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August 28, 2006

VIA E-MAIL

Senator Arlen Specter
Chairman
U.S. Senate Committee on the Judiciary
224 Dirksen Senate Office Building
Washington, DC 20510

Re: Questions from July 19, 2006 Hearing

Dear Senator Specter:

Thank you for the opportunity to address the Judiciary Committee on the issue of credit and debit card interchange fees. I very much appreciated the discussion and the thoughtful remarks from you and your colleagues. I have enclosed with this letter my answers to the questions that I received as a follow-up to the hearing.

If there is ever any additional information that I can provide on this – or any other – matter, please do not hesitate to let me know.

Respectfully,

Bill Douglass

Enclosure

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Question from Senator DeWine: *There are still stores that do not take credit cards, and some accept only Discover, American Express, or some other card, including their own cards – and don't accept Visa or MasterCard. If Visa and MasterCard charge interchange fees that you think are too high, why can't you switch to accepting only other cards?*

Answer: The merchants that do not accept Visa and MasterCard are few and far between. The courts have found that Visa and MasterCard have market power and I can tell you from experience that they do. Merchant acceptance of Visa/MasterCard is [well over 90 percent]. If I don't accept their cards I will lose business. The number of consumers who use Discover and American Express are tiny compared to Visa and MasterCard. With nearly 80 percent of the market, Visa and MasterCard are just too dominant for me to stop taking their cards.

Question from Senator DeWine: *We have heard from merchants, including some of the witnesses for this hearing, that Visa's and MasterCard's interchange fees are above competitive levels. But, at the same time, we have heard that the number of stores that are choosing to accept Visa or MasterCard is increasing. How do you reconcile these facts?*

Answer: Merchants have no choice but to accept Visa and MasterCard. Because of the market power of those two card associations, merchant acceptance of their products will continue to increase. Unfortunately, in the broken market of interchange fees, these associations only compete in one way – to raise their interchange fees in order to attract banks to issue more of their cards. This is directly the opposite of the competitive dynamics in healthy markets and consumers are unaware of the inflationary pressure this puts on the price of everything they buy. The antitrust and other fundamental problems with this system have made it such that there is no competition. This market must be fixed so that it can function properly.

Question from Chairman Specter: *In your written testimony, you state that "member banks must agree to charge the same interchange rates." What is your basis for this statement? Do you believe it would make a difference if Visa and MasterCard member banks could charge different rates? If not, how else would you suggest injecting competition into the market?*

Answer: There are several sources for this statement, but perhaps the most emphatic statement on this point was made by Tim Muris when he testified on behalf of the Electronic Payments Coalition before the Commerce, Trade and Consumer Protection Subcommittee of the House Energy and Commerce Committee on February 14, 2006. Both Visa and MasterCard are members of the Electronic Payments Coalition. In both his written and oral testimony at that hearing, Mr. Muris stated not only that Visa and MasterCard fix the interchange fee to be charged by all member banks, but that a centrally set fee was "essential" to the operation of the system. Without it, he argued that the entire system would be at risk because certain issuers may "hold-up" the system by demanding higher fees. Mr. Muris noted that Visa first adopted a fixed fee in 1970. He did not state when MasterCard first used a fixed fee.

While Mr. Muris argues that a fixed fee is essential, it is not clear that is the case and even he notes that reasonableness can never be a defense to price-fixing. It is clear that this price-fixing needs to stop. It is less clear how to rework the current system to inject competition into it. Part of the problem currently is that a competitive system cannot exist without information. Visa and MasterCard keep their rules and the full schedule of their rates secret and that makes it difficult for merchants and consumers to act in ways that might bring about some form of price competition. While we need to know more of the facts about the system to come to the right solution – and Visa and MasterCard's agreement to provide the Committee with their full operating rules may aid this process – making more information available is one place to start.

<u>Question from Chairman Specter</u>: *MasterCard has argued that its IPO eliminated the antitrust problems that you testified to by prohibiting its member banks from owning <u>voting</u> stock. Can you explain why you disagree in more detail?*

Answer: The bank members of MasterCard retain effective control of the organization in spite of the IPO. The new class of stock issued to member banks allows those member banks to exercise veto power over major business decisions of MasterCard. In addition, the limitations on a purchaser's ownership interest in MasterCard stock will keep any new investor from being able to control the direction of the organization. These and other provisions of the IPO along with the current forces pushing interchange fees higher will mean that member banks will continue to exercise effective control of the organization. The bottom line is that the IPO does not in any way solve the antitrust problems with interchange fees.

<u>Question from Chairman Specter</u>: *You testified that you would not surcharge your customers, but do you agree with Visa and MasterCard's restrictive rules regarding merchant pricing? Do you think those should change?*

Answer: While my experience is that surcharging probably would not be an effective strategy for my particular business, I do not think that Visa and MasterCard should dictate the way that merchants price their goods and services. Cash discounts and surcharges may be an effective way for some merchants to let their customers know the costs that are associated with card acceptance. If that works for some businesses, then they ought to be able to do it. The Visa/MasterCard rules restricting this kind of pricing information from being part of the consideration for purchasers is wrong and is part of the reason why this is a broken market. These restrictions certainly should not exist.

<u>Question from Senator Grassley</u>: *Many retailers have complained about a lack of transparency in many aspects of the credit card interchange fee operation. Among other things, you have alleged that the Visa and MasterCard interchange rules are hidden – that is, only synopses are made available to the merchants, the appropriate federal regulatory agency, and the public. What do you think of the credit card companies' original proposal to make available copies of the rules only to those who agree not to discuss them?*

Answer: This proposal by Visa is not a serious attempt to address retailers' concerns. Requiring me to sign a non-disclosure agreement (or gag order) if I view the rules will not allow me to make a realistic assessment of my rights and where I stand. Typically, I rely on my trade association, the National Association of Convenience Stores (NACS), to help me work through these types of situations. Trade associations may send out summaries or advisories or have meetings on the subject that allow retailers to ask questions. None of this will be possible if Visa's gag order is in place. In fact, and perhaps this is the point, if I were to sign such a gag order then I would not be able to discuss the rules with this Committee or my Representatives in Congress. That clearly is not in the public interest.

Question from Senator Grassley: *Why can't gasoline distributors advertise at service stations both the price a customer would pay if using a credit card and the price a customer would pay if using cash? Do the interchange fee rules prohibit advertising both cash and credit card prices to consumers? Do any other rules or statutes prohibit you from advertising both prices? I would think that with gasoline prices at record highs, customers would welcome any savings they could get when they buy gas at the pump.*

Answer: There are several problems that Visa and MasterCard impose with respect to advertising prices. Most importantly, they require that merchants most prominently advertise the full, credit card price for their products. The effect of this rule in my industry is dramatic. Consumers driving by a motor fuel outlet have a limited time to observe the prices. Even if I post a smaller sign indicating the cash discount price, many will not see it and will not realize the potential savings that I am offering. This rule serves to both hide credit card costs within the price of the product and hamper any attempts to discount for cash. In addition to that, banks have instructed merchants that if they want to discount for cash they need to separately post the cash price for each product as opposed to, for example, posting a sign at the register or on the pump stating that all products receive a certain percentage or dollar discount for the use of cash. This requirement can impose large administrative costs on merchants who want to discount for cash. Posting two sets of prices – cash and credit – for three grades of gasoline is one thing, but doing that for every item inside the store is just too difficult to work. I would also note that while Mr. Peirez said during the hearing that the operating rules did not impose this requirement, at least some Visa and MasterCard member banks believe otherwise and have imposed this requirement on merchants. Situations like this are another reason why merchants need the rules and need to be able to discuss them to protect the full extent of their ability to run their business.

The interaction of Visa's and MasterCard's rules with state pricing laws can also be problematic for merchants. Some states require pricing on individual items so that every item on a shelf would need both the credit card price and the cash price. Posting two prices on the shelf would be very, very difficult for many retailers, but putting two prices on every individual item would be even more burdensome. In sum, the Visa and MasterCard rules that require posting the card price most prominently causes multiple difficulties and makes the merchant's legal right to discount for cash ineffective for most retailers.