

**STATEMENT OF MALLORY DUNCAN**

**ON BEHALF OF**

**THE NATIONAL RETAIL FEDERATION**

**BEFORE THE**

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

**HEARING ON**

**CREDIT CARD INTERCHANGE RATES**

**JULY 19, 2007**

Chairman Conyers and Members of the Task Force, I am honored to appear before you today. My name is Mallory Duncan and I am Senior Vice President and General Counsel of the National Retail Federation (NRF). The National Retail Federation is the world's largest retail trade association, with membership that comprises all retail formats and channels of distribution including department, specialty, discount, catalog, Internet, independent stores, chain restaurants, drug stores and grocery stores as well as the industry's key trading partners of retail goods and services. NRF represents an industry with more than 1.6 million U.S. retail establishments, more than 24 million employees - about one in five American workers - and 2006 sales of \$4.7 trillion. As the industry umbrella group, NRF also represents more than 100 state, national and international retail associations.

NRF is also a member of the Merchants Payments Coalition (the MPC). The MPC is a group of 22 national and more than 70 state trade associations 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 is fighting for 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. These merchant associations account for more than 60 percent of the non-automotive card based transaction volume in the United States. NRF and the MPC are very pleased that the Task Force is holding this hearing to explore one of the most significant issues ever to face the merchant community.

The collective setting of interchange fees by Visa and MasterCard represents an on-going antitrust violation and it costs merchants and their customers—that is, America's consumers—tens of billions of dollars annually. These fees, hidden from consumers, are in addition to the late fees, over-the-limit fees, and other card fees with which consumers are only too familiar. This Task Force has an important perspective on this issue. The problems with interchange fees stem from basic antitrust law and competition policy issues with which this Committee is familiar. We hope that this hearing will be the first step in a thorough exploration of these issues by the Task Force.

I would like to do a couple of things in my testimony today. First, I will describe interchange fees and some of the major problems with them. Second, I will discuss the antitrust law violations raised by the Visa and MasterCard interchange fee system. My comments will reflect the mission of the Merchants Payments Coalition, which is to bring about a more competitive and transparent card system that benefits all of us. We look forward to working with the Task Force to help achieve this objective.

## I. WHAT ARE INTERCHANGE FEES AND HOW DO THEY HARM CONSUMERS, MERCHANTS AND THE U.S. ECONOMY?

Interchange fees are collectively set by Visa and MasterCard member banks. And each of those supposedly competing banks charges those same rates.

When a consumer buys an item with a Visa or MasterCard credit or debit card, the merchant does not receive full face value from the bank to which it submits the charge. The difference between the face value of the customer's purchase and the amount the merchant actually receives is called the "merchant discount," the vast majority of which is the interchange that is paid by the merchant to the bank that issued the customer's card. The average consumer has no idea that this fee is imposed every time he or she makes purchases with a Visa or MasterCard. In this way, interchange acts as a hidden sales tax on U.S. commerce, raising both merchant costs and ultimately the price of goods and services sold to consumers.

All of the incentives for the banks agreeing on the interchange fee are geared toward raising the fee higher and higher. The higher the fee, the more money card-issuing banks make. And banks that have merchant accounts and receive the transaction from the merchants (known as acquiring banks) do not lose a cent because they all charge the merchant for the entire cost of the interchange fee. These fees are so high that merchants simply cannot absorb the costs. They must pass along much of these fees to consumers.

Visa and MasterCard are able to get away with this, however, because they have market power – both individually and jointly according to the courts. By a very conservative estimate, Visa and MasterCard together control more than eighty percent of the credit card market. The vast majority of merchants therefore have no choice but to accept their cards. In fact, a recent study by the Kansas City Federal Reserve Bank concludes that merchants realistically cannot refuse to accept Visa and MasterCard payment cards, regardless of interchange fee costs.

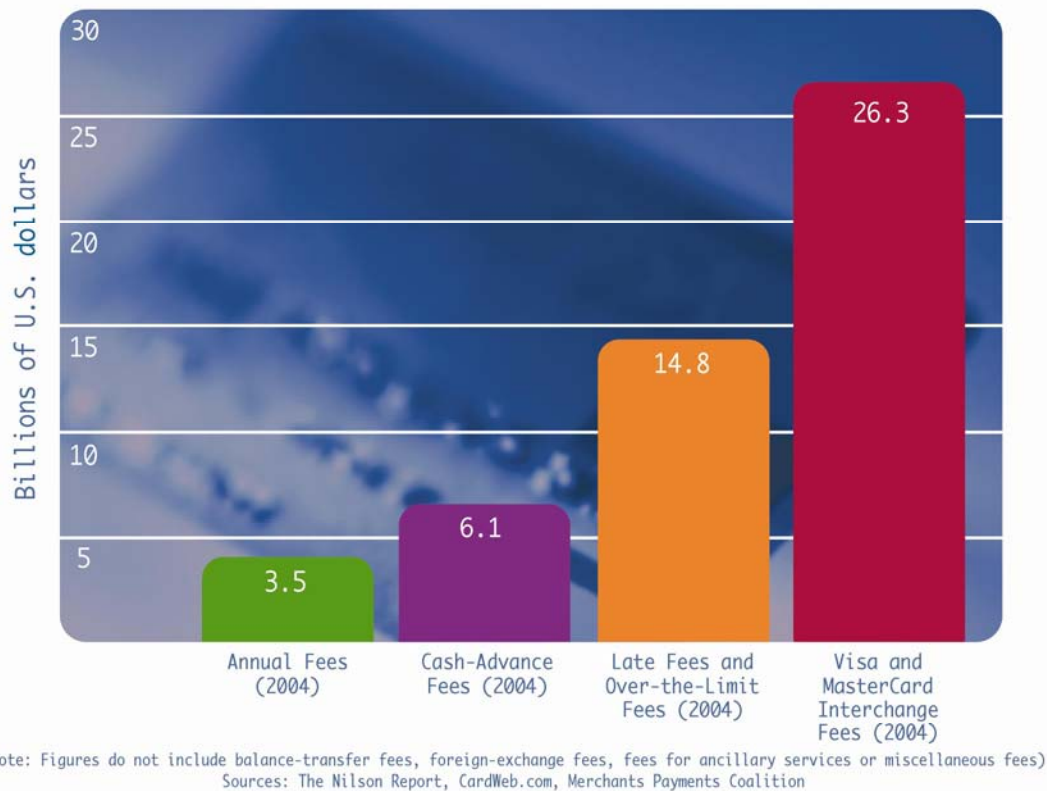
The result is that interchange fees continue to increase. Consequently, the perverse effects of the current interchange fee system are growing, and are of growing concern, because electronic payments, especially card payments, are an increasing percentage of consumer transactions, replacing checks and cash. In 2003, in fact, the number of electronic payments exceeded the number of check payments for the first time in U. S. history. This event is significant, because checks are cleared at "par" (paid by banks at their face value) and the cost of the checking system is borne by the banking system, with Federal Reserve pricing rules limiting check clearing costs to the cost of processing checks. On the other hand, because card-based payments are credited to a merchant's account only at a discount, merchants, and ultimately consumers, not only must pay for costs of the card transaction processing system—but also make a significant contribution to the cost of marketing and issuing cards, themselves. Indeed, the funds Visa and MasterCard banks collect through these fees goes toward marketing efforts such as the more than 6 billion credit card solicitations sent to consumers in 2005.

Because these collectively-set interchange fees are passed on to merchants by banks that process the merchants' card transactions, the merchants inevitably must take this cost into account when

pricing the goods or services they sell. As a result, even consumers who pay by cash or check subsidize card-issuing banks' marketing efforts.

The result is an inflationary sales tax on all Americans. Individual consumers and consumer advocates have raised issues for years regarding unfair consumer practices by the card companies. But a primary source of funding of the marketing that lures consumers into these problematic situations is the interchange fee. These fees dwarf the more visible card fees, as set out in Figure 1. Cure the problems associated with the vastly inflated interchange fees and the volume of abusive marketing by card companies will be reduced.

**Figure 1**  
**Total Card Fees By Type (2004)**



Tellingly, in other nations that have put an end to this price-fixing scheme by Visa and MasterCard, merchants and consumers have benefited. These fees should be lower in the United States than in other countries because we have the largest transaction volume (which should create economies of scale) and we have the best technology and very low fraud rates. Unfortunately, however, U.S. merchants and consumers are being fleeced.

These huge fees are even more pernicious because they are hidden. The card associations make every effort to ensure that card holders remain unaware of the interchange fee costs their usage of cards imposes. First, card association rules require merchants to advertise the price that a card user would pay as the primary advertised price. Second, card association rules prevent merchants from using different prices to reflect the different levels of interchange fees associated with different types or brands of payment cards.

Indeed, the Federal Reserve Board informed Congress in a 2004 report on disclosure of fees for the use of debit cards, “Because these interchange fees are generally unknown to consumers, most people still remain unaware of the effects of their choices on merchants’ costs or card issuers’ revenues.” Visa’s and MasterCard’s rules governing the interchange fee system then distorts consumer choices by depriving consumers of the price cues they need to put a market-based check on the size of the fees. Consumers then assume that using a card is free (or even a benefit because they get some type of “reward”) even though it makes all of us pay more for virtually everything we buy.

Those rewards are a key part of the problem and it bears noting that the rewards consumers receive are worth far less than the interchange fees they pay. The result is that these fees impose a large but hidden burden on merchants and all of their customers.

In sum, the combination of interchange fees and card system rules limiting hiding the fees and limiting retailers’ ability to deal with them distorts the price signals regarding the use of cards and thus the nature of competition between payment systems. The higher cost to merchants for customer use of payment cards flows through into higher prices for all consumers – whether they use cards or not.

## II. PRICE-FIXING BY CARD ASSOCIATION MEMBERS (OR THEIR AGENTS) IS UNLAWFUL.

Visa and MasterCard both were formed as consortiums of competitors. Those competitors, banks, compete to get consumers to sign-up for and use their cards. Visa and MasterCard, then, are cartels whose members set the fees they will charge and all agree to charge the same fees.

This price-fixing by cartels is illegal and has long been a central element of the antitrust prohibitions of the Sherman Act. The recent initial public offering by MasterCard does not change the essential nature of the price-fixing arrangement. MasterCard still engages in price-fixing on behalf of its members. While MasterCard itself is now a separate entity and not simply an association of banks, competing banks cannot escape liability by simply allowing a third party to fix prices on their behalf.

That is just what happens now. MasterCard member banks agreed as part of the IPO that the interchange fee system would continue to operate in the same way – with MasterCard setting the fees and all member banks charging the same rates. The price-fixing agreement, then, is largely unchanged and member banks have collectively kept a significant ownership interest in MasterCard. Member banks also appoint members to the board and they remain MasterCard’s only customers.

As MasterCard put it, “We are, and will continue to be, significantly dependent on our relationships with our issuers and acquirers [member banks]....” MasterCard has proven this to be true in its actions. It continues to fix interchange rates and its member banks continue to agree to charge those same fixed rates. With the price-fixing unabated since the IPO, MasterCard’s interchange rates have continued to rise.

While Visa and MasterCard sometimes argue that their behavior is not illegal price-fixing because they are joint ventures, those arguments do not apply to the system they have created. Much greater detail regarding the reasons that this argument falls flat could be advanced in legal briefs, but from my perspective the key is this -- interchange fees are not fees charged by a joint venture for products or services sold by the joint venture. Rather, they are fees that association members have agreed that they each will charge as card issuers to the banks that process merchant transactions and that those banks will in turn pass on to merchants. Thus, reliance on precedents applicable to the setting of a joint venture’s own prices is irrelevant to an analysis of interchange fees.

Indeed, in recent years, a number of other countries have found interchange fees to be antitrust violations. These findings of illegality include:

- Australia, 2000 (by the Australian Competition and Consumer Commission);
- European Commission, 2002 (cross-border transaction by Visa);
- Spain, April 2005 (interchange fees of major card associations) Competition Court of Spain;
- European Commission, June 23, 2006 (Statement of Objections to MasterCard based on the preliminary view that its credit and debit card interchange fee mechanisms are unlawful); and
- Poland, January 2007 (ordering abolition of Visa and MasterCard interchange fees).

Antitrust authorities in the U.S., however, have not yet taken action against the collective setting of interchange fees. While this may be based in part on the existence of the Eleventh Circuit’s 1986 decision in the NaBANCO case, that case is no longer supportable.

The NaBANCO decision was based on a very different payment cards market. More than twenty years ago, Visa and MasterCard did not have the stranglehold on the payments market that they have today. The decision that Visa did not have market power has since been decided differently by Second Circuit Court of Appeals and the idea that centrally fixed interchange was necessary to get the fledgling system off the ground is clearly outdated.

Over time, some of the rules that Visa and MasterCard have claimed were essential to their systems (such as denying banks the ability to issue Discover and American Express cards and tying the acceptance of debit cards to the acceptance of credit cards) have fallen by the wayside after antitrust challenges. These cases have gradually shown a variety of problems with the structure of Visa and MasterCard’s systems.

Other nations that have examined interchange have found decided problems with Visa and MasterCard’s attempts to justify the legal and economic basis for the size of their interchange

fees. In fact, the European Commission's Directorates for Competition and Financial Services jointly conduct a comprehensive study into the European payment card industry in general, and Visa and MasterCard in particular. The final report of this study was released in January. The Commission found no evidence to support the card systems' arguments in favor of benefits to consumers of the high fee levels associated with the existing interchange fee mechanism. In particular, the Commission rejected arguments that lower interchange fees to merchants would result in higher fees to consumers:

There is no economic evidence for such a claim. Firstly, the inquiry's data suggests that in most cases card issuers would remain profitable with very low levels of interchange fees or even without any interchange fees at all. Secondly, the international card networks have failed to substantiate the argument that lower interchange fee would have to be compensated with higher cardholder fees. The evidence gathered during the inquiry rather suggests that the pass-through of higher interchange fees to lower cardholder fees is small. Consumers already pay the cost of the interchange fee without knowing it. This cost is now hidden in the final retail price and is therefore non-transparent.

Similarly, the Australian experience has refuted claims that decreases in interchange fees would undercut the viability of card systems. In fact, after several years' experience with reduced interchange fees, the Australian central bank has concluded that card issues have responded to lower merchant fees by offering consumers a choice: Low cost cards with low interest rates and fees and no rewards, and rewards cards with higher interest rates and annual fees.

Indeed, this resulting *price competition* is precisely the outcome the card systems feared: For example MasterCard had complained to the Australian Reserve Bank about having its members forced to compete on price:

“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.”

Thus, the evidence is clearly mounting that the theoretical arguments in favor of any use of interchange fees as a subsidy for card-issuers' costs are factually unsupportable, and cannot serve as a justification for cartel price fixing.

### III. CONCLUSION: CONGRESS SHOULD ACT

In my view, this hearing is not yet about solutions. It is the first opportunity for the Task Force to explore the issue. Visa and MasterCard consistently want to skip over anyone analyzing the actual problem and simply want to criticize potential solutions or regulatory schemes in other parts of the world. This is a convenient way for Visa and MasterCard to continue to keep their illegal behavior out of the spotlight and, they hope, cut-off discussion before Congress learns too much about what they have been doing.

Suffice it to say that there are a broad range of legislative solutions – both within and outside this Committee’s jurisdiction – that could improve on the current system. The antitrust problems and lack of a competitive interchange fee market cry out for solutions and there are many that do not constitute the government price control bogeyman that the credit card companies claim we want.

Simply the act of holding this hearing and investigating the problem are large steps forward in the effort to inform people about these practices and find the right solution. We sincerely appreciate the Task Force’s interest and stand willing and able to work with all of you on this important public policy issue.