee, whenever a consumer uses a card issued by that bank to purchase products or services from a merchant. The banks simply deduct this fee from the purchase price otherwise owed to the merchant before remitting the funds to the merchant.

C. Competing banks collude to fix the interchange rates and related terms

Simply put, interchange rates and terms are not determined by competition in the marketplace between these thousands of competing banks. Instead, the rival banks that use Visa and MasterCard as cartel managers collectively set uniform interchange rates (that apply to every Visa or MasterCard transaction regardless of the bank that issued the card or signed the merchant). They similarly agree to impose the same terms (*i.e.*, operating rules) on the merchants. In short, these rival banks collude rather than compete.

In the Visa and MasterCard electronic payment systems, therefore, the interchange rates and terms imposed upon the merchant are the same regardless of which bank issued the consumer's card.[2] In short, the banks have established cartels within different electronic payment systems (*e.g.*, one for Visa, a different one for MasterCard). The result is that merchants cannot negotiate with individual banks regarding interchange rates and terms. Because rival banks don't compete, merchants don't get rates and terms that would have been negotiated in a competitive marketplace.

D. Interchange fees cost Americans $42 billion in 2007 alone

These colluding banks imposed $42 billion of interchange fees on Americans in 2007 alone. Research indicates that these fees are more than seven times the banks' costs to process the transactions. Given the magnitude of these fees, merchants must factor this cost into the price of the goods or services they sell. As a result, consumers using payment cards and even consumers who pay by cash, check, or food stamps are harmed by these fees. Unfortunately, consumers are not aware that their choice of payment card will affect the amount of hidden fees imposed upon merchants, and that this choice can affect the prices all consumers pay.

In sum, the problem is that (i) competing banks collude to fix anticompetitive rates and terms and (ii) because of market power, merchants are forced to accept them. The result is that Americans currently pay $42 billion a year in interchange fees that are set by collusion, not market forces.

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[2] It should be noted that there is not a single interchange rate for each specific brand (*e.g.*, Visa). Rather, there is an entire schedule of interchange rates that differ depending upon the type of card the consumer uses. For example, a "premium" Visa card marketed to affluent individuals is likely to have an even higher interchange rate than a "classic" Visa card marketed to college students. The key point is that while a couple of hundred different interchange rates may exist within a specific brand like MasterCard, every issuing bank for that electronic payment system imposes the same schedule of interchange rates on merchants.

III. THE CREDIT CARD FAIR FEE ACT IS A MARKET-BASED REMEDY TO THE INTERCHANGE PROBLEM

A. Overview of the remedy

H.R. 5546 addresses the interchange problem by creating two paths to market-based rates and terms. First, and primarily, the bill facilitates voluntary negotiation and agreement between the parties. Second, if the parties cannot reach agreement, each side submits a final offer. Then a judicial panel chooses the one final offer that it decides (based upon evidence and witnesses presented by the parties in an expedited proceeding) is closest to the rates and terms that would have been negotiated in a competitive marketplace.

Either way, the parties themselves propose the interchange rates and terms under this bill. Even if the judges have to choose one of the two "final offers," both offers contain rates and terms proposed by a party. The judges have no discretion to make any modification. Thus, the bill's practical, market-based approach – driven by the parties, not government regulators – levels the playing field without dictating the outcome.

B. Key elements of the Credit Card Fair Fee Act

Mr. Chairman, based on the MPC's analysis of H.R. 5546, we believe its provisions provide an effective, market-based remedy to the underlying problems created by Visa and MasterCard's anticompetitive behavior. In particular, the MPC believes the following are key elements of the Act:

1. Precedent exists for using this type of market-based legislative remedy. This remedy follows an approach Congress has used for years to determine market-based royalty rates and terms for the licensing of copyrighted sound recordings. It was most recently revised by the Copyright Royalty and Distribution Reform Act of 2004, legislation supported by the bipartisan leadership of the House and Senate Judiciary Committees. This approach is codified in Title 17 of the U.S. Code.
2. The remedy would apply only to electronic payment systems with substantial market power. Regardless of their corporate form, Visa and MasterCard are both electronic payment systems controlled by rival banks. For each of these electronic payment systems, otherwise competing banks that control them currently eliminate competition by collectively setting the rates and terms that they then impose upon merchants. Because both Visa and MasterCard have substantial market power, merchants must accept these anticompetitively-set rates and terms which ultimately harm consumers. Accordingly, the remedy covers only electronic payment systems that have substantial market power (and these may change over time).
3. The remedy would facilitate reaching a voluntary agreement on rates and terms. Voluntary agreement would be facilitated by granting both merchants and a covered electronic payment system (including its affiliated banks) limited antitrust immunity to negotiate collectively. Additionally, these

parties will negotiate in the face of a binding judicial proceeding if they fail to reach a voluntary agreement – a proceeding whose outcome neither side would be able to control.

4. Absent voluntary agreement among all parties, each side would submit a set of rates and terms for judges to choose between in an expedited, market-based proceeding. If the parties fail to reach a voluntary agreement, a panel of judges appointed by DOJ and the FTC would hold a binding proceeding. This panel would choose one of the two sets of rates and terms offered by the parties. Each proceeding would be expedited with a limited 60-day discovery period and other statutory deadlines. Critically important, the judges would be required to apply a market standard in making their choice – they would select the set of rates and terms that most closely represents what would have been negotiated in a competitive marketplace.
5. Market-based rates and terms would be available to any merchant regardless of size, industry, or location. A covered electronic payment system would have to offer the rates and terms chosen in such a market-based proceeding to any merchant who wants them. A covered electronic payment system could not force any individual merchant to negotiate separately.
6. Non-universal voluntary agreements would be possible and could be used as evidence in proceedings before the judicial panel. One or more merchants and a covered electronic payment system (including its affiliated banks) would have the option to negotiate a voluntary agreement at any time. While such an individual agreement would not formally apply to all merchants and parties, the judges and parties could look to it in a subsequent proceeding as evidence of the appropriate rates and terms.
7. Rates and terms would be set for only three years. The rates and terms chosen by the panel of judges would be in effect for three years, and then the process would repeat itself. This would allow the parties and judges periodically to take into account any changed circumstances that may impact the rates and terms. Experience with Title 17 suggests that any voluntary agreements negotiated likely would have the same duration.
8. Both sides would have limited antitrust immunity for negotiating voluntary agreements and, if necessary, participating in the market-based proceedings. Pursuant to a limited grant of immunity, all of the parties on each side would be able to negotiate and participate in any binding proceedings collectively without any risk of antitrust liability. In fact, each side could create and use a single common agent to engage in these negotiations and proceedings, as has occurred under Title 17's existing, analogous statutory approach.

C. Differences from Title 17 music licensing

Although the Credit Card Fair Fee Act is modeled after a similar process for licensing copyrighted sound recordings that is codified in Title 17 of the U.S. Code, there are significant differences and, we think, improvements. These include:

1. Statutory approach even better suited for the electronic payment system industry. The Credit Card Fair Fee Act addresses the electronic payment systems industry rather than the sound recording industry. This type of statutory approach is better suited for the electronic payment systems industry because that industry has well-defined revenue and cost attributes. In contrast, applying this statutory approach to the music industry can implicate intangible measures of artistic value.
2. Competitive market standard governing judges clarified to close loopholes. If a judicial proceeding is necessary under the Credit Card Fair Fee Act, the Act would require judges to select one of the final offers submitted by the two sides based upon a competitive market standard. This competitive market standard is more specific than the general willing buyer/willing seller standard in Title 17 whose meaning parties have litigated. Accordingly, this more precise standard should result in less need for interpretation.
3. Determination by judges limited to choosing one of the two final offers submitted by the parties. Under the Credit Card Fair Fee Act, the judges do not have the authority to select any rates and terms they wish if there is a proceeding. Instead, they are constrained simply to choose the one final offer of rates and terms (of the two presented by the parties) that they determine more closely reflects what would have been negotiated in a competitive market. Title 17 places no such constraint on its judges.
4. Required filing of voluntarily negotiated access agreements. Unlike Title 17, the Credit Card Fair Fee Act requires that the parties publicly file any voluntarily negotiated access agreements. This facilitates a transparent process as well as the use of these arms-length agreements as evidence of marketplace behavior in all subsequent negotiations and proceedings.
5. Oversight bodies with antitrust expertise and limited role. The Credit Card Fair Fee Act delegates a limited oversight role to the Antitrust Division of the Department of Justice and the Federal Trade Commission because they have extensive experience addressing the very type of antitrust concerns that create the need for the Act. This differs from Title 17, where the Librarian of Congress and Register of Copyrights provide oversight and copyright expertise. Further, while both approaches permit appeal to the D.C. Circuit, the Credit Card Fair Fee Act relieves the oversight bodies of having to address "novel questions of law." This results in a more limited and less burdensome role for the oversight bodies than under Title 17.
6. Reexamination of rates and terms every three years. The Credit Card Fair Fee Act requires a reexamination of the rates and terms every three years to take into account any relevant changes in the marketplace. Under Title 17 cycles typically last five years.
7. Streamlined initiation of judicial proceedings if no voluntary agreement among all. Under the Credit Card Fair Fee Act, all merchants participate in a single consolidated proceeding for each covered electronic payment system. In contrast, Title 17 calls for multiple proceedings for various users of

copyrighted sound recordings. By avoiding the need to determine which merchants are supposed to participate in which of several proceedings, the procedure for initiating a judicial proceeding under the Credit Card Fair Fee Act is more streamlined than the procedure under Title 17.

8. Initial disclosures to further expedite discovery. To further expedite the 60-day discovery process, the Credit Card Fair Fee Act requires a limited number of affected companies to provide initial disclosures to the other side. Although analogous to the approach of the Federal Rules of Civil Procedure, there is no provision for iuitial disclosures in Title 17.
9. Penalties for failure to comply with discovery requests. The Credit Card Fair Fee Act also provides for sanctions against parties that fail to comply with discovery requests. Again, this approach is analogous to procedures in other judicial proceedings, but Title 17 does not include any such penalties.

IV. H.R. 5546 PROVIDES A STRONG PRO-CONSUMER, MARKET-BASED REMEDY TO THE INTERCHANGE PROBLEM

Mr. Chairman, based upon the MPC's analysis, the pro-consumer, market-based rationale for H.R. 5546 is strong.

A. The collective setting of interchange fees by a cartel of competing banks is classic price fixing that violates the antitrust laws. Merely changing corporate form through an IPO does not immunize this anticompetitive conduct.

Traditionally, Visa and MasterCard were associations of competing banks. The collective setting of interchange fees (by or on behalf of member banks) by each of these card associations constitutes classic price fixing by a cartel of competitors that violates the antitrust laws.

Recent changes in ownership structure due to the Visa and MasterCard IPOs reflect changes merely in form, not substance. The card systems now simply act as the agents of these competing banks in managing the interchange fee cartel. The card systems (regardless of the nominal "independence" of board members) have every incentive to fulfill their expected cartel manager function, since these affiliated banks are the card systems' only customers. These cartel manager arrangements continue to violate the antitrust laws.

Specifically, the antitrust laws forbid a "hub-and-spoke" form of conspiracy in which a central agent manages a cartel even if the conspirators do not expressly agree with each other to go along with the hub's plan.[3] The antitrust violation is even clearer where there is an agreement among members along the "rim" to utilize the hub.[4]

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[3] *See, e.g., Toys "R" Us v. FTC*, 221 F.3d 928, 932 (7th Cir. 2000).
[4] *See, e.g., Spectators' Communication Network v. Colonial Country Club*, 253 F. 3d 215 (5th Cir. 2001).

This is precisely the case with the Visa and MasterCard reorganizations. By agreeing to these reorganizations based on the understanding that existing agreements such as the interchange fee mechanism would continue, the member banks have agreed to use the services of Visa and MasterCard as managers of their existing interchange fee cartels. Moreover, when the member banks agreed to designate Visa or MasterCard as the ongoing manager of the interchange fee-setting process, they had every reason to believe that their boards would operate in their collective best interest as cartel agent: the member banks would remain significant shareholders, and they would remain the payment systems' dominant, if not only, customers.

According to Visa, "[a] significant portion of our operating revenues are concentrated among our largest customers . . . Loss of business from any of our largest customers could have a material adverse effect on our business."[5] Similarly, MasterCard says "[w]e are, and will continue to be, significantly dependent on our relationships with our [member banks]."[6] As the saying goes the proof of the pudding is in the eating: since the IPO, MasterCard has not made any changes to reduce interchange rates or make its rules more reasonable for merchants, and none of its affiliated banks has offered to accept interchange rates different from those set by MasterCard. The price fixing continues unabated.

The existence of a post-IPO antitrust violation was recently confirmed in the European Commission's decision holding that MasterCard's setting of interchange fees in Europe violates European competition law, notwithstanding the IPO. The Commission has ordered MasterCard to terminate those interchange fees within six months, rejecting the argument that a change in corporate form somehow immunizes an electronic payment system from antitrust liability:

> MasterCard's viewpoint that the IPO . . . had changed the organization's governance so fundamentally that any decision of MasterCard Incorporated's Global Board no longer qualifies as a decision of an association [of its member banks] but rather as [a] "unilateral" act which each member bank bilaterally agrees to abide by, cannot be accepted . . . MasterCard's member banks shaped and eventually approved the IPO in order to perpetuate the MIF [multilateral interchange fee] as part of the business model in a form they perceived to be less exposed to antitrust scrutiny. Contrary to MasterCard's argument, the aim of avoiding exposure to antitrust risks due to the MasterCard MIF was a clear driving force behind the IPO. Rather than modifying the business model to bring it in line with EU competition law, the banks chose to change the governance of their co-ordination specifically for antitrust sensitive decision making. The member banks effectively "outsourced" this decision making to a new management body and made sure that their direct influence ... would be limited to minority rights. However, the banks also agreed to the IPO ... after MasterCard's management assured them that the banks' interests will continue to

[5] Visa SEC Form S-1, at 23 (November 2007).
[6] MasterCard SEC Form S-1, Amendment No. 8, at 21 (May 23, 2006).

be preserved under a new "enhanced customer approach" and via the local input of the banks in the decision making. It cannot be doubted that in approving the IPO and thereby delegating the decision making powers for the MIF to the new independent Global Board, the member banks legitimately expected and therefore agreed that the Board would henceforth set the MIF in a manner that is in their common interest.[7]

B. Courts have ruled recently that Visa and MasterCard possess market power

Whatever the merits of the use of an interchange fee when Visa was an "infant" electronic payment system, those justifications have become irrelevant more than three decades later. The electronic payment system marketplace is now mature. Courts last reviewed the legality of interchange more than two decades ago when the "VISA business arrangement [wa]s relatively young."[8] At that time, "the court determined that the relevant product market was all payment devices (including cash, checks, and all forms of credit cards) and that VISA did not possess power in that market."[9]

Much has changed over the last several decades. More than twenty years of evolution in payment systems has substantially changed the boundaries of the relevant market. In the current century, "neither consumers nor [Visa and MasterCard] view debit, cash, and checks as reasonably interchangeable with credit cards."[10] Another court pointed out that Visa itself had "adopted this market definition, excluding all forms of payment except credit and charge cards" in a previous case.[11] Accordingly, the findings in *NaBANCO* are irrelevant to any antitrust analysis of today's mature credit card market.

Not surprisingly, therefore, multiple courts have held recently that Visa and MasterCard have market power:

- Following a thirty-four day trial, a district court in the Southern District of New York held that "whether considered jointly or separately, [Visa and MasterCard] have market power." [12] Specific evidence supporting this holding was that "Visa members accounted for approximately 47% of the dollar volume of credit and

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[7] European Commission Decision, COMP/34.579, at ¶¶ 357, 378-379 (December 19, 2007) (footnotes omitted).

[8] *National Bancard Corp. (NaBANCO) v. Visa USA*, 596 F. Supp. 1231, 1263 (S. D. Fla. 1984).

[9] *National Bankcard Corporation v. Visa U.S.A., Inc.*, 779 F.2d 592, 603 (11th Cir. 1986) (concluding also that the fees were "reasonably cost related").

[10] *United States v. Visa U.S.A., Inc.*, 163 F.Supp.2d 322, 338 (S.D.N.Y. 2001) (holding that "general purpose cards constitute a product market").

[11] *In re Visa Check/Mastermoney Antitrust Litigation*, 2003 WL 1712568 at *3 (E.D.N.Y. April 1, 2003) (citing *SCFC ILC, Inc. v. Visa U.S.A., Inc.*, 36 F.3d 958, 966 (10th Cir. 1994) ("Visa USA stipulated 'the relevant market is the general purpose card market in the United States'").

[12] *Visa U.S.A., Inc.*, 163 F.Supp.2d at 341. The court defined this market as the one in which networks like Visa and MasterCard "provide the infrastructure and mechanisms through which general purpose card transactions are conducted, including the authorization, settlement, and clearance of transactions." *Id.* at 338. The court also noted that "[m]erchant acceptance of a card brand is also defined and controlled at the system level and the merchant discount rate is established, directly or indirectly, by the networks." *Id.*

charge card transactions and MasterCard members for approximately 26%."[13] Combined, Visa and MasterCard together control over 73% of the volume of transactions on general purpose cards in the United States and approximately 85% of the cards issued.[14] In addition to these high market shares, Visa and MasterCard "have demonstrated their power in the network services market by effectively precluding their largest competitor from successfully soliciting any bank as a customer for its network services and brand."[15] Based upon these and other facts in the record – *e.g.*, that the market is highly concentrated and has high barriers to entry – the Second Circuit affirmed the trial court, ruling that Visa and MasterCard "jointly and separately, have power within the market for network services."[16]

- In addition to this government case against the Visa and MasterCard joint ventures, there was a private case brought by merchants who also claimed that Visa and MasterCard engaged in anticompetitive conduct in violation of the antitrust laws. In this private action, another court held that "Visa possesses appreciable economic power" in the credit card services market, finding that Visa's share of the credit card market alone was nearly 60 percent.[17]

Given this market power, merchants cannot refuse to accept Visa and MasterCard cards as a practical matter. As the court in *Visa Check/Mastermoney Antitrust Litigation* observed, "evidence establishes conclusively that merchants have not switched to other payment devices despite significant increases in the interchange fees on the defendants' credit cards."[18] These findings are consistent with a recent staff report by the Kansas City Federal Reserve that concluded merchants cannot realistically refuse to accept Visa and MasterCard.[19] The bottom line is that the market power of Visa and MasterCard means that the vast majority of merchants have no realistic ability to refuse to accept their cards.

C. No individual bank will negotiate interchange fees with merchants

Visa and MasterCard each claim that on certain occasions they will negotiate with a merchant or set of merchants regarding interchange fees (typically as part of a settlement of a lawsuit or as an initial offer to entice new categories of merchants to start accepting their cards). Such claims actually prove the merchants' point because the anticompetitive harm at issue here is that rival banks collude to fix prices rather than compete. The banks' use of Visa and MasterCard to manage the two cartels is part of the problem. The

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[13] *Id.* at 341.
[14] *Id.*
[15] *United States v. Visa U.S.A., Inc.*, 344 F.3d 229, 240 (2d Cir. 2003).
[16] *Id.* at 239.
[17] *In re Visa Check/Mastermoney Antitrust Litigation*, 2003 WL 1712568 at *3-*4 (E.D.N.Y. April 1, 2003).
[18] *Id.* at *3 ("there is no cross-elasticity of demand at the merchant level between the defendants' products and all other forms of payment").
[19] F. Hayashi, "A Puzzle of Payment Card Pricing: Why Are Merchants Still Accepting Card Payments?" *Review of Network Economics* 144, at 172 (March 2006).

fact that Visa or MasterCard, in their role as cartel manager, may negotiate with merchants on behalf of the cartel of colluding banks underscores the anticompetitive nature of this interchange scheme. In a competitive market, *individual* banks would compete with each other by negotiating interchange rates and terms on their own with the merchants. Under the current Visa and MasterCard interchange systems, this never happens – no individual bank will negotiate interchange fees with merchants.

D. The Act directly addresses the inability of individual merchants effectively to bargain with a cartel with market power

As just noted, Visa and MasterCard each has the ability to act as a collective cartel agent on behalf of all of its banks. In contrast, competing merchants (given the constraints of the antitrust laws) must attempt to bargain individually with each cartel. Not surprisingly given this disparity of bargaining power, meaningful bargaining over interchange rates and terms does not occur under the circumstances. The Australian central bank highlighted this reality just last month, following an extensive review of the first four years' operation of interchange fee regulation:[20]

> Following a careful consideration of this issue, the [Bank's Payment Systems] Board remains of the view that, in the absence of regulatory oversight, there is a significant risk that interchange fees in some systems will be set at levels that are too high . . . The main reason for this is that *merchants find it difficult to exert sufficient downward pressure on interchange fees, largely as a result of the structure of incentives that they face* . . . In a sense, merchants are in a game akin to the 'prisoner's dilemma': *they would be better off if they could collectively agree on the terms of credit card acceptance, paying no more than their collective benefit, but instead they act individually and, as a result, can in aggregate potentially pay more for credit card acceptance than the benefit they receive.*

Rather than adopting Australia's regulatory solution, however, H.R. 5546 solves these problems of negotiating structure by facilitating merchants' ability voluntarily to negotiate with a card system as part of a group in a market-based process that promotes transparency. If there is no agreement, a judicial panel will choose one of the two parties' final offers that most closely reflects a competitive solution, a further incentive to the parties reaching an agreement.

E. Interchange fees account for approximately 2% of every Visa and MasterCard transaction in the United States

As explained in a recent GAO study, merchants pay interchange fees of approximately 2% on Visa and MasterCard transactions ($2 on a $100 transaction).[21] While there are other fees that go to the merchant's bank and the electronic payment system (Visa or

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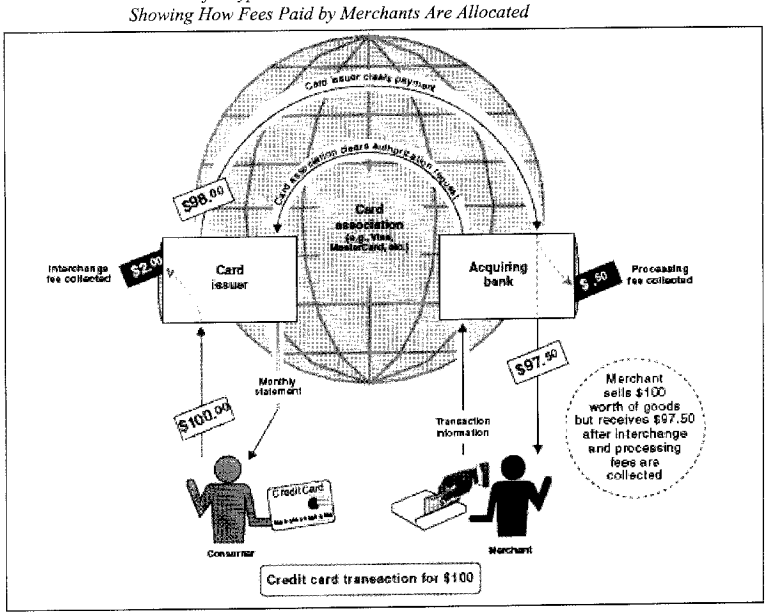
[20] Payment Systems Board, Reserve Bank of Australia, *Preliminary Conclusions of the 2007/08 Review*, at 15 (April 2008) (emphasis added).

[21] GAO, *Credit Cards- Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosure to Consumers*, GAO-06-929, at 74 (September 2006).

MasterCard), the interchange fees account for approximately 80% of the total fees charged. Here is a graphic from that GAO study explaining how the Visa and MasterCard interchange scheme works:

Illustration of a Typical Credit Card Purchase Transaction Showing How Fees Paid by Merchants Are Allocated



Source: GAO (analysis); Art Explosion (images).

It is also notable that interchange fees are largely imposed on a percentage basis rather than as a flat per-transaction fee, so merchants pay an interchange fee of $0.20 on a $10 transaction but $2 on a $100 transaction. This means that the banks realize a surge in interchange fees simply when prices rise for items like gasoline or food, even though there is no increase in the cost to process these transactions. Visa and MasterCard also charge interchange fees on the gross amount of the transaction, which typically includes some amount of state and local taxes. In other words, the banks charge interchange fees even on amounts that merchants collect for the government but do not retain.

Additionally, interchange rates in the United States are significantly higher than in those countries in which policymakers have challenged the anticompetitive conduct of Visa,

MasterCard, and their affiliated banks. As noted above, the average interchange rate that Americans pay is approximately 2%. In contrast, the average interchange rate in Australia is only 0.5 percent.[22] Similarly, under a recently-expired consent decree with the European Commission, Visa's cross-border interchange rate had decreased to 0.7 percent.[23]

F. There is no procompetitive justification for the electronic payment systems' price fixing and exploitation of market power

H.R. 5546 appropriately affects only payment systems that process at least 20% of U.S. electronic card payments. According to a recent working paper by the staff at the Federal Reserve Bank of Kansas City, it appears "market power of credit card networks" is a factor that "plays a critical role in determining the card pricing."[24] The reality is that Visa and MasterCard interchange fees do not appear to be based upon costs – a further indication that market forces do not determine interchange rates. A 2006 consultant's report concludes that transaction processing comprises only 13% of interchange costs.[25]

Visa and MasterCard argue there are justifications for their anticompetitive interchange rates and terms, but the governments that have addressed these justifications have rejected them. For example, a 2006 study jointly undertaken by the EC's Competition and Financial Services Directorates:[26]

> [S]eem[s] to cast substantial doubt on the justifications for the existence of interchange fees put forward by the payment card systems. For instance, one international network believes that in the absence of . . . interchange fees paid by acquirers to issuers, issuers would have to recoup all of their costs from cardholders and this would lead to a level of card issuing that is "not optimal" for the system as a whole. This statement seems to be largely refuted by our results. The justification put forward by another international network, which considers that the interchange fee provides for a transfer of revenue between issuers and acquirers to achieve the optimal delivery of services by both acquirers and issuers to merchants and cardholders, is also not supported by our results . . . In such a context, the role of interchange fees as a "mechanism to redress the imbalance

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[22] Reserve Bank of Australia, "Interchange Fees for the Visa and MasterCard Schemes" (Press Release, September 29, 2006).

[23] European Commission, "Antitrust: Commission prohibits MasterCard's intra-EEA Multilateral Interchange Fee, at 2 (Press Release, December 19, 2007) The Commission noted that the MasterCard's credit card interchange fee, which the Commission found to be unlawful, varied between 0.8 and 1.2 percent. *Id.* at 1.

[24] Z. Wang, *Market Structure and Credit Card Pricing: What Drives Interchange?* at 38 (December 2006).

[25] Diamond Management and Technology Consultants, *A New Business Model for Card Payments,* at 10 (2006).

[26] European Commission, *Financial Services Sector Inquiry, Interim Report I: Payment Cards,* at 71 (April 12, 2006).

between issuers' and acquirers' costs and revenues in delivering a payment card service" is not readily understandable.

More specifically, in its recent investigation of MasterCard's interchange fee system, the European Commission's Competition Directorate gave MasterCard the opportunity to demonstrate that the theoretical justifications given for interchange fees could be demonstrated factually. The EC concluded that MasterCard simply could not show that the theoretical benefits of interchange fees actually exist.

In particular, the EC attempted to verify "whether the model underlying MasterCard's MIF [multilateral interchange fee] was founded on realistic assumptions, whether the methodology used to implement that model could be considered objective and reasonable and whether the MIF had indeed led to the positive effects that MasterCard claims." The EC concluded that MasterCard could not meet that burden.[27] Accordingly, the EC gave MasterCard six months (from December 2007) to end its interchange fee for transactions across European national boundaries or institute a new compensation mechanism that did not violate EC competition law.

G. Congress is best-suited to remedy the interchange problem prospectively

Visa, MasterCard, and some members of the MPC currently are participating in litigation regarding interchange. Specifically, *In re Payment Card Interchange Fee & Merchant Discount Antitrust Litigation* (MDL Docket No. 05-1720) is comprised of approximately 50 class actions and individual lawsuits that have been designated multidistrict litigation and transferred for pretrial proceedings to U.S. District Court Judge Gleeson in the Eastern District of New York. Visa and MasterCard have argued that it is inappropriate for Congress to act while this litigation is pending, noting specifically that the parties have been participating in mediation sessions. This argument is misguided.[28]

First, resolution of these antitrust class action lawsuits can take literally years. For example, a similar antitrust class action against Visa and MasterCard was pending for over seven years before they agreed to settle. It is also typical for courts to require the parties in complex commercial litigation to participate in non-binding mediation sessions.

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[27] European Commission, *Antitrust: Commission prohibits MasterCard's intra-EEA Multilateral Interchange Fee – frequently asked questions*, MEMO/07/590, at 2-3 (December 19, 2007). MasterCard is appealing this decision.

[28] Visa and MasterCard also like to cite an individual case – *Kendall* – from California that addressed interchange practices but was dismissed prior to full discovery because the complaint was not well-pleaded. In contrast, substantial discovery already has taken place in *In re Payment Card Interchange Fee & Merchant Discount Antitrust Litigation* that would make a dismissal like in *Kendall* virtually impossible. With the benefit of this discovery the amended complaint in *In re Payment Card Interchange Fee & Merchant Discount Antitrust Litigation* is not susceptible to dismissal on the points raised in *Kendall* given its additional allegations and specificity supporting its claims. Tellingly, while Visa and MasterCard like to highlight the *Kendall* dismissal here in Congress, their lawyers have not even attempted to make the same arguments to the court in the pending litigation.

Unfortunately, however, participation by the parties in these mandatory sessions does not indicate that the case is about to end. Any resolution of the pending interchange litigation may take years, including possible appeals and remands, while Visa and MasterCard's ongoing price fixing and exploitation of their market power continues unabated.

Second, while courts are effective at remedying past unlawful conduct, Congress better-suited to prevent *future* anticompetitive conduct in a complex industry such as electronic payment systems. In large part, this is because there are only a limited number of injunctive relief options available to courts to affect on-going conduct. The experience of the AT&T divestiture decree is surely a cautionary one for Congress. In that case a federal district judge ruled on the fundamental details of the telephone industry for over a decade based primarily upon an historical court record.

For these reasons, the MPC believes Congress should enact the Credit Card Fair Fee Act as a market-based, non-regulatory remedy and not wait for resolution by the courts.

H. Consumers will benefit from lower interchange fees under H.R. 5546

All consumers shoulder the burden of interchange fees as they are a factor in merchants' pricing of goods and services. In fact, U.S. households paid an average of more than $300 for hidden interchange fees in 2006, including households that did not even use payment cards. The Credit Card Fair Fee Act is a market-based approach to relieving consumers of this burden.

This market-based approach stands in contrast to the solutions undertaken in other countries, such as direct regulation of interchange fees by the central bank (Australia), negotiated rate reductions between card systems and central banks (Mexico), or direct intervention by competition authorities (in the European Union). While their approaches differed, however, all of these countries addressed the same problem we are facing in the United States – anticompetitive interchange rates and terms imposed by cartels of rival banks that possess market power. Accordingly, despite these differences in approach, experiences in countries like Australia are instructive in anticipating the potential impact of H.R. 5546 here in the United States:

1. Billions of dollars of relief to merchants and consumers

Australia's regulators have found that lower interchange rates for Australian credit and debit card holders have benefited consumers in several ways. For example, the central bank concluded that the overall consumer price index was lower than it otherwise would have been had interchange fees not been subject to central bank limitations, with the bulk of interchange fee savings passed on to merchants' customers.[29] More specifically, the Reserve Bank found that as a result of the reforms, "the net savings to merchants was around $920 million in 2006/07. Since the reforms came into effect in 2003, merchants

[29] Payment Systems Board, Reserve Bank of Australia, *Preliminary Conclusions of the 2007/08 Review*, at 23 (April 2008).

have saved a net total of at least $2.5 billion which, in the normal course, would be passed through into lower prices for goods and services."[30]

2. Increased competition among banks for consumers

Additionally, even the credit card companies themselves have recognized that competition among credit card issuers has flourished in Australia since the reforms. Notably, however, the new competition has focused on price rather than on mileage points and other features apart from price. This reconfirms that high interchange fees are a subsidy from merchants and their customers to cards with high marketing costs and expensive features. In an August 2005 letter to the Reserve Bank of Australia, MasterCard stated:[31]

> MasterCard does not disagree that there is, *at present,* strong competition amongst issuers of credit cards. Such competition has been enhanced by the fact that, at present, issuers have been able to recover eligible costs.... One distinct characteristic of the product offerings in recent times, however, has been the increase in the number of 'low cost' credit card offerings. While MasterCard believes that it is beneficial for there to be 'low cost' credit card products being offered, it also believes that, with the common benchmark interchange fee, in the future there will be fewer 'fully featured' credit card offerings and the competition between issuers will be based on increasingly homogeneous 'low cost' credit card offerings.

Subsequent events have confirmed the benefits to cardholders from this interest rate competition. According to the central bank, "Interest rates on 'no frills' cards range from 9-13 per cent compared with interest rates of 17 percent or higher on most standard rewards-based cards."[32] The head of one major Australian bank (ANZ Bank) was pleased with the results of competing on interest rates, rather than rewards: the shift away from the bank's loyalty point system resulted in a loss of credit-card transactors which has been offset by growth in customers wanting the lower-rate cards. "We lost a lot of ground (in transactors) but gained a lot of ground in people actually borrowing against their credit cards because of the lower rates . . . Over the long run that will be more beneficial to us in terms that the earnings have shifted away from transactions to much more interest bearing accounts."[33]

3. Lower net bank fees

Opponents of the Credit Card Fair Fee Act reportedly have argued that if cartel-set interchange fees are lowered, banks will merely raise other fees to their customers. This

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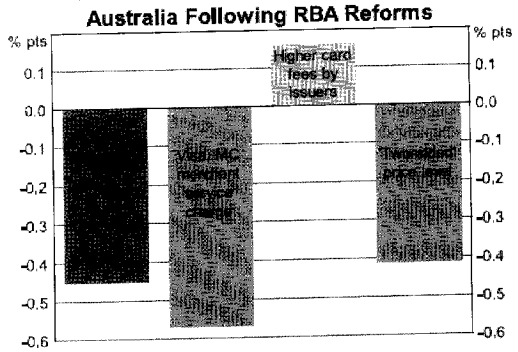
[30] Payments System Board, Reserve Bank of Australia, *Annual Report 2007*, at 26 (October 2007).
[31] Letter from Senior Vice President—Australia, MasterCard International to Head of Payments Policy, Reserve Bank of Australia, August 25, 2005, at 3 (emphasis in original).
[32] Reserve Bank of Australia, *Statement on Monetary Policy*, at 50 (Feb. 13, 2006).
[33] "Credit Cards Trend to Lower Rates," *The Australian*, (Feb. 22, 2006).

line of argument is truly remarkable. No bank is entitled to the illegal revenues from high cartel prices. Visa and MasterCard banks around the world continue to issue cards even though interchange fees in many countries are significantly lower than they are in the United States. In fact, it is far more likely that banks will respond to lower payments from merchants (if that is the result of the agreement process) by reducing their extraordinary card marketing expenditures, such as the billions of unsolicited junk mail credit card solicitations they send out each year.[34]

One study of the impact of interchange fee regulation by the Australian central bank concluded that the merchant discount charged by acquirers fell more than the decline in interchange fees, and the decline in costs to merchants more than offset any increased fees charged to cardholders. Consequently, looking at payment cards as a "two-sided" market of cardholders and merchants, the controls on interchange fees had led to a net 41 basis point per transaction reduction in the cost of cards:[35]

'Two-sided' Visa/MasterCard Price in Australia Following RBA Reforms



Source: RBA Bulletin Table C.3 and Chang *et al* (2005)
Note: Uses midpoint of Chang *et al* estimates of increase in cardholder fees

[34] There were over 5 billion such solicitations in 2007, with a response rates of 0.5 percent (one out of 200). Thus, banks with loan losses and/or sub-prime card holders apparently reduced mailings, while banks with relatively fewer problems, such as Chase, *increased* their junk mail solicitations. Synovate, "US credit card mail volume declined in 4th quarter 2007 as troubled issuers pulled back" (Press release, February 6, 2008).

[35] A. Frankel, "Towards a Competitive Card Payments Marketplace," in Reserve Bank of Australia, *Proceedings, Payments System Review Conference* 27, at 63 (April 2008).

4. Competitive pressures on all merchants to compete away cost reductions in the form of lower consumer prices

Some opponents of the legislation also argue that even if there are significant reductions in the interchange fees charged merchants, consumers as a whole will not benefit because merchants will not reduce prices for consumers. I find such claims divorced from reality.

Australia's central bank has concluded that the bulk of cost savings to merchants resulting from the lower interchange fees "ha[s] been, or will eventually be, passed through into savings to consumers."[36] At the same time, these interchange reforms have provided credit card users with a *choice* they previously did not have: no-frills cards with lower fees and interest rates or rewards cards with higher rates – just the outcome one would expect in a competitive card marketplace. Not surprisingly, the Reserve Bank's current review of its regulation of credit and debit card interchange fees and related rules found significant benefits to society from improving the pricing signals to consumers regarding the true relative costs and benefits of various forms of payment:[37]

> The Board's overall assessment is that the welfare gains from the reforms are likely to have been substantial. Not only has the change in payment patterns *relative to what would have occurred in the absence of the reforms* resulted in lower costs, but there has also likely been an increase in welfare from consumers using a payment instrument from which they derive higher benefits.

Further, retailing is one of the most competitive segments of the American economy, and there is competitive pressure on all merchants to compete away cost reductions in the form of lower consumer prices. My ten years' experience as a Circuit City executive taught me that retailers factor cost reductions in pricing decisions to remain competitive, particularly when, as here, any lower interchange fees achieved through H.R. 5546 would be broadly available to all merchants.

V. CONCLUSION

Mr. Chairman, for the reasons discussed above, the Merchants Payments Coalition supports H.R. 5546 as a market-based remedy to address the current anticompetitive and dysfunctional interchange scheme that the banks have designed and perpetuated. The MPC urges the full committee to report H.R. 5546 favorably to the House as soon as possible.

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[36] Payment Systems Board, Reserve Bank of Australia, *Preliminary Conclusions of the 2007/08 Review*, at 23 (April 2008).
[37] *Id.* at 20 (emphasis in original).

Mr. CONYERS. Thank you so much.

Ed Mierzwinksi, are you an attorney?

Mr. MIERZWINSKI. No, sir. Consumer advocate.

Mr. CONYERS. All right. We have that title. I was going to bestow another one on you, but I am not authorized.

Mr. MIERZWINSKI. Okay. [Laughter.]

Mr. CONYERS. Mr. Ed Mierzwinski, consumer advocate in the office of the National Association of State Public Interest Research Groups. He has been testifying since 1989 and has been before Congress and the State legislatures on a wide range of issues.

And we are very happy to have you here. And your written testimony is already in the record, and you may add any comments you would like at this time.

TESTIMONY OF EDWARD MIERZWINKSI, CONSUMER PROGRAM DIRECTOR, U.S. PUBLIC INTEREST RESEARCH GROUP

Mr. MIERZWINSKI. Thank you very much, Mr. Chairman and Members of the Committee.

As you said, I have been working here in Congress since 1989 as a consumer advocate for the Public Interest Research Groups. And over that period of time, the consumer advocates, our group and other organizations, have tried to rein in the unfair practices of the issuing banks and other unfair practices of the card network associations. And it has been very difficult, over the years, to get any changes made.

Lately, we have seen some progress. We are running a campaign on college campuses to go after unfair college credit card marketing. Recently, the Federal Reserve Board of Governors joined the consumer advocates' call to rein in the unfair practices of the card-issuing banks.

And for years, the merchants have been trying through a number of strategies, litigation strategies, convincing the Department of Justice to investigate, to go after the anti-competitive practices of the bank networks, which, until recently, were owned and controlled by the biggest banks.

And I am unconvinced, completely unconvinced, that there is any competition in this marketplace. The so-called 6,000 issuers are really dominated by the very small number in the tight oligopoly of issuers that dominate the marketplace.

For many years, those issuers have the Office of the Comptroller of the Currency at their back. They could do whatever they wanted. They could change the rates at any time, for any reason. They could impose mandatory arbitration on consumers, preventing us from getting any justice.

And the merchants have faced the same problem. So when we look at this issue, it is a very significant issue for us. Consumers pay too much; merchants pay too much. And when the merchants pay too much, it affects consumers. Consumers pay more at the store and more at the pump, because of the collusive nature of the agreements that are forced on them with no negotiations, no transparency, by the bank associations.

And I am very concerned for the unbanked. I am very concerned that the 27 million people who pay cash at stores are paying part

of the cost of interchange. They are paying part of the cost of my rewards.

And I believe that it is fortunate that your Committee is shining light on this important issue. And you have certainly got the attention of the industry, based on the size of the—the filled seats in the room.

What we are very pleased with is that your legislation, the Credit Card Fair Fee Act, would create a non-price-control mechanism. It would force negotiation, increase transparency, without going to price controls.

I have, you know, worked against the banks for many years. They do their polling. They know that "price controls" is an evil word on Capitol Hill, so they use it in almost every statement that they make about every piece of legislation.

But I want to say that your bill is much more elegantly crafted than that. I believe it is a common-sense approach to the problem that will force the two sides to the bargaining table.

I am unconvinced with the little pieces of the Australian report that have been extracted by the bank witnesses or by the network witnesses. I think the reports are much more complex than that. I think you see in Australia that there has been more competition developed. There are new kinds of lower-cost cards out there. Debit card customers are getting lower rates.

And I think that the Committee, I am sure your staff, will take a very close look at what is really happening in the other countries that have restricted or banned or changed the way that the interchange system is forced on the merchants. And I encourage you to continue to do that.

But we are simply not in any way convinced that the price to consumers will go up or that the merchants won't pass along any savings. There will be changes in the marketplace, but there are consumers that need to be considered, including the cash consumers and including the consumers who carry a balance and have the basic credit cards, the classic credit cards.

If I carry a balance on a credit card, I shouldn't have a rewards card in the first place. One-percent rewards against up to 36-percent interest? That is not going to help me very much at all. And some consumers out there, the ones that I care about, are paying 36-percent interest under the unfair practices that many of the issuers are imposing upon them, although the Federal Reserve is trying to stop it.

Again, we are very encouraged by sunlight being the best disinfectant, that your Committee is shining on this issue. We look forward to working with you to try to get the card issuers who have demonstrated market power according to the U.S. courts, that have prevented the merchants from negotiating fairly with them, that have raised the prices that all consumers pay—your legislation is important step forward. We look forward to working with you on it.

Thank you.

[The prepared statement of Mr. Mierzwinski follows:]

PREPARED STATEMENT OF EDMUND MIERZWINSKI

Testimony of Edmund Mierzwinski
Consumer Program Director
U.S. PIRG

Hearing on HR 5546,
the Credit Card Fair Fee Act of 2008

Before the Antitrust Task Force
House Judiciary Committee
U.S. House of Representatives

The Honorable John Conyers, Chairman

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15 May 2008

Testimony of Edmund Mierzwinski
Consumer Program Director
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Chairman Conyers and Ranking Member Chabot, thank you for the privilege of testifying today on the important subject of credit card interchange fees. I am Consumer Program Director of the U.S. Public Interest Research Group, the nonpartisan and nonprofit federation of state PIRGs.[1] As an advocate for consumers we welcome the opportunity to discuss the introduction of HR 5546, the Credit Card Fair Fee Act of 2008 (Conyers-Cannon), your bi-partisan legislation to address antitrust concerns regarding interchange fees imposed on merchants by credit card networks. We welcome the committee's continued attention to credit card interchange rates. As you know, over 25 years ago, Supreme Court Justice Marshall spoke of the importance of the antitrust laws as the "magna carta of economic freedom." Thus, the vigilance of the Committee's Task Force in assuring the aggressive enforcement of the antitrust laws is important to every U.S. consumer.

A primary purpose of my organization is to advocate on behalf of all consumers for a fair and competitive marketplace. We regularly advocate before state and federal regulators and legislators on both consumer protection[2] and competition policy issues[3] in the credit card marketplace. We have also launched a major campaign on over 40 college campuses around the

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[1] The United States Public Interest Research Group (U.S. PIRG) serves as the federation of and the federal lobbying office for the state PIRGs. State PIRGs are non-profit, non-partisan consumer, public health and good government watchdog groups with over one million members around the United States. U.S. PIRG places a special emphasis on predatory financial practices and financial education and maintains a website at www.truthaboutcredit.org for consumers to obtain non-partisan information and fact sheets about credit card company practices. Recent major PIRG reports on credit card practices include the following: Characteristics of Fair Campus Credit Cards (April 2008); The Campus Credit Card Trap: A Survey of College Students and Credit Card Marketing (March 2008); Graduating Into Debt: A Survey of On-Campus Credit Card Marketing In Maryland (2004); Deflate Your Rate: How To Lower Your Credit Card APR (2002) and The Credit Card Trap: How To Spot It, How To Avoid It (2001). www.uspirg.org or www.truthaboutcredit.org.

[2] For example, see recent testimony on unfair consumer credit card practices by Edmund Mierzwinski, U.S. PIRG, House Subcommittee on Financial Institutions and Credit, Hearing on the Credit Cardholders Bill of Rights, HR 5244, 17 April 2008, available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/mierzwinski041708.pdf (last visited 13 May 2008) and on "Improving Credit Card Consumer Protection: Recent Industry and Regulatory Initiatives," 7 June 2007; available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/htmierzwinski060707.pdf (both last visited 13 May 2008)

[3] For example, see also see the joint testimony of U.S. PIRG, Consumer Action and the Consumer Federation of America, before this Antitrust Task Force, on Interchange Fees, 19 July 2007, available at http://judiciary.house.gov/media/pdfs/Mierzwinski070719.pdf (last visited 13 May 2008) and testimony of U.S. PIRG and the Consumer Federation of America, by Edmund Mierzwinski, Consumer Program Director, U.S. PIRG, before the House Committee on Energy and Commerce, Hearing on The Law and Economics of Interchange Fees, Subcommittee on Commerce, Trade, and Consumer Protection, 15 February 2006 available at http://energycommerce.house.gov/reparchives/108/Hearings/02152006hearing1774/Mierzwinski2730.htm .

country against unfair credit card marketing practices.[4] We recognize that financial service markets work best where there is vigorous competition protected from anticompetitive practices. The work of your Committee in overseeing enforcement of the antitrust laws plays a vital role for this important marketplace.

SUMMARY:

One year ago I testified before this Committee and presented a simple message: the deceptive and anticompetitive practices of the two credit card associations – Visa and MasterCard -- have injured both consumers and merchants for many years. One year later that message still rings true. Interchange fees are hidden charges paid by all Americans, regardless of whether they use credit, debit, checks or cash. These fees impose the greatest hardship on the most vulnerable consumers – the millions of American consumers without credit cards or banking relationships. These consumers basically subsidize credit card usage by paying inflated prices – prices inflated by the billions of dollars of anticompetitive interchange fees. And unfortunately, those credit card interchange fees continue to accelerate, because there is nothing to restrain Visa and MasterCard from charging consumers and merchants more.

Your legislation, HR 5546, the Credit Card Fair Fee Act of 2008, would address the problem by creating a mechanism to enable merchants to negotiate with Visa and MasterCard and compel the card associations to engage in those negotiations. It provides a framework, adapted from the Copyright Tribunal, to facilitate negotiations and resolutions of disputes. When negotiations fail, your bill builds on existing models to require proposals from both sides to a special panel. The panel does not set prices or establish government price controls, as bank propaganda asserts; instead, it evaluates the two proposals based on what prices would be in a competitive market. The way that the bill is structured, there is pressure on both the merchants and issuers to come to an agreement—otherwise the panel picks one or the other of their proposals. These are positive outcomes.

The opponents of the legislation may suggest that consumers will be harmed from the enactment of the legislation because banks will not longer be able to provide allegedly attractive rewards programs. Even if that is true – and it is not – that should not drive the Committee's evaluation of the legislation. Rewards programs are not a "free gift" given by banks. Rather all consumers pay for rewards in the form of higher prices for the goods they purchase everyday. Only a small portion of cardholders actually receive rewards and the portion they receive is very modest compared to what cardholders pay in interchange. But most important, the most vulnerable consumers, those without credit cards, receive nothing from interchange, and subsidize the supposedly free gift of rewards programs for more affluent consumers.

None of the alternatives to legislation is particularly likely to resolve the fundamental competitive concerns in this market. The rapidly accelerating interchange fees appear to be a clear exercise of market power by Visa and MasterCard. In the past year alone interchange fees have increased from $36 billion to $42 billion or over 16%. Did consumers benefit from this rapid increase? Did cash customers benefit? Obviously not. Did credit card customers benefit?

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[4] See truthaboutcredit.org for information about the campaign.

Did rewards programs improve substantially? Were there greater benefits to cardholders in some fashion? We doubt it.

Discussion

Based on our experience in these and other markets we believe there are two essential elements to a competitive marketplace: information and choice. Accurate and transparent information is necessary for consumers to make accurate choices. When information is readily available consumers can make choices, effectively compelling firms to compete for their purchases. And choice is a necessary element too. Absent choice, the discipline of the market will be lost.

The credit card market lacks both choice and adequate information. From a consumer's perspective it lacks choice because it is an oligopolistic market in which a small set of card-issuers dominate the market and establish a set of deceptive practices that harm consumers. From a merchant's perspective it lacks choice because merchants have no alternative but to accept the card associations' cards even when the associations significantly increase prices.

Markets don't work when there are hidden fees and rules – and no one hides fees and rules better than the credit card companies. Credit card markets lack the information necessary for both consumers and merchants to make informed choices. The markets lack adequate information for consumers to detect the fraudulent and exploitative practices of many card-issuers. For merchants, the markets lack adequate information because the associations prevent merchants from accurately informing consumers of the costs of credit card acceptance or attempting to direct them to more efficient and lower priced payment mechanisms. Moreover, the banks and associations engage in other deceptive practices to increase the interchange problem. Since the costs of accepting cards are passed on in the overall costs of goods, all consumers – affluent, working-class, and poor – ultimately pay these hidden charges. Low-income Americans, most without bank affiliations, are paying more for goods and services to fund credit card company programs for which they are not even eligible.

Interchange and Its Effects

We present six main points:

- All consumers, even those who pay with cash and checks, pay more at the store and more at the pump because these interchange fees are passed on in the overall cost of goods sold.
- The significant increases in interchange fees signal a broken market. Visa and MasterCard have tremendous market power, which allows them to dictate the terms of trade: merchants have no choice but to accept Visa and MasterCard products on the sellers' terms. It is not surprising that interchange fees have increased significantly and are much higher in the U.S. than other countries.
- The card associations' rules prevent merchants from informing consumers on the costs of payment and limit the ability of merchants to direct consumers to the safest, lowest cost, and most efficient forms of payment.
- In addition, both the associations and banks engage in a variety of deceptive practices to drive consumers to higher-cost forms of payment.

- Neither the card-issuance or card network markets are competitive. Because of lax merger policy the card-issuance market has become an oligopoly. Interchange and consumer fees have increased as concentration has increased to alarming levels.
- Finally, this oligopolistic concentration has allowed issuers to engage in a variety of unfair and anti-consumer practices.

Interchange Fees Force Consumers to Pay Higher Prices

The interchange fee system is hidden from consumers and the public. The card associations do not disclose publicly their fees or the basis for these fees. Some public reports maintain that, on average, interchange fees cost merchants 1.6 percent or more of each transaction on a credit or signature debit card. In 2007, credit card interchange fees alone cost merchants and consumers an estimated $42 billion.

Like all other costs incurred by merchants, interchange fees are included – at least in part – when pricing goods and services. Card associations may suggest that interchange fees fund attractive rewards programs. Setting aside the question of the value of these programs, many consumers with credit cards do not use them and those without credit cards receive no benefits.[5] Over 27 percent of Americans do not have credit cards. For these consumers, interchange fees are especially pernicious and regressive.[6] These low-income Americans subsidize interchange fees for "services" that they are not eligible to use. No charge could be as regressive as one in which low income consumers receive no benefits.

The regressive nature of this charge is exacerbated because interchange fees are assessed as a proportion of overall sales. For example, when gas prices averaged $1.87 per gallon in 2004, interchange fees totaled about $12.5 million per day. In 2005, gas prices averaged about $2.75 per gallon nationally; credit card companies then made $18.4 million a day. These companies made an additional $2.2 billion dollars per year simply because of rising gas prices.[7] This problem will increase if gas prices continue to increase. It is difficult enough for low and moderate income consumers to afford skyrocketing gasoline prices without having to pay additional fees that are passed on to them.

Increases in Interchange Fees Signal a Broken Market

Credit card interchange fees were intended to compensate card-issuers for certain costs, such as the costs of issuance, fraud, risk of loss, float and processing. Yet as all these costs have decreased in the past decade credit card interchange fees have increased. According to the Food Marketing Institute (FMI), these fees have increased over 20 percent in the past few years even though all the costs of card processing and issuance have fallen. The United States appears to be

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[5] We seriously doubt consumers receive anything close to $42 billion in benefits through rewards programs. Some of the interchange fees undoubtedly fund industry marketing efforts, such as the more than 5 billion annual mail solicitations consumers receive for credit cards. Moreover, credit card issuance is a tremendously profitable line of business. According to the Federal Reserve, it is consistently the most profitable line of banking.

[6] U.S. Census Bureau, *Statistical Abstract 2006*, Table 1176.

[7] Margaret Webb Pressler, "Card Companies Are Filling Up at the Station," in Washington Post. September 25, 2005: pg. F01.

the only country in which credit card interchange fees are increasing and it has far higher fees that almost any other industrialized country. FMI projects that these fees will increase 22 percent annually.[8]

In a competitive market, prices would fall when costs decrease. In the credit card market, the opposite happens. The card associations may say that they need to increase interchange fees to compete for the loyalty of card issuers. But what about merchants and consumers? Merchants certainly have no choice but to accept Visa or MasterCards.

In the Justice Department case against Visa and MasterCard, the Court determined that both associations had market power because merchants were compelled to accept these cards even in the face of a significant price increase. Almost all merchants are forced to accept Visa and MasterCard's terms, no matter what the interchange rates or contractual terms. Armed with this market power, credit card companies can, and do, increase interchange fees without suffering any repercussions.

Are these substantial interchange fees necessary? Examples outside the United States suggest this is not the case. As a recent European Commission decision detailed, numerous countries operate payment systems without the use of interchange fees. In those countries the ultimate costs of these systems is modest and the systems operate quite efficiently. In other countries, interchange rates are about one-third less than they are in the United States. In the United Kingdom, for example, merchants pay about 0.7 percent.

Another example is the debit market in Canada. In that market, there are no interchange fees. Even without interchange, there is higher debit card usage and merchant acceptance than in the United States. Some consumers pay direct fees for debit card use but because those fees are transparent there is active competition to reduce those fees. Ultimately everyone in Canada pays less for the cost of payment services.[9]

There is a great deal of debate about the impact of reductions in interchange fees in Australia, but a careful analysis of that debate demonstrates that the reduction in interchange fees ultimately benefited consumers in the reduction of card costs, greater innovation, and greater competition leading to lower interest rates. Several years ago the government mandated a reduction in interchange fees in Australia from 0.95 to 0.55 percent (both rates far lower than the current rates in the U.S.) A recent study of the Reserve Bank of Australia found that the reduction in interchange benefited all consumers since the bulk of the reduced rates "ha[s] been, or will eventually be, passed through into savings to consumers." Moreover, the evidence seems fairly clear that the reduction of interchange resulted in an outbreak of competition by card issuers, which now compete more aggressively in offering cards with lower fees and lower interest rates. Reducing interchange has also spurred innovation, leading the card issuers to offer new types of cards such as no-frill cards with lower fees and lower interest rates. Finally, the Report found an overall benefit to society because consumers received better pricing signals, creating an incentive for them to use the most efficient forms of payment.

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[8] Food Marketing Institute, "Hidden Credit Card Fees: The True Cost of a Plastic Marketplace" (February, 2006).

[9] Gordon Schnell and Jeffrey Shinder, "The Great Canadian Debit Debate," *Credit Card Management*, May 2004. http://www.constantinecannon.com/pdf_etc/TheGreatCanadianDebit.pdf.

As the members of the Committee recognize, interchange, like any other credit card policy, affects different groups of consumers differently. In fact one of the strongest reasons for attacking the interchange fee problem is that the costs of interchange are borne by all consumers: thus, cash paying customers, many of whom are not eligible for credit cards, effectively subsidize the attractive rewards programs for far more affluent consumers. In considering efforts to solve the interchange fee problem, protecting these consumers must be the first priority of this Committee.

The evidence from Australia seems relatively clear: cash paying customers benefit from the reduction in interchange:

> The Board acknowledges that the reforms have not affected all parties equally. In particular, those who use EFTPOS and cash are more likely to have been made better off as a result of the reforms than those who use credit cards extensively and pay their balances off by the due date. Previously, this latter group was receiving significant benefits, partly at the expense of the former.[10]

For those individuals holding credit cards, there are general benefits in lower interest rates and card fees. And for transactors (those who pay off their balance on time) there was a slight decrease in benefits, as rewards programs have been reduced, but these programs only benefit some users. In the United States, where interchange fees are considerably higher, the potential savings for each consumer could be far greater.

Finally, the opponents of a competitive interchange fee market may suggest that any reduction in interchange fees must result in an increase in other fees such as annual fees or late fees. This argument overstates any legitimate concern. First, a reduction in interchange will not necessarily result in higher bank fees; instead, the banks may choose to reduce the blizzard of promotional materials they send out every day. Second, the results in Australia show that if there is any significant change it is in the reduction of rewards programs. But rewards programs benefit only a small portion of card users. Third, the competition in Australia to offer consumers lower interest rates will likely outweigh any costs or reduction of rewards. In the U.S., we find that lower interest rates are the most important criteria for most consumers to use when determining their choice of cards and reform that improves those rates will be an important consumer benefit, even if there is some reduction of rewards programs.

Deceptive Practices Increase Prices for Consumers

As we suggested earlier, accurate and complete information serves a critical role in making sure the forces of competition work. As the government does not regulate or compel disclosure of credit card interchange fees, most consumers have no idea that they exist and that they are paying for services that they may not even use. In fact, Visa, MasterCard and the card issuing banks engage in a variety of practices to prevent well-informed consumers from exercising their choices.

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[10] Reserve Bank of Australia, Reform of Australia's Payment System: Preliminary Conclusions of the 2007/08 Review (April 2008).

First, Visa and MasterCard rules prevent merchants from disclosing fees to their customers or attempting to steer consumers to lower-priced payment options, such as cash or online debit cards. They cannot charge a distinctive price or surcharge based on payment options. They cannot attempt to direct consumers to lower cost options such as cash, checks and online debit.[11]

Second, card associations and banks use misleading marketing to encourage consumers to use their credit cards or signature debit cards as frequently as possible. Reward incentives, such as frequent flier miles, are designed to seem as though customers are paid to use these cards. In reality, these consumers and other consumers are simply paying for those rewards.

This lack of disclosure is especially problematic with the recent efforts of the card associations to "convert" cardholders from regular credit cards to so-called "premium cards" such as the Visa "Signature" or the MasterCard "World" cards. These cards have a significantly higher interchange fee than traditional cards, among the highest of all interchange fees. For example, a premium card may cost merchants well over 2.0 percent compared to 1.6 percent for a traditional card. These premium cards focus only on the highest-income consumers. However, they offer minimal additional benefits. Consumers do not realize that everyone else pays higher prices on goods and services when they themselves use a premium card and consumers are wholly unaware that converting to a premium card will ultimately cost all consumers more. Nor, as stated above, can merchants refuse to accept these cards or attempt to direct consumers to lower priced cards through differential pricing. These premium cards are simply a scheme to substantially increase hidden interchange fees.

Third, although merchants can't surcharge or use differential prices to direct consumers to the most efficient and lowest priced payment options, banks do have that power. Not surprisingly, they use it to direct consumers to less efficient, higher cost options. The debit card market illustrates this problem. Signature based debit is more expensive and less secure than online debit because online debit transactions are instantaneous. Online debit has a far lower rate of fraud. Online debit transaction interchange fees are capped at fixed levels; they only cost merchants between $0.17 and $0.50 per transaction.[12] Conversely, credit and signature debit cards cost merchants up to 2% of the entire transaction, no matter how large. Instead of promoting online debit which is safer and less costly, banks increasingly surcharge consumers seeking to make these transactions with penalty fees of as much as 50 cents a transaction.[13]

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[11] We note that the standard canned industry response is that "nothing in our rules prevents cash discounts from being offered." But requiring that there be separate price markings for each product with the higher interchange price and the lower cash price makes cash discounts very hard to offer. Fuel is a relatively simple example, but even there with a variety of different octane grades and products (gasoline, diesel, etc.) card association rules can make discounting more difficult than it ought to be. And if it is difficult for fuel, imagine the logistical difficulties created for offering cash discounts at a convenience store with a thousand different items, let alone a grocery store with thousands of different items for sale. The card associations may not technically prohibit cash discounts, but they do what they can to make sure it does not happen very often.

[12] November 2004, Federal Reserve Board, Report to the Congress on Disclosure of Point-of-Sale Debit Card Fees, See Figure 4, page 14 available at http://www.federalreserve.gov/boarddocs/rptcongress/posdebit2004.pdf.

[13] A 2003 NYPIRG report found that 89% of the banks surveyed assess a fee for online debit PIN-based transactions. The average fee assessed is 70¢. The fees ranged from 10¢ to $1.50. See "Pricey Plastic: A NYPIRG Report and Survey of Plastic Card Fees," 2003, available at http://www.nypirg.org/consumer/cards/debit.html (last visited 18 July 2007). While a Federal Reserve study found substantially lower numbers of banks imposing PIN debit fees, it found fees in the same range: "At sampled institutions that charge fees for PIN debit, the fees range from roughly

Consumers are paying more for a less safe and more costly product.[14] These penalties effectively steer consumers to the less efficient, less secure, more costly signature debit product. While the use of online debit cards is the best option for both consumers and merchants, deceptive and manipulative tactics ensure the most expensive payment possible is used.

These examples show that card associations and banks use some of the same deceptive practices against merchants as we have seen them use against consumers for years. Not only do the merchants suffer as a result, but consumers, unwittingly, do too.

Not surprisingly, outside the United States, where these anticompetitive practices are not permissible, online debit is the most preferred form of debit. Online debit is a far safer and more secure product. Where market forces are not restrained and consumers can make fully informed choices, the lower-priced, more efficient product prevails.

The Potential Impact of the Proposed Legislation

The legislation you have co-sponsored Mr. Chairman, H.R. 5546, the Credit Card Fee Act, addresses the interchange fee problem by creating a structure for the voluntary negotiation of interchange fees and, if agreement can not be reached, for the resolution of disputes about the amount of the fees. The Act, modeled in part after the Copyright Royalty Tribunal, provides a mechanism for resolution of interchange fee disputes. We believe this would be a useful approach to addressing the concerns of the market power of the card associations and rapidly increasing interchange fees.

We believe there are three important considerations for the legislation:

- First, this is a non-regulatory approach. The legislation envisions a system of negotiation and resolution which focuses on private parties reaching an agreement, rather than a government mandated solution
- Second, if the parties are unable to reach an agreement, the tribunal hearing the dispute must apply a market standard in choosing the appropriate fee level – in this respect the proposal envisions that the tribunal would not set prices, but would only have the power to chose which of the final offers of the parties most closely represents the rates and terms that would have been negotiated in a competitive market.
- Finally, market based rates and terms are available to any merchant regardless of size, industry or location.

We believe the proposed legislation offers some promise of remedying the competitive problems posed by interchange fees. It seems highly unlikely that either Visa or MasterCard's market

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$0.10 to $2.00 per transaction (figure 5). The median (and mean) fee is approximately $0.75." See "Report to the Congress on the Disclosure of Point-of-Sale Debit Fees," November 2004, Federal Reserve Board of Governors, available at http://www.federalreserve.gov/boarddocs/rptcongress/posdebit2004.pdf (last visited 18 July 2007).

[14] All plastic is not created equal. Congress should also upgrade the weak consumer and anti-fraud protections applicable to debit, ATM and stored value cards (regulated under the Electronic Fund Transfer Act and Regulation D) to the higher standard credit cards are subject to (that of the Truth In Lending Act and Regulation Z). But within the debit card universe, PIN-based online transactions are more secure than offline signature based transactions.

power will be diminished significantly in the foreseeable future. The legislation presents an opportunity to create a market oriented approach to remedying Visa and MasterCard's ability to exercise their market power by charging anticompetitive interchange fees.

2. Increased Consolidation of Card-issuers Harms Consumers More Broadly

The credit card issuing market has become significantly more concentrated over the past few years as numerous card issuers have merged. For example in the past few years we have seen mega-mergers such as Bank of America's acquisitions of Fleet and MBNA. The top ten card issuers now have over 90% of the market, and the level of concentration has increased from an HHI of about 1100 in 1998 to an HHI of over 1800 today, a level that the Department of Justice Merger Guidelines define as highly concentrated. Unfortunately the Department of Justice has not challenged any of these mergers and there is little to suggest that concentration in this market will not continue to increase dramatically.

Of course, we expect the card associations and their members to suggest that the credit card issuance market is un-concentrated and vigorously competitive.[15] But the facts are to the contrary. There have been numerous antitrust suits alleging that card issuers and the associations have colluded over fees, exchange rates, and important contractual terms.[16] While concentration has increased dramatically over the past seven years, interchange fees, other fees charged to consumers, deceptive practices, and interest rates have increased significantly. Although the parties to these mergers suggested that there would be significant efficiencies from these mergers, consumers have seen few, if any, benefits. After years of consolidation the bad news for consumers is clear: an oligopolistic market which is a fertile environment for collusion, higher prices, more hidden fees, and more deceptive practices.

3. The Credit Card Oligopoly Also Allows Issuers to Use Anti-Consumer Practices Against Cardholders

In testimony last month to the House Financial Services Committee, we describe a series of egregious practices conducted by card issuers against their cardholders. These practices include the use of punitive penalty interest rates, imposition of questionable late and over-the-limit fees, manipulation of teaser rates, and other practices designed to increase and extend high-cost credit card debt to consumers. In our testimony we documented the seduction of vulnerable populations including youth and recent immigrants into acquiring credit cards. We set forward the practice of using certain contractual terms in the issuers' one-sided contracts with consumers, including a clause asserting the right to "change the rules at any time for any reason, including

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[15] In testimony in 2005 Timothy Muris testified that "[n]o [card] issuer has market power, and issuers respond to increases in interchange fees by enhancing card benefits to consumers." We doubt that Visa and MasterCard or card-issuers act as benevolent monopolists, but in any case there is no systematic study to suggest that increased interchange is passed on to consumers in greater benefits. Even if this allegation was substantiated, it would still be true that all consumers, including those who do not use credit cards pay for those "increased benefits."

[16] Visa, MasterCard and several card-issuing banks recently settled an antitrust suit for $336 million alleging they had fixed the credit card foreign currency exchange rates. Other litigation involves alleged collusion by card-issuers over credit card late fees and over limit fees (In re Late Fee and Over Limit Fee Litigation, Civ. No. C-07-0634 SBA (N.D. Cal.)) and alleged collusion by card-issuers and networks requiring the use of mandatory arbitration provisions (Ross v. Bank of America, N.A. et. al. Civ. No. 05-07116 (S.D.N.Y.)).

no reason," and a clause subjecting cardholder disputes to extra-judicial binding mandatory arbitration.[17]

As a result of its ability to engage in these practices, the credit card industry, already the most profitable form of banking according to Federal Reserve Board annual reports to Congress, has seen its profits grow to new heights on the wings of revenue derived from punitive APRs of 36% or more, imposition of late and over-the-limit fees of up to $39 issued on a repeat basis for violations that may not have been violations and from deceptive disclosures of the true cost of credit, which encourage the most at-risk segment of the customer base to carry large unpaid balances at unaffordable interest rates. Numerous credit card complaints to us allege that companies raised rates when bills were paid on time. Others allege that rate increases were due to alleged late payments to someone else; yet, the banks have told other Congressional panels that they do not engage in this practice, known as universal default.

To elaborate, the most common unfair credit card issuer practices include the following:

- Unfair and deceptive telephone and direct mail solicitation to existing credit card customers – ranging from misleading teaser rates to add-ons such as debt cancellation and debt suspension products, sometimes called "freeze protection," which are merely the old predatory product credit life, health, disability insurance products wrapped in a new weak regulatory structure to avoid pesky state insurance regulators;[18]
- Increasing the use of unfair penalty interest rates ranging as high as 30-35% APR or more, including, under the widespread practice of "universal default," imposing such rates on consumers who allegedly miss even one payment to <u>any</u> other creditor, despite a perfect payment history to that credit card company;
- Imposing those punitive penalty interest rates retroactively, that is on prior balances, further exacerbating the worsening levels of high-cost credit card debt;
- Imposing higher late payment fees, which are often levied in dubious circumstances, even when consumers mail payments 10-14 days in advance;
- Using a variety of mail trickery, such as changing the due dates of monthly bills, making the due date a Sunday but not posting on the weekend; shortening the period between when a bill is mailed out and when that bill is due, etc;
- Increasing the use of aggressive and deceptive marketing to new customer segments, such as college students with neither a credit history no an ability to repay and to persons with previous poor credit history;
- Making partnerships with telemarketers making deceptive pitches for over-priced freeze protection and credit life insurance, roadside assistance, book or travel clubs and other unnecessary card add-ons;

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[17] In 2005, Rep. Hank Johnson (D-GA), a member of this Committee, and several other Committee members, introduced important legislation, HR 3010, the Arbitration Fairness Act, to amend chapter 1 of title 9 of United States Code with respect to unfair use of mandatory arbitration in a variety of consumer, small business and employee contracts. We encourage the Committee to act favorably on this proposal, which is supported by a variety of civil justice, consumer, small farmer and other organizations. Companion Senate legislation, S. 1782, was introduced by Senator Russ Feingold (D-WI).

[18] See an Office of the Comptroller of the Currency (OCC) regulatory interpretative letter endorsing debt cancellation and debt suspension products at http://www.occ.treas.gov/interp/jan01/int903.doc

- Imposing unfair, pre-dispute mandatory arbitration[19] as a term in credit card contracts to prevent consumers from exercising their full rights in court; and the concomitant growing use of these arbitration clauses in unfair debt collection schemes;
- The failure of the industry to pass along the benefits of what, until recently, were several years of unprecedented the Federal Reserve Board interest rate cuts intended to provide economic stimulus, through the use of unfair floors in credit card contracts; and
- Using the clause "Any term can be changed at any time for any reason, including no reason" in credit card contracts as allowed by Delaware and other safe harbor state laws.

You may ask why we are raising these practices before an Antitrust Task Force. There are three reasons. First, the representatives of the card industry will suggest the manifold, almost limitless benefits of credit cards. We think this Committee should recognize that the story of benefits is far more ambiguous.

More important, the oligopolistic market structure of the card-issuance market facilitates these deceptive and onerous practices. The ability of these dominant card-issuers to impose these terms is derived from the tight oligopoly that the largest issuing firms maintain in the marketplace. We urge the Committee and its Antitrust Task Force to examine closely the competition issues that allow this oligopoly to treat customers so unfairly. In particular, we urge you to question whether the Department of Justice, in approving every recent credit card company merger with no conditions, has adequately reviewed the competition implications of the mergers.

Finally, we believe these deceptive and anticonsumer practices demonstrate the lack of competition in the card network market. Visa and MasterCard have the ability to prevent many of these practices through their regulation of card-issuers. Yet these associations -- that are aggressive in regulating merchants (e.g., preventing them from offering cash discounts) -- seem rather timid when it comes to restricting the deceptive practices of their bank members. If there was active competition in the card network market one would expect Visa and MasterCard would compete in trying to self-regulate and stop these anticonsumer practices. Similarly, if there were not substantial entry barriers one might expect a more consumer friendly card network to arise. But the dominance of Visa and MasterCard and the substantial entry barriers effectively protect these deceptive and anticonsumer practices.

In response to our efforts, and the efforts of other consumer groups, Chairwoman Maloney of the Financial Institutions and Consumer Credit Subcommittee, joined by over one hundred co-sponsors, has introduced legislation to address many of these unfair credit card practices by issuing banks, the Credit Cardholders Bill of Rights, HR 5244. A number of other significant proposals have also been filed by other members.

Demonstrating the gravity of the situation even more, earlier this month, three regulatory agencies led by the Federal Reserve Board of Governors proposed to ban the worst issuer

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[19] U.S. PIRG and many other consumer, civil rights, small business and small farmer organizations are members of a broad campaign to educate the public and the Congress about the need to eliminate one-sided binding mandatory arbitration (BMA) clauses in consumer and other contracts. See http://www.givemebackmyrights.org/

practices as unfair and deceptive practices, using their authority under the Federal Trade Commission Act:

> The Federal Reserve Board on Friday proposed rules to prohibit unfair practices regarding credit cards and overdraft services that would, among other provisions, protect consumers from unexpected increases in the rate charged on pre-existing credit card balances. The rules, proposed for public comment under the Federal Trade Commission Act (FTC Act), also would forbid banks from imposing interest charges using the "two-cycle" billing method, would require that consumers receive a reasonable amount of time to make their credit card payments, and would prohibit the use of payment allocation methods that unfairly maximize interest charges. They also include protections for consumers that use overdraft services offered by their bank.

For the regulators to move beyond their typical light-handed touch of "maybe a new disclosure," and instead propose to outright ban a variety of lucrative common practices used by the largest and supposedly most reputable credit card issuers surely demonstrates even more evidence that the market is broken and cannot police itself.

Conclusion

In the past some of the defenders of interchange fees have claimed that "[i]f consumers understood the threat that the merchants' campaign [against interchange] poses to the plastic in their wallets, I suspect that we would see nothing less than a revolt." He could not have been more wrong. If consumers understood the existence or the dimensions of the hidden fees assessed by the banks and associations, they would truly rebel. Credit card companies make billions of dollars each year through interchange fees, which ultimately all consumers must pay, including the millions of Americans without credit cards. Low income cash-paying customers subsidize an inflated rewards program that benefits only a small portion of cardholders. The credit card market lacks the critical foundations of healthy competition – choice and adequate information. As a consumer advocate, I am gravely concerned about the fairness and legality of bank schemes to increase credit and debit card fee income.

We applaud you for recognizing the problem and proposing thoughtful legislation which offers the promise of remedying the interchange fee problem. Along with other consumer groups, we hope to work with you on this and other efforts to protect consumers from anticompetitive tactics in this vital market.

Thank you for considering this testimony. I welcome your questions.

Mr. CONYERS. Thank you very much.

I thank all of you.

You heard the Members of Congress, and you have heard your fellow panelists at this witness table.

Mr. Robinson, what say you now about the subject matter that brings us here? In other words, has anything deepened your resolve or made you wonder more or had you nearly blow your stack or what? [Laughter.]

What are your feelings about the measure at this point?

Mr. ROBINSON. I guess a couple of things.

One, it has not reduced my resolve. And I think just to truly hit on a couple of points for me is that, one, I am not anti-plastic. I do recognize that they provide benefits. The concern that I have, which I think has been stated more than once and clearly stated, is that there is a complaint about anti-competitive behavior, which, you know, occurs with, you know, what we see in the high rates and some of the abusive rules.

And, you know, we do hear the comments that this is some sort of price control, and I hope that that has come across clearly that this solution is not a price control mechanism.

So those are just a couple of my thoughts.

Mr. CONYERS. Thank you.

Attorney Floum?

Mr. FLOUM. Yes, sir. Well, I am struck today hearing from Mr. Robinson and the other witnesses for the Merchants Payments Coalition. They acknowledge the value that electronic payments brings to them, but they want it for less money. Well, I guess that is the way of the world, but the way to handle that is through the marketplace and through negotiation.

And I hope if we have dispelled anything today, it is that we and the acquiring financial institutions stand ready and willing and eager to negotiate. If we at Visa thought that lowering interchange rates would drive more volume, we would lower them tomorrow. So we would like to negotiate with the merchants so that they would prefer our products. That is the free market, not price controls.

And with all respect to the witnesses, if you look at the bill, with subpoenas and depositions and three administrative law judges who would set a single price, that is not the free market. That is regulatory intervention setting prices.

So I remain as concerned as when I started about the bill and what it would do, particularly to consumers.

The final point, if I can, Mr. Chairman, is we hear about subsidization and the problem with cash spenders subsidizing card users. And we think that the subsidy runs in the other direction. I quoted from the GAO report where, with the increased use of electronic payments, the GAO, the Government, was saving more money. The use of electronics is cheaper for merchants than cash and check. And so, as the volume goes up, their savings goes up. If there is a subsidy, it runs in the other direction, and electronic payments drive efficiency.

Thank you, Mr. Chairman.

Mr. CONYERS. Mr. Peirez, what say you?

Mr. PEIREZ. Thank you, Mr. Chairman.

I am actually encouraged, to a limited extent, in listening to my colleagues, Mr. Cannon and Mr. Robinson, in that I think the crux of their complaint is really about one thing and one thing only: a claim that there is some alleged anti-competitive conduct as a result of allegation of market power and that that causes an inability to negotiate. I think everything else becomes noise, but ultimately that is their core complaint.

And the reason I am encouraged is, if that is really the crux of the complaint, luckily for us we have a very effective system of antitrust laws in this country that have proven to be able to address these types of things, including when Mr. Cannon's firm brought a case against us in the past, not just, as Mr. Cannon would have us believe, for past conduct but also in changing future conduct.

Now, we don't think that that case will prove out to have any of the allegations that they make be true. But if, in fact, that is the crux of the complaint, then indeed the best defense against alleged anti-competitive conduct is enforcement of the antitrust laws for the purpose of free, competitive markets, as was found throughout the report from the Modernization Commission.

And I gave one quote, but I will give one other: "The antitrust laws stand as a bulwark to protect free-market competition. They prohibit anti-competitive restraints that harm consumer welfare."

So I think that enforcement of those laws, if, in fact, there is a problem, is the best recourse, rather than trying to set up an alternate process to address the same thing.

Thank you.

Mr. CONYERS. Thank you.

Mr. Blum?

Mr. BLUM. Thank you, Mr. Chairman.

My concern, listening here today, is that perhaps we are using that noise a little bit to cloud the issue, and that for some reason we have some oversimplification of what I view as a very complex system.

I think we are missing some of the transference-of-technology issues that we have talked about, where we seem to have a perception that it is as easy as swiping the card and then we somehow gouge some merchant for simply swiping the card.

You know, I would just bring to everybody's attention that the transference of risk, the transference of float on the funds, you know, the transference of maintaining the system from a check-or a cash-based retailer to a card-based processor is moved over on my side.

So I am just concerned that there is some oversimplification of that issue, that we are using the noise to speak about "if technology has been that improved, why haven't costs gone down," I would challenge—the gas industry, as an example. I was surprised to hear that MasterCard capped the interchange on gas purchases.

I think if this technology is so simplified, I would like to see the merchants apply it at the pump, so that when I use my MasterCard to fill up an SUV, that the price of gas, when I exceed whatever their cap is, begins to be lowered. I don't see the technological, you know, advances that they are using to challenge what we have done with the interchange income.

Thank you, Mr. Chairman.

Mr. CONYERS. Thank you.

Before I go to Mr. Cannon, Mr. Mierzwinski?

Mr. MIERZWINSKI. Mr. Chairman, I think what is interesting to me as a consumer representative is that the tricks and traps that have been imposed on consumers seem to be paralleled in the merchant association relationship.

The consumers don't always know and don't have the right to go to court. The consumers have their rates changed at any time for no reason. The kinds of ways that the banks have tried to expand the volume of sales on consumers through the use of rewards and other things—it just strikes me as a parallel.

And I know that consumers have no ability to negotiate with the banks, and the merchants are saying they have no ability to negotiate with the card associations. I am not surprised.

Mr. CONYERS. Yes.

Mr. Cannon?

Mr. CANNON. Mr. Chairman, it is interesting, Mr. Floum, a few minutes ago, and Mr. Peirez, both of whom are friends of mine, keep talking about, "We like to negotiate," or, "We at Visa" or "We at MasterCard like to negotiate." But if you remember what Mr. Floum said at the beginning of the hearing, is Visa or MasterCard don't really get the benefit of interchange, but what they get is dues and assessments, is what it is called.

So, again, the question we have is, who is the proper party to negotiate with? Now, what you don't see here today is Citicorp or Chase or one of the other very large banks that control the vast majority of credit card receivables in the country. And to my knowledge, Mr. Chairman, I don't know of anybody that has ever successfully sat down with Citicorp or Chase to negotiate an interchange rate.

It is really not an issue of market power here. Your bill, obviously, has a screen there that talks about market power. The question here is, how did we get to be where we are today? How did these rates get to be as high as they are today?

And the point is, we got this way because of a price-fixing agreement that goes on today between large banks. The fact that it is Visa and MasterCard that help control it and run it is important, but keep your eye on, I would submit, the most important players here, which really are not at this table.

Mr. CONYERS. We should have invited other witnesses? Is that what you are telling me?

Mr. CANNON. I think it would have been a great idea; I think it would be terrific.

Mr. CONYERS. We may have to have a second hearing. I hope they would respond without the use of the processes that follow nonresponse. But we will see.

Ranking Member Steve Chabot?

Mr. CHABOT. Thank you, Mr. Chairman.

And I come from the philosophical perspective that less government is better and less regulation is generally better than more and that markets should be free and unfettered and unencumbered to the greatest degree possible and that competition is good for consumers.

On the other hand, you know, I want consumers to pay less and be able to stretch their paycheck as far as possible and hopefully be able to, you know, save as much as possible, maybe invest a little, and better the family. And I want retailers to be successful and hopefully employ more people, especially in the 1st District of Ohio, in Cincinnati, which is my district.

So if each one who would like to, if you could make your best case, your best argument as to why, in this particular case, it is appropriate for us to regulate more because of the various issues that we have discussed and in previous hearings. Because I think this is really a very important issue.

Mr. Robinson, you would be welcome to go, and we will just go right down the line, anybody that wants to take a shot at it.

Mr. ROBINSON. Thank you.

I agree with you, I agree with you, that less regulation is better, especially when you have a competitive market. I think that our complaint is that this is not a competitive market. And so you have to do something to make it competitive.

I have heard that we have the ability to negotiate. I think that negotiating ability is illusory. I mean, I don't think that exists.

There is an example that was showed up there about NACS having negotiated this deal on the interchange fees. I think it is important to understand what NACS negotiated. NACS did not negotiate interchange. It only negotiated the processing fee. And if you were to use the example, it is kind of like having no ability to negotiate on the refrigerator, you just get to negotiate on the delivery charge. And that is the situation.

So, you know, we would love to have the ability to negotiate. We would love to have a competitive market. And that is the reason that we think, since it is not—we don't have the ability to negotiate, we do not have a competitive market, and that is the reason that we are here talking to you today.

Mr. CHABOT. Okay. Thank you very much.

Mr. Floum?

Mr. FLOUM. Ranking Member Chabot, thank you for the question.

There is no need to regulate or for the courts to determine that there is any kind of problem unless there is market dysfunction. That is the only reason that there would need to be intervention either by the legislature or by the courts.

There is absolutely no evidence of market dysfunction. If Visa was a monopolist, as the merchants like to claim because it is very rhetorical, what we would be doing is we would be lowering output and raising prices. That is what monopolists do. But instead, as I have mentioned, our rates have not gone up over 10 years, and over 30 years they have gone down significantly.

Diners Club was the first credit card network. It charged a 7-percent merchant discount rate. Today's average Visa merchant discount rate is a third of that. And our interchange rate has remained flat at 1.6 percent.

So we are not raising prices. And we are not restricting output, because everyone wants to use our cards and millions of more merchants are accepting the card. So there is no indicia of market dysfunction.

My colleague here says, "Well, the volume goes up, so the rates should come down." That is what they are saying today. But, again, that ignores the incredible innovation in our business. It is not the same Visa product; it is not at all. Fraud rates have come down. It is much more automated. It works a lot better. And instead of one product, we have 10.

So the fact that we have held rates flat I think is quite remarkable, given the innovation in our products and the tremendous benefits that we drive to consumers, retailers and the economy in general.

Thank you.

Mr. CHABOT. Thank you.

Mr. Peirez?

Mr. PEIREZ. Thank you.

First, I am further encouraged that Mr. Cannon still considers me a friend as we continue through these hearings. So, more good news.

But I would like to take off on the refrigerator example for just a second, because I think it is very illustrative. And I would say that what is really at issue here is negotiating about the refrigerator versus the condenser, the ice tray, the shelving inside, and the other pieces like the power cord.

Ultimately, merchants negotiate for MasterCard acceptance the fee that they will pay. They negotiate that every day, and no witness has ever claimed they don't, with the hundreds of merchant banks that are out there and independent service organizations that are out there that provide those services. And those fees have gone down over time, as you would expect them to.

That is no different—and I think this is a very important point—than the way that merchants negotiate with American Express. No merchant has claimed that they must accept American Express. They can't say that they have monopoly power, as we have heard, or now, you know, Mr. Cannon saying it is not simply a question of market power, it is a cartel. Okay, fine, same issue, antitrust at its core. They can't claim AmEx is a cartel or ever has been. We don't believe we are either. But they can't claim it as to AmEx. They have always negotiated with AmEx; they say that all the time. And they pay more for AmEx than they pay for MasterCard and, I believe, for Visa.

At the end of the day, the merchants can negotiate the fees they pay. They also have the ability to negotiate certain interchange fees. There are examples I would be happy to go through with any Members of the Task Force, those examples, in great detail.

But separate and apart from that, they negotiate the merchant discount fees they pay every day. They pay less for our system than a system that doesn't have all the alleged antitrust problems that they are claiming here in American Express.

And I would also point out that merchants are the ones who initially invented credit cards. And it costs merchants much more money to run their own system than to use ours.

And there is nothing that prevents merchants today from keeping their own cards, creating their own cards, offering cards together for acceptance. Many of them are utilizing rails built by companies that are just coming into the market, like Tempo and

others, today. Merchants invited Discover. Sears invented it; ended up selling it. But there is no reason why merchants can't do that, as well.

So there are many opportunities for them to change costs, reduce costs, or otherwise. But ultimately they pay less for our cards than if they did it themselves. They pay less for our cards than they do for AmEx, where they don't allege any antitrust problems and they don't allege an inability to negotiate. And I will leave it at that.

Mr. CHABOT. Thank you.

Mr. Chairman, do the other witnesses have time to answer, or should I yield back?

Okay, if the last three could maybe make it relatively brief, because I think they have covered a pretty wide range there, but if you could maybe make it short.

Mr. BLUM. Thank you, Ranking Member Chabot.

My concern on any kind of legislation is that, you know, if enacted, from a credit union perspective, the adverse or unintended consequences are not necessarily visible here in this bill.

First of all, I have heard about protecting the consumer. Nowhere in this bill, in this regulation, says that once the three-judge panel decides on some sort of capped rate that the consumer benefits directly from it. There is no legal requirement for that reduced, if you will, interchange to be passed on.

Secondly, I think that if you were to cap a component, from a credit union position, of interchange, you would also have to cap my fraud. You would have to cap my responsibility for fraud losses by, you know, another large retailer's disclosing information that cost me money. You would have to cap my cost of overnight funds for those immediate settlements and my back-end processing costs. And if you don't regulate those as well, you are attempting to regulate a component of the industry that is, as I said, very complex.

Thank you, Mr. Chabot.

Mr. CANNON. Mr. Chabot, all I would add is that you would legislate when you have a market dysfunction, as you say, or a market failure. What is the market dysfunction here? It is the collusion and it is the price-fixing that has gone on over a large number of years. That is the market failure; that is the market dysfunction.

I would also have to add, for Mr. Floum, one more time, he needs to talk about what his increase in revenue or fees are, not what his increase in his rates are. There is percentage, and then there is absolute revenue, and that is a very important distinction.

The other thing I would also say is, in terms of the merchant discount fee, that is true, the merchant discount fee is both interchange and processing fee on top of that. But I will tell you, by comparison, processing fees is like negotiating for the flea on the tail of the dog. It is a very small part of this, and they know it.

And they know that negotiation is not possible on interchange. And I have never heard of anybody who has gone to a bank like Citibank or Chase and said, "We have successfully negotiated interchange rates."

Mr. MIERZWINSKI. Thank you, Mr. Chabot.

Mr. Cannon and Mr. Robinson have pointed out that there is no ability to negotiate anything other than the merchant processing fee. I have no information to dispute that.

As a result of your hearings, the merchants are finally starting to see little bits of the industry's paper and their rules. They kept those hidden for years and years. They are trickling them out now. They may be available.

So I think there is just a clear example of market failure here. The companies have market power; they are abusing it.

But I want to point out just another example. It was pointed out earlier that debit cards have no interest on them, so we only need the revenue from interchange to make money on the debit cards.

There are a lot of unfair practices related to debit cards and consumers. The cheapest and safest, most secure kind of debit card is when you use your pin. Some companies charge you a fee to use your pin and give you a reward to use the unsecure, signature-based debit card.

They are also gaming the system of how much money you have in your checking account. We have heard about the $42 billion they make in interchange. $17 billion a year goes to the banks, in terms of tricking consumers into using their debit cards when they don't have any money in their accounts, allegedly.

So I think there are just a lot of unfair practices out there. And, again, I will just say what is happening in the merchant universe seems parallel to what has happened in the consumer universe. We have the Federal Reserve stepping in on the consumer side, in the consumer universe, and I think it is fortunate that the Judiciary Task Force is stepping in on behalf of the merchants.

Mr. CHABOT. Thank you very much.

And thank you to all the panel members.

Mr. CONYERS. Thank you very much, Steve Chabot.

I turn now to Sheila Jackson Lee, the distinguished gentlelady from Texas.

Ms. JACKSON LEE. Mr. Chairman, thank you very much.

I want the audience to recognize that there has been a series of these very important Task Force hearings that I really believe shed light on crucial and important issues.

I hope the witnesses will take to heart the interest of the Members in ensuring that the legislative fixes, which we happen to believe have merit, are in fact an effective pathway.

So I want to thank the Chairman for his initiative. And I hope the witnesses will take this as an opportunity, as I have seen that you have done, to be instructive.

Mr. Robinson, my question to you is why, in the marketplace as it is now postured, you cannot survive or you cannot find a remedy on the interchange fees, in terms of some mutual agreements.

Mr. ROBINSON. Let me be clear. Are you asking me why they won't negotiate with me?

Ms. JACKSON LEE. I am asking you why the market is not helping you at this point. So you can answer it in any way you so desire. Why do you need the legislation?

Mr. ROBINSON. I believe that we need the legislation because the banks and the credit card companies have a, sort of, favored situation, where they have the ability to set rates and they can give us those rates in basically a take-it-or-leave-it type of a situation.

We do get to negotiate with them on things like the processing fee. I used the delivery charge on the refrigerator analogy, and Mr.

Cannon used the flea in the dog analogy—that is probably closer to a better analogy.

So the reality for us is that we do not have the ability to negotiate with them currently. And, you know, they keep saying that we have the ability to negotiate, but just because they say it doesn't make it so.

So that is why I believe that we need this legislation.

Ms. JACKSON LEE. Mr. Cannon, build on that. Why do you not have the ability to negotiate? Interchange fees are represented by the industry to pay for their risk, pay for their processing and paper. They represent that there is some market discussion of retailers who, every day, can shout out to them and get relief. What is your response to that?

Mr. CANNON. Ms. Jackson Lee, first, let me thank you on behalf of the merchants for cosponsoring the bill. We appreciate that very much.

But, secondly, it is important to focus on what this means. There is so much discussion about negotiation. And it is important to understand this tiny little bit and then the rest of it, which the bulk of this is the interchange fee, set by and between banks with Visa and MasterCard.

Ms. JACKSON LEE. The bank of the merchant and the bank of the issuer?

Mr. CANNON. No, ma'am. No, ma'am. All of the banks—the banks that all get the interchange fee are the issuing banks. So that is the Citis and Chases. And, as I said earlier——

Ms. JACKSON LEE. And some of them may be banks of merchants?

Mr. CANNON. Oh, banks of merchants—oh, sure. Well, if you are an issuing bank and you issue a credit card, then that interchange comes back to you, absolutely, no doubt about that.

But the point there is that is not negotiated. And——

Ms. JACKSON LEE. So you are suggesting that the merchant's bank—I happen to go to Joe Smith Bank. It is my friendly neighborhood bank. They have been knowing me, I have been having mom-and-pop grocery store for 20 years. You are suggesting that that bank who has issued me a card will not advocate for me, the merchant?

Mr. CANNON. Oh, that is absolutely true.

Ms. JACKSON LEE. You need to make it clear on the record. That bank is the bank of the merchant.

Mr. CANNON. Oh, sure. Well, it is the merchant's acquiring bank. That is where——

Ms. JACKSON LEE. I understand.

Mr. CANNON. You are a merchant, you have to have a banking relationship or a credit card—so you have that bank be your acquiring bank. That is fine. That bank can also be an issuing bank. And it is the issuing banks that get the interchange. And that is how that works.

So you have to understand—and there are banks all over this country that are both issuing banks and——

Ms. JACKSON LEE. And acquiring banks. All right.

Mr. CANNON. They certainly are.

Ms. JACKSON LEE. So let's go to the point of why the market does not work. You are saying the merchants are put at a disadvantage. Let's see if we can get it precisely why.

Mr. CANNON. The market does not work because, as the system exists today, there is no ability for the merchants, the merchant community, to negotiate, to try to do something in the marketplace.

Now, retailers, as a whole, and certainly Tom, they are used to negotiating for every single thing, every aspect of their business, every day, except when it comes to credit card acceptance. And they have learned long ago that that just simply is not a possibility.

And the reason it is not is because of how this has developed over time. Because you have all of these banks, which over the years have essentially gotten together and agreed, this is going to be the amount that we are going to charge each other. And, as you know, there is litigation on this today, there are 50 lawsuits in New York, that are alleging that that agreement constitutes price-fixing, good old-fashioned price-fixing, getting together.

I worked at Circuit City. I knew that Circuit City and Best Buy couldn't get in a room and decide what the price of TVs are going to be. However, you have these independent entities, these independent banks that get together——

Ms. JACKSON LEE. With no intervention. With no oversight, no intervention.

Mr. CANNON. Well, you know, Visa and MasterCard is obviously a private entity. These banks are private entities. In the end, these are rooms full of competitors. And I can't get in a room with my competitors and fix the price of anything. And that is what has occurred over the years.

And so we have today a situation where we have enormously high interchange fees, as we believe it—by the way, one study showed that, in terms of the amount of money that it cost to actually provide the service, is 13 percent of the total of interchange. That means that is a roughly 87-percent profit margin. I would love to have that, but I can tell you that——

Ms. JACKSON LEE. Let me give equal time to Mr. Floum.

Mr. Floum, look precisely at the legislative fix or the legislative structure, which, in laymen's terms, I believe, simply opens the door to the retailer or the merchant to sit in the room and to give antitrust immunity or to be able to protect that discussion where you can come out with a rate that is fair.

What Mr. Cannon said seems to be shocking, that you have an 80-percent turnaround on profit. And I respect the fact that you have paper, machines, you have risk. What is wrong with having this kind of protection for you to have a discussion that just includes a third party and a protection against antitrust laws?

Mr. FLOUM. Thank you for the opportunity to respond, Congresswoman.

There is nothing wrong with negotiation. That is the free market, and I think everyone at this table is in favor of the free market and the opportunity to negotiate.

What is wrong with the bill is it is a negotiation with subpoenas and depositions and a three-judge tribunal that would ultimately determine the rate, and that is not the free market.

Now, if I could just explain about interchange, because I think that there is a complexity to this which is important to understand. Again, the interchange rate is an interbank transfer fee. It is not what the merchants pay. The merchants pay merchant discount rates. And they should and can negotiate.

Now, as to this—I have heard at least 10 times, it is price-fixing, it is a cartel, it is competitors getting in the room. There have been four courts in the United States that have looked directly at this issue, whether interchange is unlawful under the antitrust laws in the United States. Every single one of those courts has found that interchange is pro-competitive and is lawful.

You couldn't have a system without interchange. Because we have 16,000 banks—and you might go to Joe Smith Bank and buy something, and your bank is Joe Smith Bank, and you might buy something from a merchant who banks with Chase, in order for that transaction to happen instantaneously, securely at the point of sale, there needs to be a rate that is predetermined. That is what interchange is.

Nobody has suggested, that I am aware of, in the world that interchange should be abolished. Instead they are saying it should be lower. And——

Ms. JACKSON LEE. If you would yield to me for a moment?

Mr. FLOUM. Yes, ma'am.

Ms. JACKSON LEE. I need to put on the record that I think the magnitude of the profit and the return that you are getting, 641 million credit cards and growing, $1.7 trillion—so even if this is a competitive fairness, meaning that you are already competitive, the returns are enormous and the retailers are suffering.

But I understand that, as the legislation is structured, there is an arbitration, there is a first step. There probably could be an agreement without yielding to the legislative fix if it would work, if you would work and let it work in the marketplace by listening to the merchants and the retailers.

The problem we saw was that the only people that were part of the interchange—and you have right risk that should be addressed—was enormously one-sided. We couldn't find a way to get in the door. You haven't shown us the way to get in the door.

We would be happy if you would have a structure, a private market structure for these individuals to get into the door. This gives them the door opening.

And we want to look for a way that this works. But I think the fact that there is an arbitration first and then the court gives you some relief. And I hear what you are saying, and I am not unsympathetic. But I am very sympathetic to a sector of the marketplace that seems to be shut out.

If you want to finish the sentence.

Then I will yield back, Mr. Chairman.

Mr. FLOUM. Thank you again, Congresswoman, for the opportunity.

I am not sure if you were in the room——

Ms. JACKSON LEE. Probably in another hearing.

Mr. FLOUM [continuing]. When I mentioned that interchange revenues do not come to Visa or MasterCard. We don't receive those revenues. We set interchange to try to grow our system.

Now, with respect to negotiation, I would love to talk to Mr. Robinson right after this hearing or any other merchant who would like to discuss how they can drive volume to our network in return for incentives and other ways that they can offset their costs. So we are very much in favor of those discussions.

Ms. JACKSON LEE. Just one sentence, Mr. Chairman.

I hear you, Mr. Floum—I am sorry if I am saying it incorrectly. But let me just say this. The banks and the card have—I don't want to use this very strong word of "collusion," but they certainly have an opportunity to speak to each other.

And I think that is the crux of our concern. And I will allow you to think about that, as others question you, to be able to clarify that point for us.

Mr. Chairman, I thank you very much, and I yield back.

Mr. CONYERS. Thank you so much.

The Chair recognizes the distinguished gentleman from Florida, Ric Keller.

Mr. KELLER. Well, thank you very much, Mr. Chairman.

And, Mr. Robinson, I understand your stores operate under the term Rotten Robbie? Is that right?

Mr. ROBINSON. That is correct.

Mr. KELLER. Did Visa and MasterCard give you that nickname of Rotten Robbie, or how did that nickname come about? [Laughter.]

Mr. ROBINSON. You really want that story?

Mr. KELLER. Well, if you can tell it in about 10 seconds, because I have about 20 other questions for you.

Mr. ROBINSON. Well, as a small marketer, we needed something that was catchy and that somebody would remember without having a major oil company budget. And so we picked that name because people would remember it.

Mr. KELLER. All right. Well, thank you. I am known as Rotten Ricky, but for different reasons. [Laughter.]

Mr. ROBINSON. They might be the same.

Mr. KELLER. Yes.

Mr. Floum, I am going to start with you.

And I am going to ask you all some questions on both sides, so if it seems rough at times, it will be easier later for both of you, time permitting.

You made a statement that I thought was pretty surprising. Some stuff I could agree with, but the one statement that really surprised me was, "Interchange rates have not increased over the past 10 years."

And before this Committee, on July 19, 2007, we have Steve Smith, the CEO of Food City, from Virginia. And he testified that in the 1990's his grocery stores were paying 1 percent interchange fees and now they are paying 2 percent, more for premium cards. He seemed like a pretty credible witness to me, frankly.

Last week, on May 7, 2008, Bill Douglas, the CEO of a convenience store chain called Douglas Distributing, testified that 10 years ago they were paying 1 percent interchange fees and now they are paying 2 percent on average, more for premium fees. He seemed pretty credible to me.

Do you agree with me, sir, that, in fact, the Visa interchange reward-based premium cards have gone up over the past 10 years?

Mr. FLOUM. Congressman Keller, yes. And if I could take a minute to talk about rewards cards, I think it might be instructive for the Committee. I would just ask my colleague to put up a chart, if I may, that discusses reward cards.

Our blended, average interchange rates have remained flat, as I mentioned, over the past 10 years. We have introduced debit cards that have lower interest rates, pin debit——

Mr. KELLER. Right. And I have your chart. And I only have 5 minutes, so let me say, if you look at that chart, back in 2002, you only had, like, 13 percent of people using these premium cards and now you have 63 percent, or two-thirds of the credit market is these premium cards, right?

Mr. FLOUM. Correct.

Mr. KELLER. Okay. And so, if now you have two-thirds of the market with premium cards, and premium prices have gone up, then, in fact, these folks like Mr. Smith and Mr. Douglas were telling the truth when they are saying they are having to pay more for credit card interchange fees.

Mr. FLOUM. For rewards cards, yes, Congressman.

But I would just like to highlight that what Visa has done is gotten into a market niche that was occupied by American Express. These are high spenders. Typically they have rewards cards, travel and entertainment, jewelry stores, high-end merchandise. And look at our rates compared to American Express. They are 60 basis points lower. So it is less expensive for the retailers, thanks to the fact that we have gotten into this space.

Mr. KELLER. They have gone up over 10 years, especially with premium cards. And the fact of the matter is, the guy sitting next to you, Mr. Robinson, with his small convenience store, is absolutely required to accept the Visa premium card along with the basic Visa cards, correct?

Mr. FLOUM. Yes, that is correct.

Mr. KELLER. Okay. And if the solution here is that he has the ability to negotiate with Visa and MasterCard under the free market principles, as has been suggested by you and counsel for MasterCard, and 10 years ago the interchange fees were significantly less, around 1.2 percent according to one of your charts, then would you agree today that Mr. Robinson and his company will only, going forward, have to pay 1.2 percent interchange fees?

Mr. FLOUM. No, Congressman. And it depends—again, we have brought debit cards to Mr. Robinson and amazingly electronified his business so that he can operate on the low margins. We have enabled his business to prosper. And the debit cards are lower——

Mr. KELLER. I agree totally about the debit cards; you are 100 percent right.

But my point is, this guy doesn't have the ability to negotiate with you, because Wal-Mart is the biggest employer in the whole country, Fortune 1 on the Fortune 500, and they had to bring a suit, resulting in a $3 billion settlement, because they themselves don't have the ability to negotiate.

And so, if they don't have the ability to negotiate with you to get lower rates, how the heck is a small, mom-and-pop convenience

store in a position to negotiate lower rates on these premium reward cards that Visa offers?

Mr. FLOUM. Well, Congressman, I showed before this is Mr. Robinson's organization. This is NACS, and this is how to negotiate with first data for a low merchant discount rate. So he can and does negotiate through the National Association of Convenience Stores, which sell, I think, 85 percent of the retail gas in the country.

Mr. KELLER. Okay.

Mr. Chairman, my time has expired, but let me just say to Mr. Floum, I have a lot more questions and lot more that you will like to answer, other than those. And I want to get to the other side, too, to be fair. And hopefully, as time goes by, we will have a chance to get to the rest of them.

We have important folks waiting, so I will yield back the balance of my time, Mr. Chairman.

Mr. CONYERS. Thank you very much, Ric Keller.

The Chair recognizes Lamar Smith, Ranking Member of the full Committee.

Mr. SMITH. Thank you, Mr. Chairman.

Mr. Cannon, let me direct a couple of questions toward you.

If this bill, H.R. 5546, passes, what I want to know is what you think the consequences of the bill might be. Which is to say, how much—and presumably the rates would be lowered as a result of the bill. How are you going to benefit? How are consumers going to benefit? Is it going to mean an increase in profit to you, or is it going to be lower prices to consumers? Who is going to benefit if this bill passes?

Mr. CANNON. Well, I can tell you, Mr. Smith, right now the merchant community, and I believe justifiably so, believe that rates today are wildly beyond competitive rates. And if, in fact, you got to a——

Mr. SMITH. Could you answer my question, though?

Mr. CANNON. Yes, sir.

Mr. SMITH. My question is, are consumers going to benefit? And if so, why and how?

And, by the way, I don't mind that you would make more profit. I have nothing against profits. But I am just trying to get an answer as to who would benefit. Are consumers going to benefit from lower prices, or are you going to benefit from higher——

Mr. CANNON. Well, Mr. Smith, in this country, and coming from a retail background, as you know, I have seen this every day for 10 years. And all I can tell you is, of course retailers can't agree what they are going to do or not going to do among each other; that would be a violation of the law. But I cannot fathom that, as brutally competitive as retail is today, that somehow merchants would be able to keep a certain amount of benefit, of money, and not see that enter the competitive fray. Just knowing what I know about it, to me it seems really impossible to fathom.

However, I will say this. I think that, in terms of how this should be viewed, that it is absolutely going to be pro-consumer and that these benefits will flow into consumer pockets.

Mr. SMITH. Obviously, benefits go to merchants from using credit cards. You get instant payment, you get more business, you don't

have bounced checks, you get timely payment and so forth. Why isn't that worth a cent and a half on every dollar?

Mr. CANNON. Oh, Mr. Smith, you are not going to have merchants tell you that there is not a benefit here. You know, the credit system today is certainly a benefit.

Mr. SMITH. Right.

Mr. CANNON. But the question is, it may be a benefit, but why are we paying the rates we are paying today? Is it a result of a competitive marketplace, or is it a result of an antitrust violation and a market failure?

Mr. SMITH. So you don't think you are getting your money's worth?

Mr. CANNON. I think that is an understatement, sir.

Mr. SMITH. Okay, thanks.

Mr. Floum, let me go to you. The appearance here, with Visa and MasterCard controlling 80 percent of the market, is that there is not enough competition. At least, that is the optics on it.

Is there a time that you can point to where Visa has lowered its rate on a merchant or a group of merchants because they threatened to use another credit card or they threatened to use cash or they did use cash or they did use another type of credit card?

Mr. FLOUM. Absolutely, Congressman. There are all kinds of examples of where we have lowered rates, particularly to drive increased use in certain market segments. Supermarkets, we have lowered our rates dramatically. Gasoline, we are lowered our rates over time. Utilities, which was not a sector that worked for payment cards, we introduced low rates to drive volume.

Quick-service restaurants—here is an example. We hear about how retailers can't live without Visa or MasterCard. Well, McDonald's and other fast-food companies did very well without credit cards for years and years and years. Now they are using them. Why? Because it drives even more benefits to those retailers.

So we have rates that go down, rates that go up—it is very complicated—in order to drive usage in particular sectors.

Mr. SMITH. Okay, thank you.

And can you, Mr. Floum, or can any other member of the panel today tell me a breakdown of how interchange fees are used? In other words, I have been told that about 13 percent of the fees go to processing, maybe 44 percent go to benefits, something like that. Is that generally accurate, or can you—and the rest would be profits. Can someone give me a breakdown on where those interchange fees go and how they are used?

Mr. PEIREZ. Congressman, I can try to explain it in a very simple way, which is the interchange fee revenue that is received by the issuing bank is far, far, far less than the fully loaded cost——

Mr. SMITH. What I would like, though, is some specifics. I gave you some percentages; are those percentages accurate, or are they not accurate?

Mr. PEIREZ. They are not accurate because there are no——

Mr. SMITH. Okay. What are the accurate percentages?

Mr. PEIREZ [continuing]. There are no direct—from an accounting perspective, there is no direct way to equate——

Mr. SMITH. You can't tell me what the cost of processing is? You can't tell me what the cost of benefits are, how those fees are used?

Mr. PEIREZ. What I can tell you is that any individual bank that receives the fees can account for it in many different ways. But it is their costs of loans, the cost of funds, as you heard Mr. Floum say——

Mr. SMITH. Okay, well, what is the average? If you can't go by specific—I mean, if you want to go by specific industry, forget that. Go by the average. Give me an order of magnitude.

Mr. PEIREZ. I would say that you could take the entire amount of interchange fees and it won't cover the full cost of lending and float.

Mr. SMITH. What part of interchange fees are used for processing?

Mr. PEIREZ. I don't believe that interchange fees are directly used for processing. And I would be happy to walk through——

Mr. SMITH. I thought that was one of the arguments made.

Mr. PEIREZ. It is one of the arguments that the merchant side is making.

Mr. SMITH. So you are saying that none of the interchange fees are used to pay for the cost of processing.

Mr. PEIREZ. What I am saying is that interchange fees——

Mr. SMITH. Well, didn't you just say that or not? Did I misunderstand something?

Mr. PEIREZ. No. What I am saying is that the interchange fees are used by the issuing banks in order to cover some of their costs.

Mr. SMITH. Right.

Mr. PEIREZ. Different issuing banks may use it for different things, but it ultimately is far exceeded by their costs of lending, their cost of float, their cost of credit risk assumption, their cost of fraud, as Mr. Floum laid out.

Mr. SMITH. I know I have some more time, because the precedent has already been set. So I want to yield Mr. Keller a couple of minutes. [Laughter.]

But having said that, I am disappointed you didn't answer my question.

I will yield the balance of my time, at least 2 or 3 minutes, to the gentleman from Florida, Mr. Keller.

Mr. CONYERS. Who said you had any more time? [Laughter.]

Mr. SMITH. I was going by the precedent set by my colleague from Texas, Mr. Chairman.

Mr. CONYERS. Okay.

Mr. KELLER. I can wait another round, Mr. Chairman.

Mr. CONYERS. Oh, no. Go ahead.

Mr. SMITH. Just 2 minutes.

Mr. CONYERS. Go right ahead, Ric.

Mr. KELLER. Okay.

Mr. Floum, let me go back to you. You made a statement earlier about prior case law said that you guys haven't violated antitrust laws. Correct?

Mr. FLOUM. Yes, sir.

Mr. KELLER. And, in fact, I pulled the most recent decision, the 9th Circuit case of *Kendall v. Visa*, just handed down, March 7, 2008. And you are certainly correct in that. And I want to walk through the gist of what that says for our nonlawyers.

MasterCard, Visa and some banks were accused of essentially engaging in price-fixing, conspiracy and collusion. And the court gave the plaintiffs a chance to amend their complaint to be more specific and tell us the details. And they came back, and they, after deposing a couple key witnesses, had no details, just legal conclusions. And the court said, I am throwing it out. It is not enough just to make legal conclusions. They said, specifically, tell us who did what to whom, where and when?

Is that a fair summary?

Mr. FLOUM. Yes.

Mr. KELLER. Okay. I then pulled the most recent class action litigation in the Eastern District of New York against Visa and MasterCard. This is a 98-page complaint. You are familiar with this certain litigation?

Mr. FLOUM. I am.

Mr. KELLER. Well, I decided to spend all night reading this 98-page complaint from cover to cover, and what I found was, in fact, more just legal conclusions.

And I will give you a quote: They collectively fixed interchange fees. These are illegal. MasterCard and Visa, by agreeing separately and together to establish and implement and maintain a price-fixing scheme whereby they fixed supercompetitive credit card interchange fees, nothing more than legal conclusions once again.

Is that a fair summary?

Mr. FLOUM. I think that is very fair.

Mr. KELLER. Okay. With that as the basis, let me just ask you—and I am going to ask you directly, Mr. Peirez, as well, with your high position at MasterCard—Mr. Peirez and Mr. Floum, have you ever had conversations, or anyone between MasterCard and Visa, where you talked about acting together to fix the interchange fee rates at a certain amount?

Mr. FLOUM. Absolutely not.

Mr. KELLER. Have you ever conspired with each other or with banks to raise interchange fee rates?

Mr. FLOUM. No, sir.

Mr. PEIREZ. No.

Mr. KELLER. Have you ever colluded either with MasterCard or any bank on the planet to set interchange fee rates?

Mr. FLOUM. No, sir.

Mr. KELLER. Okay.

Mr. Mierzwinski, do you have any evidence, in terms of disgruntled employees, witnesses, documents, letters, anything that would contradict the testimony of MasterCard and Visa that they have never engaged in illegal price-fixing, conspiracy or collusion?

Mr. MIERZWINSKI. The consumer groups don't have anything like that. I don't know whether the merchants do.

Mr. KELLER. Mr. Cannon, do you have any specific evidence, as requested by the 9th Circuit Court of Appeals, to contradict what you heard today?

Mr. CANNON. Well, Mr. Keller, a couple things about that.

Number one, the issue here isn't alleged conspiracy between MasterCard and Visa. I don't think there are allegations about that.

Mr. KELLER. Well, that is actually—that is the issue. Trust me, I didn't need my Ambien for this——

Mr. CANNON. Let me put it this way. From the merchants' perspective, the question here that we raise is the conversations, agreements, et cetera, between the banks. And that is the Visa system and the MasterCard system. And, in fact, that is what this legislation is directed to do and pointed at doing, is making sure that that negotiation—excuse me, the agreement on that side is somehow eliminated and that negotiations start with this legislation.

But the point is, on Kendall, as you know, virtually no discovery done on that. Really, a motion to dismiss——

Mr. KELLER. Depositions were taken of MasterCard and Visa.

Mr. CANNON. I believe that is correct.

Mr. KELLER. All right. Massive amounts of discovery, I believe, in New York, at this point. To my knowledge, I don't even believe that Visa or MasterCard or the parties in that case have even raised Kendall as determinative of—that case would have been dismissed——

Mr. CANNON. I am thinking you are going to see it, down the road, raised.

Mr. KELLER. Since you brought up this legislation, you are a fan of it, let me ask you this about this legislation. One thing is very different in this Conyers bill than the Copyright Royalty Board, and that is this: When this three-judge panel hears the decision—and let's say it is Mr. Robinson's little company versus the big banks and MasterCard and Visa—they are bound by what each side makes as their final offer.

So, for example, if Mr. Robinson says, "I want the 1-percent interchange fee rate that we used to have 10 years ago," and MasterCard and Visa and the banks say, "No, we want a 5-percent interchange rate," that judge panel is required to take either 1 percent or 5 percent. He cannot pick something in the middle like 3 percent.

Is that correct?

Mr. CANNON. He would have to pick whatever comes closest to the standard——

Mr. KELLER. But is that a correct statement?

Mr. CANNON. Yes, sir, absolutely.

Mr. KELLER. Okay. And that is the difference in the copyright royalty situation.

Mr. CANNON. Sure, that the judges on the CRB are essentially allowed to make their own decision. The whole idea behind the legislation, as I understand it, is you wanted to make sure that the fate were still in the hands of the parties. And so, therefore, you would assume that perhaps negotiation offers would come fairly close to each other. You don't know for sure.

Mr. KELLER. I just wanted to clarify that.

And I will get to other questions later, Mr. Chairman. Thank you for indulging us, and we yield back the balance of my time for now.

Mr. COHEN. [Presiding.] The gentleman from Utah?

Mr. CANNON OF UTAH. I thank the Chair, but I had to miss part of this hearing because I had some War College people in my office, and I needed to spend time with them.

Mr. Issa has been very patient. I would appreciate it if you would pass me over and give time to Mr. Issa.

Mr. COHEN. All right.

Mr. Issa?

Mr. ISSA. I thank the Chairman since I have the Army War College next.

I think because this is an antitrust Task Force, I should start off by full statement. I do know Mr. Cannon. I did sell to Best Buy and Circuit in my last profession. And they do hate each other, and they do fight bitterly to the bottom. The only sad truth is that when they can't make a profit after they have beat down the prices, they usually come back to the manufacturers or suppliers like myself. So my experience makes Steve a friend and an acquaintance sometimes.

For the rest of the panel, I am sure I would have loved you all if I would have been a vendor, equally. [Laughter.]

Mr. Robinson, I am going to work with you for a moment, because I view myself and I view everyone on this dais—we are on the board of directors, not the executive committee, but the board of directors of the United States of America, Inc. We have an absolute responsibility to make sure that we do everything we can to maintain the opportunity for America to be competitive around the world.

And the antitrust laws, since the time of Teddy Roosevelt, have been all about making sure that America is competitive, because in the long run competition makes America do better globally.

I am going to ask you, if you could have the so-called 1-percent rate that is available in Spain and you could open a bank account in Spain and run your millions of dollars through that account at that rate, knowing that it is a global market and those funds would be transfered for a de minimis amount back into U.S. dollars, would you do that today?

Mr. ROBINSON. Yes.

Mr. ISSA. So the absence of a global market in which other countries' merchants—the gas station in Madrid—has a lower cost of a transaction, even if it is my credit card, my premium United Airlines Mileage Plus card, even if it is that card, they have a lower cost of transaction than you do. Is that your understanding?

Mr. ROBINSON. That is my understanding.

Mr. ISSA. Okay. I have a "no" next to you from Visa, so I want to be fair.

My understanding is that some countries, many countries around the world have set rates, and the rates are lower than what Mr. Robinson pays today.

Mr. FLOUM. Thanks for the opportunity to respond, Congressman.

Mr. ISSA. You are welcome.

Mr. FLOUM. The merchants pay a merchant discount rate to accept cards. And the merchant discount rate in the United States is not higher than many countries in the world. It is right about the middle of the pack. The interchange rates have been reduced by regulation in certain places like the U.K. and Australia. But that, again, is not the price that merchants pay.

So I think Mr. Robinson's, if he did compete with gas stations, maybe he does, in other parts of the world, their acceptance costs are about the same as his. So it is not the case that acceptance costs are lower in other parts of the world.

The interchange rate may be, but, again, that is just an indirect cost, not the costs that they merchants pay to their——

Mr. ISSA. I appreciate that, but I never had an indirect cost that I didn't consider when I went from my top line to my bottom line. Tell me why that doesn't make Mr. Robinson more competitive if he is able to avail himself of a lower difference between selling price and net cash.

Mr. FLOUM. Oh, certainly, Congressman, that would help him. Again, but his cost is his acceptance cost, which he pays to his acquiring financial institution——

Mr. ISSA. That is now in Spain.

Mr. FLOUM. That is what he wants lowered. That is what he——

Mr. ISSA. Right. So he is going to go to Spain, and he is going to work out a deal with the Bank of Madrid. And he is going to accept people at his gas stations in dollars, okay, on U.S. credit cards like mine, but, in fact, it is going to be transported back electronically in real time every 2 hours, batched, through the Internet, and he is going to receive U.S. dollars transfered on a daily basis for the few dollars it takes, $10 for a wire transfer, of millions of dollars a day.

Now, what in the world, in a global market, is he not able to avail himself of that? And wouldn't that make him more competitive? He thinks it would.

Mr. FLOUM. Can we put up the chart on the different countries? Because I think that might help, Congressman——

Mr. ISSA. Well, the point, though, is that there is a difference in these rates. And, look, I only care about America being competitive and markets working. If a market works in China or in Australia or in Spain or anywhere in the European Union—we are talking about particularly in developed countries—and it works more efficiently, in that you accept the transaction for less money, and it would make his business more competitive or more profitable, whichever, then I think he has a right to avail himself of it.

And that is not what the bill is about. That is one of the reasons I haven't signed on to the bill, is I am trying to deal with global competitiveness, because that is the responsibility—so, as I am trying to dissect this, what I see is somebody somewhere gets a better rate, even with my credit card today, than he gets.

And in a normal market—and Steve Cannon, obviously, is very aware that the products sold at Circuit City come from anywhere in the world and they come de minimisly into the United States, as far as exchange fees, if you will, in order to give him the absolute best product at the lowest price on a global basis.

My question to you—and I am going to indulge the Chair like some of the previous ones, but this is important—is, this Committee, as we are considering legislation, regardless of whether the draft legislation becomes law, why shouldn't we ensure that the most favored price you give to any like company is available to his?

And we are talking about based on a cost basis, not necessarily based on your target markets, because target markets are kind of

a monopolistic thing. Cost and profitability tends to be more a free-market-type decision, and certainly on a global basis.

So, as I looked at all these things—and, look, I want to be a fan of every one of your interests, and the only way to do that is to ask the tough question here, which is, if you could work for less in Spain, why can't you work for less for Mr. Robinson or for Circuit City or anyone else if, in fact, in a normal global market they could simply open a bank account in Spain?

Mr. FLOUM. Well, Congressman, it is a very important question. We are a global company, and it is very important to us, as well.

I apologize. I don't think I have Spain on—oh, I do have Spain on this chart. So you can see that, in the United States, the overall acceptance costs are slightly higher than——

Mr. ISSA. But what is the lowest one on the far left? I can't see it from here.

Mr. FLOUM. That says Denmark.

Mr. ISSA. Okay. He is now doing business in Denmark, is in a global market—— [Laughter.]

I got to tell you, he skipped Spain, he went right to Denmark. And, by the way, he picked up cheese on a premium with every transaction.

Mr. FLOUM. Again, the acceptance costs are set by the acquiring banks in these different countries. The interchange rate is just a part of that. And, for the most part——

Mr. ISSA. But if he went to Denmark and put a bank account there, he would do better.

Mr. FLOUM. He would do better, in terms of the acceptance costs in Denmark, that is correct. But he would do worse than in the Netherlands.

Mr. ISSA. And I am going to close out, and I am only going to say that I would like to hear just short answers from the others.

When I look at Denmark and I look at—or Belize or anywhere in the world, but I will pick Denmark—if everybody in the United States today skipped their U.S. bank, went to Denmark and said, "How low will you go in total cost?", knowing that the interchange fee starts off low and knowing that they can put hundreds of billions of dollars in transactions through Denmark, do any of you believe for a minute that, in fact, you wouldn't find banks there willing to operate on an incredibly thin sliver to give Mr. Robinson and Circuit City and Best Buy and all the other companies a more competitive rate when they are trying to offer the lowest price to the consumer?

I will give you all the time to answer, and then that is it. I have run out of time to ask.

Mr. FLOUM. I can't argue your point, Congressman. But if you look at Australia, which I believe is on—maybe it is not—or the U.K., where there has been regulation, consumers are paying more on the other side of the equation. So interchange, in part——

Mr. ISSA. That is why I am going to Denmark.

Mr. FLOUM. Okay. Well, in Denmark, we have to look at what consumers pay in Denmark.

Mr. ISSA. Yes, sir?

Mr. PEIREZ. Sir, what you will see, Congressman, is, if, in fact, all the U.S. merchants started contracting with a bank in Denmark

in this scenario, what you would see is U.S. consumers paying more on their cards, you would see less cards made available to U.S. consumers, you would see rewards or other benefits go away from any of those consumers, you would see the period of float time go away or be charged for, you would see interest rates increase, and many other things which are detailed as a result of exactly what happened in Australia in the study I have submitted with my testimony.

So, yes, for a short period of time maybe it would appear like things are doing better, but the long-term impact would ultimately be that you would end up in a situation where credit cards here—and if you look at all these markets that are on Mr. Floum's chart, this is the one market that has the most robust, competitive marketplace for cards, the most consumers benefits and the best products available, the most diverse set of products.

So I think it is very important not to just look at one piece of the equation and say, "Well, that fee would be driven down." There would be consequences, and we are seeing them play out in some markets today.

Mr. ISSA. Mr. Blum?

Mr. BLUM. Thank you, Congressman.

I think, in your example, as a Federal credit union not authorized to operate in Denmark, I would lose significant market share and membership and, you know, the member services. I certainly wouldn't applaud or encourage any of my members to move away from me, to move overseas.

And my only concern here would be the currency transactions fees, the volatility of the currency market, what might happen switching their U.S. dollars to the Danish krone and back to U.S. dollars multiple times.

Mr. ISSA. Mr. Cannon?

Mr. CANNON. Mr. Issa, I believe that merchants in the United States would be delighted to take the Denmark rate today.

Mr. MIERZWINSKI. One point that hasn't been made yet, Mr. Issa, is that the credit card industry is the most profitable form of banking by far. And that is according to the Federal Reserve, not me. So I think the banks could absorb this. And I think if the merchants went to Denmark, they would figure out a work-around.

But right now, consumers in the United States are paying an awful lot for their credit cards, whether or not they get these so-called rewards.

Mr. ISSA. Well, thank you.

And thank you, Mr. Chairman.

I very much believe that we need to make sure that we maintain a robust and efficient system in the U.S. So lest anyone think I am inviting them to move their dollars offshore, I am not. But I do want to make sure that all of us realize that USA, Inc., has to be the most competitive in the world. And that is a goal, I think, of all of us on the dais.

And, with that, I yield to the gentleman from Florida for another 2 minutes. [Laughter.]

Mr. KELLER. I will let the gentleman from Utah go, and then if we do another round of questions, I will take it afterwards and

seize one of them, the principals here. But thank you, Mr. Issa, for yielding. I do have some questions, but I will let him go first.

Mr. COHEN. Mr. Cannon?

Mr. CANNON OF UTAH. I think, Mr. Chairman, that is the last time I am going to defer to Mr. Issa. [Laughter.]

Not because his concerns are not interesting, but because other matters press on us all.

Mr. Peirez, you were talking about all the competitiveness and the options that we have in the American market, and that is true. But it is not because of the interchange fee or the way we regulate it as opposed to other markets. It is because America is a more robust place to do business. So we actually really want to keep that environment where we are.

But you listed a series of fees that are going to go up. There is a dramatic difference between the fees you just listed—and I think others, Mr. Floum and others, have talked about those fees—and the interchange fee. That is, if you are going to add a fee on a credit card, the person who decides to use that credit card will understand those fees because they are explicit, as opposed to the interchange fee, which, really, nobody ever gets to talk about.

Isn't that the case?

Mr. PEIREZ. Thank you, Congressman. I think that is a very important question.

I think that whenever a consumer goes to a merchant and uses any form of payment, there are costs inherent in——

Mr. CANNON OF UTAH. But please just answer the question. The question is, is there not some benefit from having explicit costs versus hidden costs?

Mr. PEIREZ. Again, Mr. Congressman, I don't believe there are hidden costs. I believe that when a consumer goes to a merchant and chooses how to pay for a good or service, there are many costs involved. And I think as Mr. Floum stated earlier, it is our belief that many other forms of payment, like using a card from the retailers, American Express——

Mr. CANNON OF UTAH. Pardon me. Let me just get in here, sir. You listed a series of alternative costs that could be imposed on that transaction. The one thing that is very consistent about those alternative costs is that they are understood, or at least available for understanding, by the consumer. Whereas, the consumer has no idea about what or how much the interchange fee is, and he has no way of accessing that, and the merchant has no way of negotiating that. That is a hidden cost.

But regardless of the term we are using here, is there not something better about costs that are more transparent?

Mr. PEIREZ. We absolutely have no problem with transparency and encourage merchants to go ahead and tell consumers exactly what those costs are for them when they are making——

Mr. CANNON OF UTAH. And when did you start encouraging merchants?

Mr. PEIREZ. We have always allowed that. We have never——

Mr. CANNON OF UTAH. You have always allowed that? Did you have a practice of telling merchants they can't offer cash discounts, they can't tell what the cost is?

Mr. PEIREZ. We do not have a practice——

Mr. CANNON OF UTAH. Ever?

Mr. PEIREZ. Ever.

Mr. CANNON OF UTAH. We had a panel some time ago where two merchants were surprised that that was the case, because they had been told somewhere in the system—is it Visa that is doing that, and not you guys?

Mr. PEIREZ. I honestly don't know what Visa does. You can ask Mr. Floum.

But I can say that we do not and have not disallowed discounts for cash. We were surprised to hear that merchants actually thought they couldn't do it, and we are encouraged now that we can tell them they can.

Mr. CANNON OF UTAH. Thank you.

You said in your earlier testimony that—you talked about several things that you are making public, like you are posting rates on your Web site, you are publishing "more and more," I think was the term you used, of your rules.

When did you start doing that?

Mr. PEIREZ. Well, we have always, again, permitted the banks that contract with merchants to provide the merchants with——

Mr. CANNON OF UTAH. No, no, no. I am asking—you took actions that you touted a few minutes ago——

Mr. PEIREZ. About 4 years ago was the first time that we did it.

Prior to that time, we had a rule that required the banks that contracted with merchants to provide the rules to those merchants in their merchant agreements. We were made aware by merchants that they did not feel that they had access to those rules. So 4 years ago, we published what we believe to be the set of rules that were covering merchants.

We were told by merchants and asked by merchants for other things, which we have now published. And we are now going to publish all of our operating rules and are in the process of doing so.

Mr. CANNON OF UTAH. Good. And when did you ramp up the rate at which you began publishing?

Mr. PEIREZ. Well, we have published the first set 4 years ago. We published another set about 3 or 4 months ago. And then we have been starting, in recent days, to now get the rest of the materials ready to be published.

Mr. CANNON OF UTAH. And when did you start publishing your fees?

Mr. PEIREZ. We started publishing the fees in the fall of 2006.

Mr. CANNON OF UTAH. Good. I think the discussion over this bill and in the direction of the bill has actually had a salubrious effect on the transparency of this market. We appreciate that.

Mr. Floum, I just wanted to be fairly clear. You have been very clear and very consistent in talking about your fees and those fews—the percentage of that fee has been stable over the last 10 years. During that same period of time, the amount of transactions has skyrocketed.

Mr. FLOUM. Yes, sir.

Mr. CANNON OF UTAH. And, therefore, the gross income, the revenue, has skyrocketed.

Mr. FLOUM. Yes, sir.

Mr. CANNON OF UTAH. And at the same time, virtually all other electronic transaction processing fees have plummeted. So I suspect that the actual cost of accounting for the transaction—that is, processing the transactions—has become a lesser part of the interchange fee, has it not?

Mr. FLOUM. Again, Congressman, the rates have remained the same, and the value of those products has increased exponentially——

Mr. CANNON OF UTAH. But you have contractors out there, Visa, I believe, has contractors out there who process transactions.

Mr. FLOUM. We process them over VisaNet. We own many computers, and we have a——

Mr. CANNON OF UTAH. But you also have subcontractors out there that do—I got approached last weekend by somebody who does it and was concerned about the effect of this bill. So you have other people that actually perform services for you.

Mr. FLOUM. On the card-issuing side and on the acquiring side, there are many third-party processors, yes.

Mr. CANNON OF UTAH. So what do they do in relationship to what Visa does as its processing?

Mr. FLOUM. Well, we are the central switch, so the transaction between the acquiring bank and the issuing bank, that is what we do, we switch the transaction and we settle between those two banks.

Mr. CANNON OF UTAH. Okay. So the acquiring banks or the merchant banks have processors that prepare information for you, and then they take it to your central process.

Mr. FLOUM. Well, for example, First Data is a large merchant processor, yes.

Mr. CANNON OF UTAH. And there are also some small merchant processors.

Mr. FLOUM. Yes, sir.

Mr. CANNON OF UTAH. Have the costs that those people have been reimbursed, First Data or smaller operators, have they declined?

Mr. FLOUM. I need to answer your question directly. It really depends on the type of transaction. For a standard transaction, perhaps. But they are much more complicated today, with automatic authentication, clearing settlement, fraud control, verification of the risk and so forth. So I can't say that, in all instances, it has gone down.

Mr. CANNON OF UTAH. But has it had a tendency to decline?

Mr. FLOUM. If you are looking at it as just a scale business, you could make that argument. But, again, because it is a different product and service, I don't think that is an apt analogy, with all respect.

Mr. CANNON OF UTAH. Well, in other words, you have more service involved. You have a better product, a higher-quality product that is happening, and so there is some tendency to raise the value because of that quality.

But you are not suggesting—I mean, you are having a hard time saying this, but, in this regard, almost all prices have been falling where you have had automated transactions.

Mr. FLOUM. What we have done in recent years, Congressman, is we have paired together our products and our processing services. They are one. And so, to that extent, I can't say that the cost has declined, just because of all the added value that comes with the product and the processing sevrices.

Mr. CANNON OF UTAH. Of course, price declines tend to occur more readily where there is competition and transparency. I don't think there is any question about that.

The record ought to note that Mr. Floum has nodded in agreement.

Mr. FLOUM. I agree with you, Congressman.

Mr. CANNON OF UTAH. Thank you.

Mr. Chairman, I am not sure where we are on the light. Has it gone red and off?

Mr. COHEN. Your light never goes off, sir. [Laughter.]

Mr. CANNON OF UTAH. The problem is it doesn't go on either, right? [Laughter.]

Let me just ask one other question to Mr. Floum and probably also to Mr. Peirez.

One of the principal complaints about H.R. 5546 is that it is a price-control bill. If we amended the bill to remove the three-judge panel but still kept the antitrust exemptions in it, maybe adjusted those a bit, for the merchants and banks to negotiate the interchange terms, would that be acceptable to you?

Mr. FLOUM. We would have a problem with imposing an antitrust exemption, because the merchants——

Mr. CANNON OF UTAH. It would not be imposing; it would be allowing an exemption to people if they wanted to get together and negotiate.

Mr. FLOUM. And today they can get together and negotiate, Congressman. And there are many examples of that, and I have cited several of them, the——

Mr. CANNON OF UTAH. But my question was not what they are doing now, but if we change the law and allowed them to negotiate as a group, is that something that would remove your opposition to this bill?

Mr. FLOUM. We would certainly—it would certainly improve the bill. We would need to study the antitrust exemption. Again, the negotiation is basically between the merchant community and the acquiring community, and I have seen——

Mr. CANNON OF UTAH. But that is because the interchange fee is outside the scope of the acquiring community. Isn't that right?

Mr. FLOUM. Acquirers can negotiate interchange with issuers, and often do.

So what we do is we set default interchange rates. We allow negotiation of those rates. Those rates are frequently negotiated between issuers and acquirers. The default rate protects people like Mr. Blum, the small credit unions, who aren't able to effectively negotiate in the same way that the larger financial institutions can.

Mr. CANNON OF UTAH. How many institutions actually negotiate? I suspect that Wal-Mart does. How many others actually effectively negotiate that?

Mr. FLOUM. Well, the acquirers that have business relationships with large merchants or large groups of small merchants negotiate

with issuers over the interchange rates in return for driving volume toward that particular card program. It happens all the time, Congressman.

Mr. CANNON OF UTAH. Are there any of your thousands of Visa banks, or any of your thousands, Mr. Peirez, of your MasterCard banks, that offers a published interchange rate that is lower than the rate that is set by Visa and MasterCard?

Mr. FLOUM. A published merchant discount rate? I am not aware of any that are lower than interchange. I am aware of many that are very, very close to the interchange rate, such as the NACS, which is interchange plus 6 cents.

Mr. CANNON OF UTAH. Thank you.

Mr. Peirez, could you answer that question also, the prior question that I had asked Mr. Floum?

Mr. PEIREZ. Sure. We would definitely see an improvement in the bill were it to remove the price control setting by the three administrative law lawyers.

But as far as antitrust exemption goes, I will simply quote from the Modernization Commission as to why we would still have a problem with that, which is that, "They should be disfavored, and they should be granted rarely and only where it is necessary to satisfy a specific societal goal that trumps the benefit of a free market to consumers and the U.S. economy in general."

So it is not that you offer an antitrust exemption, according to the Modernization Commission, to deal with an antitrust problem. It is that, in fact, you offer an antitrust exemption in lieu of, and in fact to the detriment of, what the antitrust laws would otherwise enforce. So it is our belief that——

Mr. CANNON OF UTAH. That balancing act would sort of be implemented by a vote of the House and the Senate.

Mr. PEIREZ. Sure, absolutely. And we think that, from our perspective, what that would do is harm competition and harm consumers. Because, whether the prices went up or down as a result of that, when we set our default interchange rates, we do so to maximize the output of our system. We do it to increase the number of merchants that accept our cards. We do it to increase the number of cards that are issued. And we do it to increase consumer usage of our cards. And we think we are doing it incredibly effectively and legally today.

Mr. CANNON OF UTAH. Isn't all of that done within—I am not anti-profit. I love profit. I think you guys should be profitable. But isn't all that done within—the three things you just stated are done in the context of how you optimize your profit. So you say, how do we continue to grow, et cetera, while still making the most profit.

Mr. PEIREZ. Absolutely. And legally.

Mr. CANNON OF UTAH. That is a unilateral decision in a marketplace that has no way to affect that portion of that decision.

Mr. PEIREZ. We make a decision as to a default rate. It is not unilateral, in the sense that there are many, many actors who choose to participate or not participate or to go to Visa or to American Express or to PayPal or to many other payment systems that are available, many new ones that are coming out. So it does not exist in the abstract and standing alone. There are many competitive forces that play into how we set those rates.

Mr. CANNON OF UTAH. Do you have any banks that actually publish an interchange rate that is different from the default rate?

Mr. PEIREZ. I am not aware of any banks that publish any interchange rates. But I am aware of banks that have negotiated interchange rates in connection with cobranded cards, in connection with "on-us" traffic, in connection with many other instances.

I would be happy to sit down with your office and go through many examples that are confidential and I would not want to speak about in depth here.

Mr. CANNON OF UTAH. Let me just ask—before I yield back the vast amount of time remaining, I think that—Mr. Keller, did you want me to yield a couple of minutes to you?

Okay, then I yield back.

Mr. COHEN. Thank you.

Does the lady from Texas seek recognition?

Ms. JACKSON LEE. I do.

Mr. COHEN. You are recognized.

Ms. JACKSON LEE. I thank the gentleman.

And I thank the witnesses.

Let me just focus on two lines of questioning, if I might. Mr. Floum—and I won't—if Mr. Peirez and Mr. Blum want to answer—if you would answer this question: If interchange tithes do not generate profit to the credit card companies, what purpose do they serve?

Consumers are paying for the convenience of many credit cards, with the security protections, et cetera. We understand that. I think I have said that on the record before. Should consumers have to pay extra to pay for a good, functioning credit card or a good usury that a credit card may have? I would just put that on the table.

Mr. Cannon, can you give us a sense of how final-offer arbitration works in the private sector today and how you expect it to work under the context of the new legislation? In light of that system, do you view the legislation as Government price controls?

Let me yield to the three gentlemen who might want to answer about the interchange fees. I think in your testimony you have been representing that they are not profit. Then what are they?

And maybe I have missed it; maybe you have already conceded that you are willing to engage in the kind of marketplace negotiation that would give relief to these retailers.

Mr. FLOUM. Congresswoman, thank you for the question.

We are absolutely willing and eager to negotiate, as I have said before, at any time. My phone line is always open, as are our merchant representatives.

Interchange, again, is not——

Ms. JACKSON LEE. And would that mean that you would bring the interchange fee down if Mr. Robinson asked you, along with a number of others?

Mr. FLOUM. We would certainly negotiate with anyone about driving volume to Visa in return for lower rates, absolutely.

Now, with respect to the interchange question, again, interchange is not revenue to Visa. And we don't set it with the purpose of making profits to Visa. It doesn't come to Visa or Mastercard. It goes to the issuing bank——

Ms. JACKSON LEE. Well, and I think one of the elements is—and I appreciate what you have said, and that is on the record, and we will be posing these serious questions to banks. But allow me to just ask you the question, from your perspective, it is profit, is it not, to the banks? I mean, you can continue to answer, but someone is gaining a profit.

Mr. BLUM. Congresswoman, perhaps as a credit union, I can give you an example in Chartway.

I placed in my testimony that I did 14 million transactions last year, that it is not a windfall; it is not, in fact, a profit. You will see in my written testimony that I named it at 24 cents per transaction.

And that is net of some of my costs that, you know, we didn't include. We didn't include in that net, if you will, return to our shareholders or our members the cost of marketing. We didn't include in that the cost of brand repair when there is a compromise, when our members go out and attempt to use their credit card at a restaurant and it has been closed because there has been a tragic, you know, large data breach, and in order to protect a relatively small financial institution I have had to block a card. My members didn't recall that to be T.J. Maxx or to be B.J.'s. It was, "Chartway's card was closed," or, "Chartway did that," or, "Chartway did this." They expect a card to work when they want to use it, 24/7. Some of those costs associated with that pull into that 24 cents.

More importantly, years ago, those 14 million transactions equate to a little over $500 million that was transacted electronically in 2007 for Chartway. If we take it bank 10 years to when it was a check system, and prior to this larger surge 20 years, Chartway would have enjoyed 2 more days, on average, of those funds to be in our institution, where I could invest them at an overnight rate. The immediacy of that payment system, that interchange recovered for me, if you will, a small, a relatively small portion of what I lost by immediately debiting those funds and moving them out of my——

Ms. JACKSON LEE. And, you know, we have worked with credit unions. Are you suggesting to me that there is no profit that you gain through the interchange fee?

Mr. BLUM. There is an advantage. I mean, as a credit union, I don't use the word "profit." You know, I am able to——

Ms. JACKSON LEE. But it goes back into your shareholders. You must be getting something from——

Mr. BLUM. It certainly goes back in higher dividends and a lower loan rate——

Ms. JACKSON LEE. Right.

Mr. BLUM [continuing]. So there are extended services. So there are advantages.

Ms. JACKSON LEE. Well, would you be willing to sit down and negotiate in the marketplace a response to the interchange fee and lowering it?

Mr. BLUM. In negotiating in the marketplace, as a credit union, again, we are not staffed to be in that position to go out and work what I would perceive to be a rather extensive and ongoing "who are we going to meet with today."

Again, our service focuses on our membership. We need these credit and debit cards in order to compete with larger financial institutions. And I would poll the Committee: How many Committee Members would do business with a financial institution as their primary institution if that institution could not provide them credit or debit card services?

Ms. JACKSON LEE. I appreciate that.

Let me move quickly to Mr. Cannon. And, Mr. Peirez, I am not going to leave you out, and I will let you finish last.

Mr. Cannon, I asked you a question. Do I need to repeat it for you, or are you——

Mr. CANNON. Sure, I guess the question is, as I recall, the benefits of the arbitration, how it would work or how this——

Ms. JACKSON LEE. How it works today and how it will work in——

Mr. CANNON. Sure.

Ms. JACKSON LEE. It has been described as being onerous and burdensome.

Mr. CANNON. Well, I can't fathom that. Mr. Floum talked about negotiation with subpoenas. I don't think we are reading the same bill, because that has nothing to do with it. If, in fact, negotiation is successful, that is the end of it and there is no proceeding. And they understand that.

This whole process is known, as you know, Congresswoman, as baseball arbitration, which just says, the parties, all having negotiated, if they can't come to an agreement, then they just simply each decide a final offer. And then you give this panel, in this particular legislation, the authority to make a decision using a standard as to, essentially, which offer comes closest to a competitive market rate.

That is not very hard to understand. I think it is going to be simple to administer. And I will tell you, the great thing about it, I think it will get the parties together, because they will all understand what will end up being a competitive rate.

Ms. JACKSON LEE. Mr. Peirez?

Mr. PEIREZ. Thank you, Congresswoman. I guess I am going to answer the first question that you had asked about the profit?

Ms. JACKSON LEE. Yes, sir.

Mr. PEIREZ. What I can say is the interchange fees are absolutely revenue to the banks that receive them and the credit unions that receive them. As to whether they are profit, of course, you would have to look at all of their revenues and all of their costs.

If you took just interchange revenue, took all other revenue out, and looked at that relative to the costs of running the card businesses that the banks run, they would not have a profit, they would have a loss, because their costs of running it far exceed the interchange revenue.

And the perfect example of that is the fact that, for American Express to run this system themselves, they charge a higher fee to merchants than our system does, because they use that money to subsidize the running of their card business.

And when merchants run their own card systems, it costs them much more than it costs them to take our cards, which are much more cost-effective for them and consumers than the cards that

they issue directly to consumers, which is why they have ended up using our systems or co-branding their existing cards with our systems or outsourcing the management of their card programs to the banks that run our card systems.

Because, between lending, credit-risk-worthiness determinations, monthly compliance requirements, and statementing and the like, acquiring new accounts, looking at losses, costs of funds and all the other costs that are associated with running a card program, they are far in excess of what is received on interchange revenue.

So, yes, card businesses are profitable, and, yes, interchange fees are a component of the revenues that are added up to make them so, but that profitability is also competed away every day when American consumers receive the vast away of product offerings that they can choose from from a credit union like Mr. Blum's up through the largest banks in the country.

Ms. JACKSON LEE. Well, I would just ask that you submit for the record a total of those fees that you have just represented orally, that I think you indicated that the cost of the card itself, what the card company has to expend, or the bank.

Mr. PEIREZ. We can provide you some averages, and particular banks would have to give you their specific numbers.

Ms. JACKSON LEE. But if you could bring it on the——

Mr. PEIREZ. We can give you what we have.

Ms. JACKSON LEE [continuing]. Card, I would greatly appreciate it.

I do believe, again, to close, that the 671 million cards and $1.7 trillion revenues, whether it is merchants, cards, and/or issuers, which are the banks or credit unions, that we can find some way to resolve what I think has come about because of the status of our economy. We have to find relief. And, frankly, I welcome your discussion on this point.

And I yield back.

Mr. COHEN. Thank you.

The gentleman from the State of Florida and Vanderbilt University?

Mr. KELLER. Thank you very much.

Mr. Floum, I did go to Vanderbilt Law School. I was this close to going to your alma mater, Harvard Law. That is how thick my rejection letter was, if I can recall. [Laughter.]

But I was very happy to stay in Tennessee.

Mr. FLOUM. Isn't Harvard the Vanderbilt of the East?

Mr. KELLER. Something like that.

Let me ask you, Mr. Floum, about market share, because we have heard that. I went and pulled the Forbes magazine and the Nielsen Reports, and it says that the market share, collectively, of Visa and MasterCard is 75 percent, with Visa at 44 percent and MasterCard about 31 percent.

Does that seem right to you?

Mr. FLOUM. If you are just talking about cards, that sounds accurate.

Mr. KELLER. Okay. So we have a market share of 75 percent with you two; also, AmEx, 20 percent, according to them; and Discover, 5 percent.

Visa does set the default interchange rates, is that correct?

Mr. FLOUM. Yes, sir.

Mr. KELLER. What is the single lowest default interchange rate available right now from Visa?

Mr. FLOUM. I believe it is around 1.2 or so. I might be off a little bit, Congressman, but that order of magnitude, in the supermarket sector, would be one of our lowest rate.

Mr. KELLER. Mr. Peirez, what is the single lowest default interchange rate currently set by MasterCard in the supermarket sector?

Mr. PEIREZ. Solely in the supermarket sector?

Mr. KELLER. Yes, sir.

Mr. PEIREZ. It is around that 1.2——

Mr. KELLER. 1.2. Is that a coincidence, that MasterCard and Visa both have 1.2 percent as their single lowest default interchange rates in the supermarket sector?

Mr. PEIREZ. I think it is competition, just like if you go to the corner and there are four gas stations, they are all going to charge the same price for a gallon of regular.

Mr. KELLER. And what if, tomorrow, Visa decides to go to 1.3 percent as their single lowest default interchange rate for supermarkets, what would be the response of MasterCard?

Mr. PEIREZ. We would have to carefully consider whether we had an opportunity to drive more volume by not changing our rates or by lowering them. We would look at it similar to the way we did in the gas cap situation, where we said, you know, there may be an opportunity for us here. We would have to take a look at other competitive factors like what American Express is charging in that segment, whether ACH is gaining traction. There are multiple other factors.

Mr. KELLER. Okay. If that is the case, you look at the competition and you know that Visa is charging a 1.2-percent default interchange rate for the supermarket sector, why don't you lower yours to 1.1 percent to take competitive advantage of the lower rates?

Mr. PEIREZ. Again, where we think we can do that, as we did with the gas cap, we do. We have also recently—when you say the lowest rate, it is going to depend on the transaction size. But for gas, for example, if someone does fill up an SUV, for a $90 tank, that may well be our lowest rate. We have a 75-cent flat-fee rate published, I believe, for——

Mr. KELLER. All right. Let me get to some more things here. I appreciate that. And I will stick with you, Mr. Peirez, because I want to give you a chance to talk about some other stuff. I have been asking Mr. Floum a lot of questions here.

If, over at Rotten Robbie, Mr. Robinson decided to place a sign next to his cash register and says, "If you use cash, we will give you a discount on some of the items here," would he be allowed to do that?

Mr. PEIREZ. Yes.

Mr. KELLER. Would he be able to provide a discount if his customers used a debit card discount over the credit card?

Mr. PEIREZ. Under our current rules, I believe not.

Mr. KELLER. And why is that?

Mr. PEIREZ. Because we do not allow our form of payment to be discriminated versus others in the electronic space. On the cash

side, we have always allowed and continue to allow the discount for cash. But when it comes to between different electronic forms, we do not allow that.

Mr. KELLER. Would he be allowed to put a sign there in front of his cash register that said, "Please use your debit card instead of your credit card"?

Mr. PEIREZ. Yes.

Mr. KELLER. He would.

Mr. Floum, do you concur in that? Would he be able to first have a sign that says he can offer a cash discount?

Mr. FLOUM. Absolutely, Congressman.

Mr. KELLER. Would he be able to have a sign that says he can offer a discount over the credit cards if you use your debit card?

Mr. FLOUM. Yes. Under our rules for pin debit, he could also offer a discounted price.

Mr. KELLER. Okay.

You have said that you don't think that the retailers would pass along their savings if they did get a lower interchange fee. Is that correct?

Mr. FLOUM. That is what the evidence would suggest, yes, sir.

Mr. KELLER. The evidence in Australia, correct?

Mr. FLOUM. Yes, and also in a litigation settlement, interchange rates were lowered, the Wal-Mart settlement, and there was no passing along of those increased retailer profits to consumers.

Mr. KELLER. All right. I would think Wal-Mart would think they offer a pretty good deal. I mean, they are doing pretty well. But we will let them speak for themselves; they are big boys.

Mr. Robinson, you heard that you are not going to pass along any of the savings to your consumers. Let me just ask you point-blank, if you have a favorable result, either through legislation or litigation, where you pay lower interchange fees, are you going to pass along the savings to consumers, or are you going to take all the money and put it in your pocket as additional profits?

Mr. ROBINSON. Petroleum retailing is a fiercely competitive business. Generally when costs go up, generally when costs go up, we increase our prices. And generally when costs go down or benefits increase, we pass those along to the consumer also.

Mr. KELLER. Let me just be crystal-clear. Let's say you are paying 2-percent interchange fees now, and the Conyers bill passes, and you go to the arbitrator, and the arbitrator says, "I agree with 100 percent with Rotten Robbie, and it is going to be 1 percent," will Rotten Robbie customers get a discount when they go to buy donuts or gasoline or Coca-Cola as a result of that taking interchange fees from 2 percent to 1 percent?

Mr. ROBINSON. Well, I don't think the marketplace works exactly like that.

Mr. KELLER. But your whole argument——

Mr. ROBINSON. But, ultimately, ultimately, the answer to your question, the consumer will benefit.

Mr. KELLER. Okay. That is the $64,000 question, because your whole argument is you want lower interchange fees because it is better for consumers. And so that is why I want to give you the chance. He is saying it is not going to benefit consumers. Is it going to benefit consumers or not?

Mr. ROBINSON. There is not a businessman that doesn't attempt to keep the margin. But the competition always drives it back out. And when you have a competitive market—and we definitely have a competitive market, unlike some others—those benefits will go back to the consumer.

Mr. KELLER. All right. My time has expired. Let me just give you one last question. You said over and over you are a businessman and not a lawyer, and I really respect that. But I am going to ask you sort of a legal question here anyway.

And that is, when you look at this lawsuit, one of the big things in bold that you see is "jury trial demanded." And there is a reason for that, as someone who spent many years as a litigator, often on the side of the big companies, in the interest of full disclosure. But the little guy wants to have a jury. Often, the big guys would rather not have a jury; they would rather have a judge or an arbitrator and other folks, so you don't have the possibility of massive, inflated verdicts from emotion and that sort of thing. And there are always exceptions, but that is the general rule.

You are seeking legislation that is going to put you in front an arbitrator that is binding, not a jury. And, in fact, if you say you want a 1-percent fee and Mr. Floum's Visa client says, no, we want 5 percent, you are taking a real risk that this binding arbitrator may go with his side.

Are you comfortable taking that gamble and putting yourself in that forum, as opposed to the jury trial situation?

Mr. ROBINSON. The short answer is yes.

As we looked at the problem in trying to do something about the anti-competitive behavior of Visa and MasterCard, we looked at the various options. We looked at the option of breaking it up like AT&T. We looked at it dealing with it like a utility. And we felt that this was a competitive marketplace solution that, quite frankly, we might not do better with.

I have a hard time believing that we will not.

Mr. KELLER. But the gist of it is you are willing to take that gamble?

Mr. ROBINSON. Yes.

Mr. KELLER. Okay.

Issues have been raised about whether or not you have bargaining power. Have you ever worked with a merchant bank that was willing to negotiate a lower interchange fee rate?

Mr. ROBINSON. No.

Mr. KELLER. Have you ever attempted to negotiate a lower interchange fee rate with a merchant bank?

Mr. ROBINSON. We don't even know who to talk to. So, no, to answer your question, no.

Mr. KELLER. Well, your own bank you can talk to, right? I mean, the acquiring bank you can talk to?

Mr. ROBINSON. Yes. And we negotiate—the acquiring bank, we negotiate processing. And it is interesting, on the processing side, that is fiercely competitive. I mean, it is amazing how aggressive the processing banks. So you have a processing rate—and they have negotiated a processing fee, and that has come down because of competition.

Mr. KELLER. So you are able to negotiate with the banks, in terms of the acquiring bank, lower processing fees. But you are not sure who to talk to in terms of the issuing bank, negotiating lower interchange fees. Is that a fair summary?

Mr. ROBINSON. Yes. We do not negotiate interchange fees.

Mr. KELLER. Have you ever tried to negotiate with Visa or MasterCard, in terms of getting them to set lower interchange fees?

Mr. ROBINSON. It is not—I mean, it is not an option.

Mr. KELLER. You are sitting right next to two pretty big players, and they said they are going to talk to you. Do you feel any optimism? Are you going to try?

Mr. ROBINSON. I can't wait for this hearing to be over, to do that.

Mr. KELLER. Okay. You have heard the criticism from MasterCard and Visa saying that this is price control, because you are having the three-judge panel set the rate. Some folks think it is only price control if you are having the Government, itself, or bureaucrats set the rate or Congress. But they would dispute that. But others may think that you are living under a price-control system now, since you have these two companies with a 75-percent market share, and they are telling you, here is the default interchange rate that they are giving to the banks, and take it or leave it.

Do you feel that you have a price-control situation now? And if you feel that it is not price controls under the new scheme, tell me why.

Mr. ROBINSON. I would basically call the existing system a price-fixing system, not necessarily a price control. But the result is effectively the same. So that is the existing situation.

And I think that when you set up an opportunity to provide for the parties to negotiate and yet you have something that holds their feet to the fire, that at some point in time they can't just stonewall the negotiation process, I consider that a competitive system.

Mr. KELLER. Mr. Floum, let me go back with the bargaining power and negotiation issue. You have heard, essentially, that the little guys can negotiate with the acquiring banks to get lower processing fees, at least in the mind of Mr. Robinson. Do you think that is a true statement, they do have the power to at least negotiate with the acquiring banks?

Mr. FLOUM. Absolutely. And I believe they are charged a single fee for acceptance. The processing fee is a component of that. But, yes, absolutely, they can bargain with their acquirer.

Mr. KELLER. My next question is, I come into Rotten Robbie and I use my credit card, which I think is the local credit union here in the building. Does he have the ability to negotiate a lower fee with my credit union, the so-called issuing bank?

Mr. FLOUM. He does. And his group, the National Association of Convenience Stores, I would think, would have quite a lot to say about driving volume to either Visa or one of our competitors. That is competition in return for favorable terms. So I am very happy right after this to sit down with Mr. Robinson and we can talk about.

Mr. KELLER. So you are saying, not only can he negotiate with the acquiring bank, he can also, through some sort of organization like the convenience stores trade group, negotiate with a variety of issuing banks as well as MasterCard or at least Visa?

Mr. FLOUM. Yes, sir. And, again, it is a very competitive environment, and we would be looking for something that would drive volume in return for lower rates.

Mr. KELLER. Let me just—my time has expired, and I think I am the last person now, so let me just do a short question to you, Mr. Robinson.

What percentage of your customers at Rotten Robbie use credit cards, would you estimate?

Mr. ROBINSON. Right now, cash represents, total company, just a little over 25 percent. We have some locations where we are almost 90 percent plastic.

Mr. KELLER. Okay. Well, in those locations where you are 90 percent plastic, I understand you are upset about the interchange fees that you are paying to the credit cards. Why don't you just put a sign up and say, hey, if you use your debit card, I would appreciate it or may even give you a discount, since that apparently is at least allowed with Visa?

Mr. ROBINSON. Basically doing some sort of a cash discount type of a——

Mr. KELLER. Or debit card. Why don't you just tell them, hey, you know—when they hand you a card that can be used debit or credit, why don't you just tell them, can you use this as your debit instead?

Mr. ROBINSON. There is a number of considerations.

Number one, the rules that Visa and MasterCard have make it more challenging to be able to do that. You do run into some issues relative to the State weights and measures. A challenge that you run into—I mean, we would prefer to say yes to our customer, not no. And trying to do something where you have different pricing is confusing to the customer.

It is very interesting, if you are a credit card user, oftentimes you will not perceive that as a discount for cash; you will consider it a charge for credit.

Mr. KELLER. Right, but you are listening to what these smart guys are saying, and they are saying, hey, if you don't like the credit card fees, just tell them to use the debit card, because that is still a pretty good deal. And it seems common-sense to me.

If I were you, I would probably be saying, well, I can't do that with everybody because, for a debit card, you have to have money in the bank and, credit card, you don't need the money in the bank. So it is not a perfect solution.

But I just wanted to give you the chance to respond to that, because that is what you are hearing.

Let me go on and ask you this: If you decided today that, "I am mad as heck, and I am not going to take it anymore, and I am not accepting MasterCard and Visa at Rotten Robbies," what would happen to your business model?

Mr. ROBINSON. Oh, I don't think that is an option. I mean, when you are dealing with whichever number that I said, whether it be

60 percent, 80 percent, 90 percent, and you have that much business in plastic, you not accepting it just really doesn't work.

Can I just answer or make a——

Mr. KELLER. Yes, but you are saying you would go out of business if you stopped taking MasterCard and Visa?

Mr. ROBINSON. Well, probably.

Mr. KELLER. Okay. Yes, go ahead.

Mr. ROBINSON. One of my options is to push the debit side. What is very interesting is, if you look at all the advertisement, you know, for pin debit versus signature debit, if you come in with your debit card and you don't use the pin, you don't use the thing that makes the card more secure, that product doesn't go through the debit card network; that goes through the credit card network. I am charged credit card rates if you use your debit card.

Mr. KELLER. All right.

Mr. ROBINSON. So one of the things that gets a little bit challenging is, if you want to have a discount for debit, it really depends on how it is used.

Mr. KELLER. Thank you.

I have been told to wrap up. Just, in fairness, Mr. Floum, on this whole debit card issue, do you have anything that you want to respond to about encouraging folks to use debit if you are worried about the high interchange fees for credit card?

And that will be my final question. I will let you respond.

Mr. FLOUM. Thank you, Congressman.

Just to clear up any confusion, discounting is permissible. It doesn't require to label separately every item in the store, as we have heard from merchants. So that would certainly be a solution for retailers that want to try to drive their costs down by steering—it is permissible, under our rules—to different forms of payment.

Mr. KELLER. Thank you.

And I thank you, Mr. Chairman, for your indulgence. I will yield back.

And I just want to thank the witnesses so much for being here and being patient. We appreciate you doing that.

Mr. COHEN. Thank you, Mr. Keller.

I just had one question. Is there a Visa Triple Crown this year?

Mr. FLOUM. I don't think that we still sponsor the Triple Crown.

Mr. COHEN. The interchange fees weren't high enough to be able to afford it? [Laughter.]

Mr. FLOUM. I am not going to respond to that. [Laughter.]

Mr. COHEN. I didn't know if Big Brown was going to have to pay part of his winnings out of that or not.

Thank you. I would like to thank our witnesses for their testimony.

Without objection, Members will have 5 legislative days to submit any additional questions. And we would ask that you answer those questions as promptly as you can, which we will forward on to you, and they will be made part of the record.

Without objection, the record will remain open for 5 legislative days for the submission of any other additional materials.

The hearing is adjourned.

[Whereupon, at 2:34 p.m., the Task Force was adjourned.]

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