"Credit Card Interchange Fees: Antitrust Concerns?"
Hearing Before the Senate Judiciary Committee

SENATOR SPECTER

1. Do you think that the management changes adopted by MasterCard and Visa change the antitrust analysis with respect to interchange fees?

I do not believe that Visa and MasterCard's previous approach to interchange violates the antitrust laws. The changes that the companies have made to their respective corporate form and governance structures, however, do change the analysis. The financial institutions that participate in the Visa and MasterCard networks no longer play a formal role in the setting of interchange rates. Those rates should not, therefore, be seen as the product of agreements among horizontal competitors.

2. The European Commission recently found that the mechanism by which interchange fees are set raises concerns under European competition law. In your opinion, why does this mechanism raise concerns under European law, but not under the U.S. antitrust laws?

The Competition Directorate of the European Commission has undertaken an Article 17 sector inquiry of the retail banking industry, including payment cards. It is important to understand that findings made under Article 17 are only preliminary and do not constitute an infringement decision under Articles 81 and 82. No sanctions may be applied following such an Article 17 inquiry. If the EC is of the view that matters investigated may involve issues under Article 81 and/or Article 82, the EC must initiate a formal proceeding under Article 81 and/or Article 82 and follow the due process established under EC law for infringement proceedings.

The EC has been investigating the payment business for some time, and its most recent public pronouncement did address interchange fees. The EC's primary concerns, however, do not seem to be related to antitrust law or competition policy, at least as we typically understand them in the United States. The EC currently has embarked on an effort to create a single market for various products and services across the various countries of the European Union. In analyzing interchange rates and what merchants pay to accept electronic payment, the EC has observed that rates vary across the member states, and it is considering regulating rates on a community wide basis as a way of forging a single market for electronic payments. Regulated rates, of course, can be expected to have the same effect in Europe that they have had in Australia—namely higher prices for cardholders.

SENATOR DURBIN

1. When you appeared at a hearing on February 15, 2006, before the House Energy and Commerce Committee's Subcommittee on Commerce, Trade, and Consumer Protection, Representative Jan Schakowsky of Illinois asked you whether the operating rules of Visa and MasterCard were publicly available. On at least four different occasions during Representative Schakowsky's question period, she asked you, on behalf of the Electronic Payments Coalition, to provide the Committee with a full copy of the operating rules. At one point in that exchange, you said that those rules were already available on Visa's and MasterCard's websites. Then, you said that you would "go back and ask" Visa and MasterCard to provide rules. Did you ever provide the House Subcommittee with copies of the rules? If so, please explain when you delivered them, and under what conditions. If not, please explain your reasons.

The question of transparency arose several times at the House Energy and Commerce Committee hearing. Representative Schakowsky asked whether I could help the Committee and Mr. Armour get copies of the Operating Regulations of Visa and MasterCard. I indicated in response to her question and a similar question from Representative Stearns that I could not speak for Visa and MasterCard on that question, but that I would raise the issue with them. *The Law and Economics of Interchange Fees: Hearing Before the Subcomm. on Commerce, Trade, and Consumer Protection of the H. Comm. on Energy and Commerce*, 109th Cong. 66, 88 (2006).

Following the hearing, I spoke with representatives of MasterCard, and was told that MasterCard posts its Merchant Rules on its website. I understand that MasterCard produced a copy of the document on its website to Representative Schakowsky. I also spoke with representatives of Visa, and learned that Visa posts a guide on its website for merchants that accept Visa cards, which Visa provided to the Committee following the hearing.

Since the hearing, Visa has taken additional steps regarding the general distribution of its Operating Regulations. Historically, Visa has not made them available to anyone but the banks that belong to the association. As Josh Floum, Visa's General Counsel, explained at the Hearing before the Senate Judiciary Committee, the Operating Regulations will be available, subject to certain conditions, to any merchant currently accepting Visa cards that would like to see them.

2. Does Visa or MasterCard require a non-disclosure agreement before anyone is allowed to see these operating rules?

As Visa explained at the Hearing before the Committee, the Operating Regulations will be available, subject to certain conditions, to any merchant currently accepting Visa cards that would like to see them. I understand that MasterCard has posted its Merchant Rules on its website. Visa and MasterCard would be able to offer more specifics regarding disclosure of their rules and regulations.

3. Is it true that card associations' operating rules prohibit a merchant from charging a customer more if they use a credit card instead of cash, but the rules allow merchants to offer a cash discount? If so, what is the rationale for this rule? If a taxpayer files his annual return online and uses a credit card to pay taxes to the IRS, there is a "convenience fee" added to the amount of taxes owed. The same type of fee is added for paying real estate and car taxes online to a local or state government agency. Do the operating rules allow for such additional fee to be charged? If so, why is there a difference in the way your rules treat government versus commercial merchants?

I understand that the four primary payment card networks—American Express, Discover, MasterCard, and Visa—all have different policies with regard to surcharges and convenience fees. I have not studied all of the nuances regarding these policies. I do note, however, that a number of States have laws prohibiting merchants from imposing surcharges on payment card transactions.

With regard to the practice of prohibiting traditional retail merchants from levying a surcharge on a consumer's choice of a particular payment form, the practice makes economic sense for the payment network. Individual merchants act as distributors of the payment systems that they accept. In that role, merchants have an incentive to use the availability of, for example, American Express, to attract customers into their store and then use surcharges to encourage customers to use other forms of payment. Payment networks have good reason to attempt to prevent merchants from doing just that.

4. How much does each interchange transaction actually cost Visa and MasterCard to process? Does Visa and MasterCard make this information publicly available?

I do not know how much it costs Visa or MasterCard to process a particular transaction, and I do not know whether the organizations make this information available. As I explained in my testimony, however, these two companies do not earn revenue directly from interchange. Acquiring banks pay interchange fees to issuing banks on transactions exchanged on a four-party payment system. Visa and MasterCard earn their revenue from processing fees and licensing fees that they charge to the banks that participate in their systems. MasterCard is now a public company, and its financial statements are available through its website. Visa, although not a public company, also posts its annual report, including audited financial statements, on its website.

5. Do you think a cartel can escape antitrust liability by agreeing to appoint a third party to set actual price levels for the cartel?

Legitimate joint ventures are not cartels. As the Supreme Court held in *Texaco Inc. v. Dagher* earlier this year, legitimate joint ventures have the same freedom as other companies to set the price of the products that they sell. *Texaco Inc. v. Dagher*, 126 S.Ct. 1276, 1280 (2006) (finding that "it would be inconsistent with this Court's antitrust precedents to condemn the internal pricing decisions of a legitimate joint venture as *per se* unlawful"). And there can be no dispute that Visa and MasterCard have been legitimate joint ventures since they were first organized more than three decades ago. The Second, Tenth, and Eleventh Circuits (as well as numerous lower courts) have all recognized the benefits that these two organizations have provided. *United States v. Visa U.S.A., Inc.*, 344 F.3d 229 (2d Cir. 2003); *SCFC ILC, Inc. v. Visa USA, Inc.*, 36 F.3d 958 (10th Cir. 1994); *National Bancard Corp. (NaBanco) v. Visa U.S.A., Inc.*, 779 F.2d 592 (11th Cir. 1986).

With regard to whether Visa and MasterCard can reasonably expect the changes that they made to affect the antitrust analysis of their respective interchange mechanisms, I believe that the answer is yes. As I have made clear, I believe that the historic approaches of both companies are entirely legitimate and do not raise serious antitrust issues. Nevertheless, some merchants have objected to how Visa and MasterCard have set interchange rates on the ground that the two companies have brought otherwise competing financial institutions together to set those rates. Taking financial institutions out of the process of setting the rates should address this objection.

SENATOR DEWINE

1. 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?

The payment card systems offer enormous value to merchants, and new merchants embrace electronic payments every day. In fact, payment cards are one of the great innovations of the 20th century, ranking with the cell phone, the microchip, and the personal computer. The business is very competitive at all levels, and issuers, merchant banks, and payment systems are constantly vying for business.

When merchants complain about interchange fees, they are really complaining about what they pay for payments. Merchants do not pay "interchange fees." Interchange is the fee paid by an acquiring bank to an issuing bank on a particular transaction. As they do when they accept American Express and Discover, merchants that accept Visa and MasterCard pay a discount fee on those transactions.

2. After the DOJ's investigation and subsequent challenge of MasterCard's and Visa's exclusivity rules and overlap in corporate governance, interchange fees went up rather than down. Why did this happen? Do you think that Visa's and MasterCard's interchange fees are at or below competitive levels, and why?

Interchange fees balance the two-sided market for issuers and cardholders, on the one hand, and acquirers and merchants, on the other. These fees may go up or down in response to competition for the two sides of the market. As it turns out, the current weighted average interchange rate on the Visa system is actually lower than the rate that prevailed when Visa set the first interchange rate in the early 1970s. Merchants today pay far less to accept payment card transactions than they did when payment cards were first introduced.

In the decision striking down the so-called "exclusivity rules," the court provided American Express the opportunity to target the most desirable issuers. Although American Express has a smaller acceptance network, it can compete for issuers by offering higher rates of compensation for certain transactions. To compete for those transactions, Visa and MasterCard offered issuers higher rates on those types of transactions as well.