

UNITED STATES SENATE

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COMMITTEE ON THE JUDICIARY

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HEARING ON
CREDIT CARD INTERCHANGE RATES:
ANTITRUST CONCERNS?

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1 P-R-O-C-E-E-D-I-N-G-S

2 CHAIRMAN SPECTER: That does not preclude
3 the Congress from setting new rules on antitrust
4 violations. In May of 2006, MasterCard held a program
5 to transfer control over this operation from its
6 member banks to public stockholders.

7 And all the banks still own a minority
8 interest in MasterCard. They are prohibited from
9 owning voting stock, which is a sophisticated and
10 subtle way of perhaps seeking to solve the problem or
11 perhaps not by relinquishing control.

12 At the same time, Visa created a committee
13 composed exclusively of independent members of its
14 board of directors, not the member banks.

15 And, as a result of these changes, Visa
16 and MasterCard member banks now contend that they no
17 longer participate in the setting of exchange rates.

18 Well, that may be so or that may not be
19 so. It's obviously sophisticated legal work to try to
20 divest control, but in the context of what has
21 occurred in the past and in the context of what the
22 results may be circumstantially if they have the same

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1 result.

2 I'm doing a lot of reading this morning
3 from the memorandum because this is like working
4 through a maze. It's very complicated as to how these
5 arrangements are worked out.

6 And we live today in a plastic world. You
7 don't see money any more at restaurants. You don't
8 see money any more in clothing stores. You don't see
9 money any more in grocery stores. You see plastic all
10 the time.

11 I have only one credit card personally so
12 I can keep it straight. On the occasion when I don't
13 pay on time, I'm astounded at the interest rate, just
14 astounded.

15 Australia has gone to price fixing. I'm
16 not suggesting that. But I note that the Treasury
17 Department succeeded in stopping Visa and MasterCard
18 from stopping banks from issuing American Express and
19 Discover cards.

20 When I saw that, I was really impressed
21 with the power of Visa and MasterCard to stop banks
22 from issuing American Express and Discover. I thought

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1 American Express was a pretty big player.

2 At any rate, it's very complicated. I've
3 had quite a few complaints from Pennsylvanians. And
4 so I've had complaints nationally as to what these
5 implications are. So we are going to take a look.

6 I'm joined by my distinguished ranking
7 member, Senator Leahy. Senator Leahy?

8 SENATOR LEAHY: Thank you, Mr. Chairman.
9 I want to thank Vermont's state representative, Warren
10 Miller, who came down here, and his wife, Kathy, to
11 testify.

12 Leaving Vermont this time of year is not
13 always the easiest thing to do, and I appreciate it.
14 They have the Elmore Store, Lake Elmore, Vermont.

15 My first memories of going in there, I was
16 three years old with my parents to get an ice cream
17 cone. I've been there many times since. I usually
18 drop by and get caught up on the news. And they'll
19 let me know what I need to know. And I look forward
20 to hearing from you.

21 It's one of the last of the really
22 quintessential country stores run by family,

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1 hard-working, but makes it possible for a community to
2 actually have a center.

3 Now, Mr. Chairman, you mentioned that not
4 many of us have heard about the interchange fees. And
5 that's true. I'm still trying to figure out. Those
6 are fees which retailers pay the banks that process
7 credit card transactions because ultimately they are
8 going to be borne by the merchant and the consumers.

9 We are being asked whether these fees are
10 too high and whether they are too high because the
11 banks, the associations of banks, that handle credit
12 cards are behaving unfairly in the marketplace.

13 Just this week the European Union's
14 Competition Authority announced that unless Visa and
15 MasterCard change those fees, they are going to face
16 an antitrust action. This is not an issue that we can
17 ignore.

18 Retailers tell me that interchange fees
19 represent an increasingly large portion of their costs
20 of doing business. They tell me that they are
21 compelled to shift their prices, shift some of that
22 cost burden onto their customers. The customers then

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1 become harmed, whether they are using a credit card,
2 debit card, or paying cash, because the prices have to
3 be up to cover the fees that go along with it.

4 They also tell me -- and I hear this from
5 the Vermont Grocers Association and others -- that
6 they have not seen the rules for the interchange
7 systems. They cannot decipher the complicated billing
8 schemes of the credit card companies.

9 Now, there are many benefits of both
10 retailers and consumers with credit cards, greater
11 access to consumer purchasing power, more rapid
12 payments, and increased payment options for consumers.
13 In my household, it makes an easy way of keeping track
14 of what we're spending.

15 But you have to make sure that the cost of
16 accepting those credit and debit cards does not
17 outweigh the many possible benefits businesses and
18 consumers should be enjoying. So we need more
19 transparency.

20 And, Mr. Chairman, I'm sure it is the same
21 in Pennsylvania, but I know the livelihood of many
22 Vermonters depends greatly on the success of our small

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1 businesses. They are a state made up of many small
2 businesses that play a very integral part in the
3 community, the whole topic of our community.

4 I do not want interchange fees to force
5 smaller businesses, like the village store run by the
6 Millers in Elmore, to take a net loss in order to both
7 accept credits cards and sell the ice cream cones,
8 Green Mountain Coffee, and everything else that makes
9 a store like theirs a Vermont treasure because in many
10 of our towns, that is the one central spot in the town
11 unless it's town meeting day, when everybody is going
12 to be in the town hall. Otherwise that is the spot
13 everybody goes.

14 So we could say how great it is and how
15 wonderful it is, very picturesque. I actually have a
16 picture of it, just happen to have, a very picturesque
17 place to be, but family also has to make some money to
18 be able to keep it going.

19 So, anyway, Mr. Chairman, I'm glad we're
20 having this hearing. And I'll put my whole statement
21 in the record.

22 CHAIRMAN SPECTER: Thank you, Senator

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1 Leahy. Without objection, your statement will be made
2 a part of the record.

3 Senator Grassley?

4 SENATOR GRASSLEY: Could I have just 60
5 seconds?

6 CHAIRMAN SPECTER: Sure. Senator
7 Grassley, you're recognized.

8 SENATOR GRASSLEY: For several reasons.
9 Number one, I obviously owe you and Senator Leahy a
10 thank you for holding a hearing because I was part of
11 the group that asked for it.

12 And then I'm embarrassed to say that at
13 10:00 o'clock I have to have a meeting with our
14 Ambassador Schwab on a lot of trade negotiations that
15 are going on. So I won't be here very long.

16 CHAIRMAN SPECTER: (Inaudible.) Senator
17 Grassley.

18 SENATOR GRASSLEY: I'm trying to be, yes.

19 (Laughter.)

20 SENATOR GRASSLEY: And then thank you,
21 explain that I won't be able to hear all of the
22 testimony. I am going to stay until one minute to

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1 10:00 o'clock and hear what I can and then to just I
2 think emphasize what I heard Senator Leahy said. And,
3 Senator Specter, you may have said the same thing
4 about the problems. It's kind of a balancing act.

5 I'm probably one of the problems because
6 I hardly ever use cash for anything. I'd just as soon
7 not carry around cash but use my credit card an awful
8 lot for some things that maybe are not as significant
9 purposes.

10 I am just astonished by the number of
11 constituents I have come to either Washington or Iowa
12 to complain about the very dramatic increases in
13 charges that we have had on the use of credit cards
14 and asking us to look into it. I don't know where
15 we'll come out, but I'm glad you're having the hearing
16 so we can look into it.

17 CHAIRMAN SPECTER: Well, Senator Grassley,
18 I have said we were a plastic society anymore at
19 grocery stores or clothing stores or restaurants.

20 Senator Durbin, would you like 60 seconds
21 by way of balance?

22 SENATOR DURBIN: Thank you. Thank you for

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1 the hearing. I'm glad you're doing this. I'm glad
2 we're talking about this. I hope something good comes
3 of it.

4 We fought for nine years on a bankruptcy
5 bill that the credit card industry wanted desperately.
6 So the people would end up burdened with credit card
7 debt, even at the end of bankruptcy. They prevailed.
8 And people now who are running up these credit card
9 bills for everything under the sun are now going to
10 carry that debt past bankruptcy for lifetime.

11 As Elizabeth Lauren (Phonetic.) said,
12 we're creating these many little debtor prisons
13 because special interest groups, credit card
14 companies, and financial institutions are so powerful
15 on Capitol Hill.

16 It is unlikely that much will come of this
17 hearing, but I thank you for having this hearing.
18 It's a chance that the consumers will have a voice up
19 here. And I think we need much more of that.

20 I recently went to National Airport,
21 Reagan National Airport. And I saw a man in front of
22 me use his credit card for a charge of less than a

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1 dollar. And I said to the woman at the cash register,
2 "So what is the lowest amount you've ever had anybody
3 put on a credit card here at your cash register?"

4 She said, "Oh, 29 cents."

5 And I thought to myself, "This is really
6 out of hand. And when we consider the hidden fees
7 that we're addressing here, this is a tax that
8 everybody pays. This is a tax, a two percent tax, on
9 grocery purchases and a lot of other purchases that is
10 being paid over and over at the expense of retail
11 merchants in Vermont and Illinois and Pennsylvania.

12 So thank you for this hearing.

13 CHAIRMAN SPECTER: Senator Durbin, let me
14 voice just a slight -- it is not likely that nothing
15 good will come from this hearing. It is not likely.

16 Senator Cornyn, you were the early bird
17 here. Would you like 60 seconds or more?

18 SENATOR CORNYN: Thank you for holding the
19 hearing. I'm glad to hear from all the witnesses but
20 particularly one of my constituents, Mr. Douglass from
21 Sherman, Texas. So thank you for doing this. I look
22 forward to listening to all the testimony and learning

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1 more about this issue.

2 CHAIRMAN SPECTER: Senator Hatch?

3 SENATOR HATCH: No thank you. I'm just
4 interested in the hearing.

5 CHAIRMAN SPECTER: We now are going to
6 turn to our first witness, Mr. Bill Douglass, who is
7 a Chief Executive Office of Douglass Distributing
8 Company, has a record in corporate America with Exxon
9 and Humble Oil, past Chair of the American Petroleum
10 Institute, served in both the Marine Corps and the
11 Army, born and educated in eastern Pennsylvania and a
12 Bachelor's degree from Beilenberg (Phonetic.) College.

13 Thank you for joining us, Mr. Douglass,
14 and we look forward to your testimony.

15 MR. DOUGLASS: Thank you. And good
16 morning, Mr. Chairman.

17 (Inaudible.) My name, as said, is Bill
18 Douglass. And I am the CEO of Douglass Distributing
19 Company. My company, which is headquartered in
20 Sherman, Texas, as Senator Kyl said, operates 15
21 convenience stores and supplies gasoline and diesel to
22 other retail locations in the Dallas-Fort Worth area.

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1 And I'm here today, as said, representing the National
2 Association of Convenience Stores. I want to thank
3 you all for holding this hearing.

4 Credit card interchange fees hurt my
5 customers, who in the end have to pay for all these
6 charges. And they hurt my business. Credit card fees
7 are now the third highest operating cost for my
8 business and for my industry.

9 As a whole, the cost of credit cards is
10 cheated only by payroll and rent. I want to emphasize
11 to this Committee that this market is broken and
12 something must be done to fix it.

13 The courts have said that Visa and
14 MasterCard have market power. And I'll tell you that
15 the agreements among the member banks to charge the
16 same fees and fix these fees are outrageous.

17 While I'm not a lawyer, I know I can't
18 agree with my competitors about what we will charge
19 because it's against the law. And that should be just
20 as true for the bank.

21 About 60 percent of gasoline sales are
22 paid for with credit or debit cards. And this is a

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1 staggering number. And it means one simple thing. I
2 have to take these cards or I will go out of business.

3 Visa and MasterCard dominance is very
4 similar to the dominance of Ma Bell before the breakup
5 of AT&T. And per the statements by Visa and
6 MasterCard that merchants do not need to accept credit
7 cards rings just as hollow as someone saying, "We
8 could choose not to have telephone service." It
9 ignores how business is done today.

10 Accepting cards is as necessary as having
11 a phone and other utilities. The market power and
12 actions of Visa and MasterCard make this market
13 completely different in the other two-sided markets
14 the card associations like to talk about.

15 No newspaper, for example, has the
16 nationwide dominance that Visa and MasterCard have.
17 And newspaper executives do not meet to agree on the
18 rates they will charge for advertising. Yet, that is
19 just what some banks do as members of Visa and
20 MasterCard.

21 Recent changes in the government structure
22 of Visa and MasterCard have not changed this basic

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1 problem. The Committee, courts, and antitrust lawyers
2 can debate the legal technicality to this system, but
3 from my perspective, it makes no sense.

4 The average convenience store paid about
5 \$40,000 in credit card fees in 2005. The same store
6 only made \$42,000 in pre-tax profits in 2005. The
7 fact that my business and my industry are paying
8 almost as much to the credit card companies each year
9 as they are making before they pay Uncle Sam gives you
10 a sense of just how broken this market is.

11 My own fees this year are up 33 percent.
12 With all this money, I can't get a copy of the rates
13 I pay or the rules I must follow. For some reason,
14 the rules on Visa's and MasterCard's Web sites are
15 clearly inadequate, leaving out hundreds and hundreds
16 of pages of rules.

17 In my industry, the best example of this
18 or perhaps I should say the worst example is something
19 called reason code 96. This code comes up for
20 retailers of gasoline and diesel when the purchase
21 exceeds \$50 for a Visa transaction or \$75 for a
22 MasterCard transaction.

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1 With these high gas prices we have had
2 lately, exceeding these limits has become more common.
3 But Visa and MasterCard say somewhere in their hidden
4 rules that if a gas purchase exceeds these preapproved
5 levels, they can deny payment to the retailer. This
6 is true even if the consumer pays and does not dispute
7 the bill. This rule as well as its secrecy is abusive
8 and amounts to a license to steal.

9 Let me emphasize that this scheme is very
10 unfair to our customers. The average American family
11 pays \$231 in interchange and related fees every year.
12 And that is true whether or not the family even uses
13 a credit or debit card because these fees are hidden
14 in the cost of virtually everything we buy. Even
15 cash-paying consumers ultimately pay for them.

16 U.S. consumers are paying far more than
17 their share. Even though our rates should be lower
18 than other countries, just one look at the chart that
19 we have over here will tell you that something is
20 wrong here.

21 In truth, this is just a brief glimpse of
22 the problems with this market. We look forward to

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1 working with the members of this Committee and the
2 Congress to fix this broken market.

3 Thank you.

4 CHAIRMAN SPECTER: Thank you very much,
5 Mr. Douglass.

6 I'm going to go to Senator Leahy to
7 introduce Ms. Kathy Miller, who is from Vermont.
8 Senator Leahy told me yesterday about his plans for
9 August. He's going to be spending the entire month in
10 Vermont (Inaudible.) in Middlesex.

11 SENATOR LEAHY: Although I was
12 (Inaudible.) join Kathy Elmore yet this weekend.

13 Kathy Miller owns the Elmore Store. Now,
14 I didn't --

15 (Laughter.)

16 SENATOR LEAHY: I just want you to know we
17 Vermonters are proud of each other. This is what the
18 Elmore Store looks like. She is former Chair of the
19 Vermont Grocers Association.

20 She and her husband, Warren Miller, who is
21 a state representative, organized and sponsored a race
22 on Lake Elmore. She volunteers at Elmore's one-room

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1 school. I'm just very proud to have them here.

2 I would have actually worn my Elmore Store
3 t-shirt, but it's at the farm, at the farm in
4 Middlesex, Vermont. Thank you. I think Warren is
5 going to give me another one. Thank you.

6 CHAIRMAN SPECTER: Thank you for joining
7 us, Ms. Miller. The floor is yours.

8 MS. MILLER: (Inaudible.) My name is
9 Kathy Miller. I, along with my husband Warren and
10 daughter Kelly, am the owner of the Elmore Store in
11 Elmore, Vermont. I am also here today as a past Chair
12 of the Vermont Grocers Association and on behalf of
13 the Food Marketing Institute, which represents our
14 nation's supermarkets and grocery stores.

15 I would like to read what I prepared and
16 then answer your questions later. I didn't realize I
17 was going to be blown up and hanging on the wall
18 there, but I do have more postcards if anyone would
19 like to see closer up what we look like.

20 (Laughter.)

21 MS. MILLER: And I thought I was the small
22 guy in the picture.

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1 This is the store that we have owned and
2 operated now for 24 years. I am a fifth generation
3 Vermonters with deep roots in Elmore, Vermont. I am
4 the mom part of the operation. Warren, sitting behind
5 me, is pop.

6 Warren was elected to the state
7 legislature in Montpelier four years ago. We are not
8 only committed to our store but our community and our
9 state as well.

10 You may wonder why we do what we do 7 days
11 a week, 96 hours a week, 364 days a year. To be
12 honest, some days we ask ourselves. But we believe
13 that we can and do make a difference to all the people
14 and community that depend on us.

15 My concern as a small independent store
16 may seem small to you, but it is a huge burden for us
17 and very real. Credit card fees are collectively set
18 by the card associations, Visa and MasterCard. And we
19 have no control over them. They are not negotiable
20 and cannot be added on to the consumer's bill.

21 We cannot set minimum amounts to swipe
22 cards, credit or debit. That is against the Visa and

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1 MasterCard operating rules, so I am told by our local
2 bank. The fees keep increasing to us, and our profit
3 margin sinks down even lower.

4 Last year, in 2005, we did \$58,500 worth
5 of plastic transactions. The credit card fees to us
6 out-of-pocket were \$4,400. Each time a customer
7 swipes their card, it costs us 2.65 percent of the
8 total dollar amount plus a 20-cent per sale.

9 In our store, we have two gas pumps that
10 we own, not subsidized by any big petroleum company.
11 When the price of gas goes up, so does the
12 interchange. Because the fee is a percentage rate,
13 the banks make more, even though their costs are still
14 the same.

15 Last year alone, American consumers paid
16 Visa and MasterCard around \$30 billion in interchange
17 fees. FMI members have seen their costs for these
18 fees rise 700 percent in the last 10 years.

19 Since I said I was coming to Washington,
20 D.C. to testify on this issue, I can't tell you how
21 many of my customers were unaware of the hidden fees.
22 They swipe their cards and think all is free because

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1 there is no charge to them at all.

2 Obviously we lose money on many small
3 transactions and too much on others. So we have to
4 raise prices, but we can't absorb it all. In the
5 grocery business, we compete by lowering prices, not
6 by raising them.

7 I am not a lawyer or a huge Wal-Mart, but
8 I know this is a huge problem to retailers across the
9 U.S., large and small, that we are facing. So I ask
10 that you look into this matter seriously.

11 We have streamlined our business as best
12 we can. Maintenance doesn't get done as it should,
13 less money goes out in payroll, but we just can't keep
14 absorbing the fees and try to survive.

15 I would like to ask you on your next ride
16 home -- Senator Leahy is going to be here soon -- to
17 look and see how many vacant storefronts there are.
18 Just this last winter alone, within a 50-mile radius
19 of us, 4 are closed.

20 Some days I feel like I should just turn
21 in my keys, but we can't. Excuse me. We are a small
22 town of 850 people. We are one of two small stores

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1 left. We're the hub of the community. So when
2 someone needs something, who do you call? Mom or Pop
3 at the Elmore Store. We are just trying to keep the
4 doors open.

5 Thank you.

6 CHAIRMAN SPECTER: Thank you very much,
7 Ms. Miller.

8 We turn now to Mr. Joshua Floum, Executive
9 Vice President, General Counsel, Secretary of Visa
10 U.S.A. Before joining Visa, Mr. Floum had a
11 distinguished law practice, was chair of the
12 California firm of Floum, Roberts, and Owen
13 (Phonetic.); before that with the San Francisco firm
14 of Heller Ermin (Phonetic.); earned a graduate degree
15 from the University of California and a law degree
16 from Harvard.

17 We appreciate your being with us today,
18 Mr. Floum, and we look forward to your testimony.

19 MR. FLOUM: Thank you, Mr. Chairman.

20 Chairman Specter, Senator Leahy,
21 distinguished members of this Committee, my name is
22 Josh Floum. I am the General Counsel and Executive

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1 Vice President of Visa. I thank the Committee for
2 giving me the opportunity to answer the important
3 question posed.

4 And, Mr. Chairman, I would request the
5 Committee's permission to submit my written testimony
6 for the record.

7 CHAIRMAN SPECTER: Your full statement
8 will be made a part of the record, without objection.

9 MR. FLOUM: Thank you, Mr. Chairman.

10 I am proud to be able to share with this
11 Committee a bit about Visa's history and the
12 tremendous value that we derive to millions of
13 American cardholders, retailers, and large and small
14 financial institutions all around the country.

15 We believe we have been a valuable engine
16 which has helped to fuel the growth and efficiency of
17 the American economy. And we think we continue to
18 improve our products and services every day.

19 Merchants play a key role within the Visa
20 system. Visa enables the very smallest merchants to
21 have the same payment opportunities as the very
22 largest. Likewise, Visa provides to thousands of

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1 community banks and credit unions, large and often
2 very small, who have the ability through our products
3 and services to compete with the largest national
4 banks. And, as the merchants have told us, Visa
5 services provide them with guaranteed payment,
6 increased sales, and higher profits.

7 Visa provides enormous benefits to
8 cardholders as well. These benefits are just as
9 important to us as those we provide to merchants.
10 Visa services allow cardholders to access credit and
11 deposit accounts and gives them zero liability
12 protection.

13 Card issuers offer cardholders rebates,
14 airline miles, and other benefits designed to
15 encourage cardholders to use their cards.

16 And we have also responded to consumer
17 concerns about the overextension of credit, pioneering
18 the U.S. debit card category in the 1970s. Today, in
19 fact, debit cards, which do not carry interest
20 charges, make up more than half of our transactions.

21 Clearly the system is working. When a
22 market is not functioning properly and there is

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1 "monopoly"-like behavior, one would expect output to
2 be restricted and prices to be pushed up, but neither
3 is the case within the Visa system.

4 Merchants in the United States today pay
5 a lower rate to accept general purpose payment cards
6 than they did a half century ago, when those cards
7 were first introduced.

8 Visa's pricing today remains lower than
9 its smaller competitor, American Express, for example,
10 hardly the evidence of abuse of market power, as some
11 merchants claim.

12 Today, more cardholders and more merchants
13 use and accept the card than ever before. In the past
14 three years, more and more Visa cards have been put in
15 the hands of U.S. cardholders. The number of merchant
16 locations accepting the card has grown by almost a
17 million locations, again, hardly the evidence that
18 something is wrong in the marketplace.

19 Cardholders today can choose between
20 literally hundreds of credit and debit product
21 offerings. Merchants also have many, many choices.
22 With Visa, MasterCard, American Express, Discover,

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1 First Data, Pay Pal, Debit Man, Google checkout, and
2 many others, not to mention cash and check, all vying
3 for business, this is not an industry dominated by one
4 or even a few firms.

5 Price controls are a severe tool and often
6 harm the people they are designed to protect.
7 Lawmakers, regulators, and courts in the United States
8 have declined the invitation to impose price caps, but
9 regulators in other parts of the world have not
10 exercised similar restraint.

11 The impact of regulation overseas shows
12 that consumers in the United States would, in fact, be
13 hurt by artificial price controls on interchange.
14 Let's take Australia as a example.

15 Three years ago, the Reserve Bank of
16 Australia imposed artificial price caps on interchange
17 fees, the same fees that are at issue and in
18 discussion today. The Reserve Bank cut rates by some
19 43 percent. And that regulatory intervention
20 backfired.

21 Cardholders in Australia are paying more
22 for payment cards than they did before through higher

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1 annual fees and finance charges. And they are getting
2 less in terms of reward programs and other rebates.

3 Merchants meanwhile have seen their cost
4 of payment card acceptance decline, but there is no
5 evidence they passed these savings on to consumers in
6 the form of lower retail prices.

7 In fact, the Reserve Bank in Australia,
8 which had promised that retail prices would decline as
9 a result of the intervention, has given up even trying
10 to prove the existence of the promised decline.

11 The Committee poses the question of
12 whether there are antitrust concerns with interchange.
13 Our answer is an unqualified no. The merchants behind
14 these lawsuits will make their arguments in the
15 courts, but we believe we achieve the right balance in
16 values and costs as between merchants and cardholders
17 and that that issue is a business matter that should
18 be driven by supply and demand in the relevant
19 markets.

20 Indeed, the courts have specifically
21 looked at interchange in the past and in each court
22 decision have decided that interchange does not pose

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1 an antitrust problem and, in fact, promotes healthy
2 competition, efficiency, and innovation.

3 Mr. Chairman, you mentioned the Doggit
4 (Phonetic.) case at the outset, where the Supreme
5 Court said that it is entirely lawful and appropriate
6 for joint ventures to set pricing within their
7 associations. Indeed, there is no other way they
8 could function.

9 In the past 30 years, Visa has built the
10 most efficient, reliable, and secure payment system in
11 the world. We are very proud to be a part of driving
12 this country's economic growth and efficiency by
13 delivering tremendous value to cardholders and
14 merchants.

15 With more cardholders and merchants
16 participating every day --

17 CHAIRMAN SPECTER: Mr. Floum, how much
18 more time would you like?

19 MR. FLOUM: Just five seconds, Mr.
20 Chairman.

21 CHAIRMAN SPECTER: Thank you.

22 MR. FLOUM: With more and more cardholders

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1 and merchants participating today, there is no
2 antitrust problem, no reason for Congress to
3 intervene. Mr. Chairman, I wish to thank the
4 Committee for giving me this opportunity and stand
5 ready to answer any questions.

6 CHAIRMAN SPECTER: Thank you. Thank you
7 very much, Mr. Floum.

8 We now turn to Mr. Joshua Peirez,
9 Associate General Counsel for MasterCard, previously
10 was the Associate at Clifford Chance (Phonetic.),
11 where he was an antitrust litigator, Bachelor's degree
12 from Cornell and a law degree from the Brooklyn Law
13 School.

14 We appreciate your coming in today, Mr.
15 Peirez, and look forward to your testimony.

16 MR. PEIREZ: Thank you. Good morning,
17 Chairman Specter, Ranking Member Leahy, and members of
18 the Committee. My name is Joshua Peirez. And I am a
19 group executive with MasterCard Worldwide. It is my
20 pleasure to appear before you this morning to discuss
21 the highly innovative and efficient MasterCard system
22 and the issue of interchange specifically.

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1 I ask that my full written testimony be
2 submitted for the record.

3 CHAIRMAN SPECTER: Without objection, it
4 will be made a part of the record.

5 MR. PEIREZ: Thank you.

6 The payments industry is extremely
7 competitive. MasterCard competes against all forms of
8 payment, including cash and checks; other brands, such
9 as Visa, American Express, and Discover; a wide
10 variety of debit networks; as well as rapidly growing
11 alternative payment systems, such as Pay Pal, that did
12 not exist a few years ago.

13 We also compete intensely for the loyalty
14 of financial institutions, merchants, and cardholders.
15 And the result of this competition is that consumers
16 and merchants increasingly prefer to use payment cards
17 for purchases. And there are many reasons for this.

18 MasterCard cardholders know that they can
19 walk into a store almost anywhere in the world and
20 make a purchase using their card with the security
21 that comes with not having to worry about carrying a
22 lot of cash. Our popular advertising campaign says it

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1 best, "There are some things money can't buy. For
2 everything else, there's MasterCard."

3 Merchants also derive enormous benefits
4 from payment cards. Most importantly, cards increase
5 merchant profits because consumers tend to spend more
6 using payment cards. Cards are also much cheaper and
7 safer than checks, which most merchants don't even
8 accept anymore or only accept locally. It's,
9 therefore, no surprise that the number of merchant
10 outlets accepting payment cards continues to increase.

11 Historically, merchants were the first to
12 recognize the benefits of payment cards when in the
13 1920s individual merchants began to issue cards to
14 their customers. These programs were inefficient and
15 expensive for merchants to operate, but the powerful
16 desire on the part of merchants to benefit from
17 payment cards created opportunity for others.

18 In the 1950s Diners Club and American
19 Express both began to offer what is known as a
20 three-party model, in which a single company issues
21 the cards, contracts with merchants, and operates the
22 system itself.

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1 Banks then began to offer their own card
2 programs, which have evolved into the four-party
3 systems known as MasterCard and Visa. These
4 four-party systems created even greater efficiencies
5 and benefits by bringing together the cardholders and
6 merchants of hundreds and then thousands of banks to
7 complete transactions.

8 In a four-party system, such as
9 MasterCard, card issuance and merchant acquiring
10 functions are performed by financial institutions
11 licensed by MasterCard, not by MasterCard itself.

12 Since the inception of these three and
13 four-party payment systems, merchants have paid a fee
14 called a merchant discount in exchange for the
15 benefits of card acceptance. These fees are set in an
16 intensely competitive merchant acceptance environment.
17 And they cover some of the costs and the value the
18 system brings to merchants.

19 A substantial portion of the benefit
20 provided to the merchant obviously comes from
21 card-issuing activities. In recognition of this
22 reality, the card issuer has paid an interchange fee

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1 in a four-party system.

2 In the United States, MasterCard
3 management sets the default interchange fee. Banks
4 are free to use these default fees or to agree to a
5 different fee between themselves.

6 Setting default interchange fees is a
7 challenging proposition that involves an extremely
8 delicate balance. If we set the fees too high, the
9 merchant's desire and demand for MasterCard acceptance
10 will drop. If you set the fees too low, card issuers'
11 willingness to issue and promote MasterCard cards will
12 fall, as will consumer demand for those cards.

13 MasterCard management works extremely hard
14 to set interchange fees at levels that balance the
15 benefits and costs to both cardholders and merchants.
16 Some have sought to challenge the methods by which
17 MasterCard and its competitor, Visa, set their
18 respective interchange fees on antitrust grounds. To
19 date, these cases have all failed. And the courts
20 have upheld interchange fees as not violating
21 antitrust laws.

22 What the plaintiffs appear to really want

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1 is government-mandated price caps at lower levels than
2 what is offered today. There is simply no precedence
3 for such a remedy under antitrust law.

4 Such a policy also harms consumers. We
5 have one test case of the results of such price caps
6 in Australia, which demonstrates that price caps harm
7 consumers and competition. The effect in Australia
8 has been higher annual fees and finance charges for
9 consumers as well as fewer benefits.

10 In conclusion, merchants and consumers
11 benefit significantly from the use of payment cards.
12 It is my pleasure to discuss the topic with you. Then
13 I would be pleased to answer any questions you may
14 have.

15 CHAIRMAN SPECTER: Thank you very much,
16 Mr. Peirez.

17 Our next witness is a former Chairman of
18 the Federal Trade Commission, Timothy Muris, who
19 served there from 2001 to 2004. Previously he had
20 been in the Office of Management and Budget during the
21 Reagan administration.

22 He currently is of Counsel to the

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1 O'Melveny and Meyers firm, where he co-chairs the
2 antitrust practice; Bachelor's degree from San Diego
3 State and law degree from the University of
4 California, member of the Board of the Court and
5 Associate Editor of the law review there.

6 Thank you for being with us today, Mr.
7 Muris. And we look forward to your testimony.

8 MR. MURIS: Thank you very much for
9 inviting me to this important hearing. Before I
10 begin, I would like to submit my written testimony and
11 a law review article I recently wrote about this topic
12 for the record.

13 CHAIRMAN SPECTER: Without objection, both
14 will be made a part of the record.

15 MR. MURIS: Thank you.

16 As you know, I personally advise Visa on
17 antitrust and consumer protection, but the views that
18 I express today are my own.

19 Let me make three points. The first is
20 that merchants are wrong to analogize interchange to
21 the paradigmatic case for antitrust environment,
22 cartel price fixing. A cartel is a group of otherwise

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1 competing firms that fix their prices.

2 When businesses collude, they harm
3 consumers by raising price above the level that would
4 otherwise prevail. Interchange has nothing in common
5 with this behavior.

6 Unlike the cartel, a four-party payment
7 card system cannot exist without interchange. A
8 default fee reduces the cost of negotiating separate
9 fees between acquirers and issuers.

10 Moreover, for Visa to succeed, merchants
11 need to honor cards from each of the thousands of
12 issuers. Knowing that all cards must be honored,
13 individual issuers could insist on very high fees.
14 Merchants would then be subject to those fees and
15 would be less willing to accept the network. A
16 default interchange avoids this problem.

17 The difference between a cartel and Visa
18 is stark. With cartel pricing, an end to the cartel
19 lowers prices, raises output, and increases
20 innovation. The end of interchange will lead to
21 chaos.

22 The merchants understand this. They do

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1 not want interchange to end. Instead, they want lower
2 interchange rates. But this is not an antitrust
3 remedy.

4 One of the fundamental maxims of antitrust
5 is that the market, not government, should set prices.
6 Indeed, reasonableness is never a defense to price
7 fixing.

8 Interchange began with Visa long ago.
9 Bank of America started a three-party payment card
10 system in California in the 1950s. Because banks were
11 then prohibited from crossing state lines, the bank
12 tried to franchise its system to different states but
13 found few takers. It spun off the system in the
14 1970s. That spinoff, renamed Visa, began interchange
15 to coordinate the four parties involved, beginning
16 interchange long before they had any significant
17 market share.

18 My second point is to discuss how prices
19 are set. Payment card systems are an example of a
20 two-sided product connecting two groups of consumers.
21 The challenge for any two-sided product is bringing
22 both sides on board.

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1 Newspapers illustrate how most two-sided
2 products set prices. I have today's Washington Post.
3 In a business sense, what this is is a vehicle to
4 bring together readers and advertisers. The readers
5 pay very little. Okay?

6 The publishers get their money from the
7 advertisers. If newspapers charged us the direct cost
8 of supply, they would lose readers, given the
9 alternatives. Without enough readers, there wouldn't
10 be enough advertisers.

11 And, incidentally, in response to Mr.
12 Douglass' point, if you want to talk about market
13 power, I believe that the Washington Post has a very
14 large share in the relevant market here in the
15 Washington area.

16 The economics of attracting two distinct
17 groups of consumers drives the price. Okay. Again,
18 we've got readers and advertisers. The value of a
19 two-sided product to one group of customers is
20 determined by its attractiveness to the other. The
21 group with the low-cost substitutes, in this case the
22 readers, gets the better deal.

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1 For payment cards, the consumer is the
2 king. To compete with the two historically dominant
3 forms of payment, cash and check, payment card systems
4 priced to provide value to cardholders. The industry
5 has followed this model from its inception.

6 In 1948, the Diners Club card was
7 introduced with a merchant discount of seven percent.
8 Today the average discount on American Express is
9 about 2 and a half percent, while Visa, which is a
10 larger company, charges about 2.1 percent.

11 Consumers and merchants clearly enjoy the
12 benefits. Walk into a McDonald's or Subway, and you
13 can swipe your card to purchase a meal. A few years
14 ago, you couldn't do this. Nobody made those
15 restaurants take the payment cards, but, instead, they
16 found that the payment systems offered value for a
17 price that they were willing to pay.

18 Let me conclude by noting that the attack
19 on interchange taken with logical connection to end
20 interchange poses a direct threat to the American
21 consumer.

22 I understand the full fury of that

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1 consumer when aroused. While Chairman of the FTC, we
2 created the National Do Not Call Registry. And I
3 thank all the members here for their support. I
4 suspect that many Americans feel as strongly about
5 their plastic as they do about their dinner hour.

6 Thank you. I will be happy to respond to
7 your questions.

8 CHAIRMAN SPECTER: Thank you very much,
9 Mr. Muris.

10 Our final witness is Mr. Steve Cannon,
11 President and Managing Partner of Constantine Cannon
12 and service on the Senate Judiciary Committee back in
13 '97 and '98 Congress, when he was chief antitrust
14 counsel on the Judiciary Committee.

15 The '98 Congress was my first time in
16 1981, when Senator Thurmond was chairman of this
17 Committee, also from South Carolina. And Mr. Cannon
18 received his undergraduate and law degree at the
19 University of South Carolina.

20 Thank you for being with us today, Mr.
21 Cannon. And the floor is yours.

22 MR. CANNON: Thank you, Mr. Chairman.

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1 It's great to be back in this room. I must say it
2 feels a little difference on this side of the dias.

3 On behalf of the Merchants Payments
4 Coalition, I am honored to be able to present this
5 testimony on an issue of extreme importance, not only
6 to the merchant community but to the millions of
7 consumers we serve every day.

8 Merchants Payments Coalition members
9 provide virtually every American with a broad array of
10 goods and services and employ over 50 million people.
11 To answer the question posed by today's hearing, there
12 are indeed crucial and timely antitrust issues raised
13 by interchange fees.

14 Let me be clear and unequivocal. What
15 Visa and MasterCard and their member banks do is
16 illegal price fixing, pure and simple. While the
17 legal team for the cartel is here today to tell you
18 that it may be price fixing but it's not illegal, both
19 the law and common sense tell us that they are wrong.

20 It's also important to note that other
21 countries around the world have begun to figure all of
22 this out and are acting quickly and decisively to end

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1 this price fixing.

2 Just two days ago, as the Chairman
3 referenced, the European Commission conducted a
4 hearing on its preliminary findings that the
5 justification for the current interchange system had
6 no factual basis.

7 According to media reports, EC Competition
8 Commissioner Neiley Crose (Phonetic.) called for the
9 end of anti-competitive behavior in the payment card
10 industry or face antitrust action. Last April, she
11 warned that the industry's paradise days may be over.

12 You already heard a lot about Australia
13 this morning. All I can say about that is that facts
14 are stubborn things. Interchange rates there are
15 currently one-third the rate in the United States.
16 And what the card association witnesses have not told
17 you is that, in fact, fierce competition has erupted
18 between Australia and credit card issuers trying to
19 offer lower and lower interest rates to consumers,
20 rather than just trying to give you more miles.

21 And, by the way, contrary to MasterCard's
22 official written prediction of a death spiral for

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1 credit cards in Australia, credit card issuance is up,
2 as is credit card use.

3 In my written testimony, Mr. Chairman, I
4 have cited several press articles to this effect from
5 Australia, including one from last February, that
6 says, -- and I quote, -- "Australians have never had
7 easier access to a credit card with banks undercutting
8 each other in a battle for the consumer's dollar."
9 That sounds like competition to me.

10 You have also heard this morning from both
11 MasterCard and Visa that the merchants I represent
12 want price controls. This is not a surprising
13 argument since, in fact, Visa and MasterCard are
14 themselves privately controlling prices through their
15 cartel and have no other reason for anybody else to
16 get involved in the prices.

17 As of today, they are very comfortable
18 with imposing a consumer checkout fee on virtually
19 every transaction. Their plea of let the market
20 decide really means let us continue to properly
21 regulate the market among ourselves. They refuse to
22 publicly recognize, of course, that all our merchants

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1 had asked for is for Congress to look at this problem
2 and potential solutions, not price controls.

3 Our friends at the desk chair would want
4 you to think that you have only a choice, Mr.
5 Chairman, between a cartel and chaos. And that is
6 clearly not the case. There is a lot in between those
7 two choices.

8 Now I need to turn to how to remedy this
9 problem. On the question of liability for past
10 conduct, that is easy. Only the courts can determine
11 who is liable to whom for past conduct and how much
12 damage this would be, but we're not here to talk about
13 litigation this morning.

14 What industry should look like going
15 forward is a harder question. There are many
16 possibilities that Congress can consider, and I am
17 glad to discuss them or answer any questions the
18 Committee might have.

19 For the other question which is on
20 everybody's mind today, which is whether the Congress
21 has a role to play, we believe the answer is a
22 resounding yes.

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1 And, Mr. Chairman, I reference, as you
2 will remember, the breakup of the Bell system in 1982
3 as a very apt analogy. At that point in time, for 14
4 years from 1982 to 1996, Congress deferred to a single
5 federal judge, the honorable Harold Greene, to make
6 the vast majority of the most important
7 telecommunications policy decisions of that era.

8 I would only add that the arguments that
9 you heard this morning that the payment card system
10 isn't broke, so don't fix it is almost identical to
11 what the Committee heard from the Bell system 25 years
12 ago and is absolutely wrong.

13 I remember when the Bell system warned
14 that using any piece of telephone equipment that
15 Western Electric did not make would make the entire
16 telephone network come crashing down, not to mention
17 that \$2 a minute was a very reasonable price for the
18 miracle of long distance.

19 Mr. Chairman, that concludes my remarks.
20 Thank you. I would be glad to answer any questions
21 you may have.

22 CHAIRMAN SPECTER: Thank you very much for

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1 that testimony, Mr. Cannon.

2 We now turn to the portion of the hearing
3 on questioning by members of the panel to five minutes
4 each.

5 Mr. Peirez, you said that all cases have
6 failed. Is that your testimony?

7 MR. PEIREZ: All the cases challenging
8 interchange have failed, yes.

9 CHAIRMAN SPECTER: Well, isn't it true
10 that there were recently 50 cases consolidated in the
11 Eastern District of New York which are ongoing and
12 have not failed?

13 MR. PEIREZ: Those cases are pending in
14 the early stages. And we will see where those cases
15 go now. My testimony was that to date all the cases
16 have failed.

17 CHAIRMAN SPECTER: Well, those cases
18 haven't failed, have they?

19 MR. PEIREZ: That is true. They have not
20 failed, not yet.

21 CHAIRMAN SPECTER: Okay. I just want to
22 be sure that there are some that haven't failed.

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1 MR. PEIREZ: There are pending cases, yes.

2 CHAIRMAN SPECTER: Mr. Muris, one of the
3 cases alleged that the collective setting of
4 interchange rates by banks that compete with each
5 other to issue cards to consumers constitutes illegal
6 price fixing and that there was a substantial overlap
7 between the banks that are members of MasterCard and
8 those that are members of Visa, which precludes
9 competition between the two credit card companies.

10 Do those facts, if established, constitute
11 a violation of the antitrust laws in your opinion?

12 MR. MURIS: No. And let me analogize
13 what's going on here. I think Mr. Cannon's reference
14 to AT&T really shows this is not a simple price-fixing
15 case.

16 If you and Senator Leahy practiced law as
17 competitors and you did nothing else but agree to fix
18 prices, that would be an antitrust violation. If you
19 formed a law firm and you fixed prices, that wouldn't
20 be because you formed a legal joint venture.

21 And what is happening here is -- and the
22 Doggit case I think makes this clear -- we have a

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1 legal joint venture, which has the right to set
2 prices. What we have here is a business dispute. Mr.
3 --

4 CHAIRMAN SPECTER: Let me interrupt, Mr.
5 Muris. You have already said is it doesn't constitute
6 a violation.

7 MR. MURIS: Yes.

8 CHAIRMAN SPECTER: Should it? Should the
9 antitrust laws be modified? It sounds to me likely
10 clearly anti-competitive practices.

11 MR. MURIS: Well, as you recall when we
12 met, I learned my antitrust law from Jim Leatler
13 (Phonetic.). And Professor Leatler was a strong
14 believer in the market and underlying antitrust law as
15 a strong belief in the market.

16 The market should set the prices here.
17 And legal joint ventures have and the Supreme Court
18 made clear just this year the right to set a price.

19 So I think if you did change, obviously
20 you have a right to change the antitrust law. You
21 would be changing it in a fundamental way that would
22 be inconsistent with the 116-year history of the

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1 Sherman Act.

2 CHAIRMAN SPECTER: Mr. Floum, according to
3 the briefing materials provided to me, the Justice
4 Department successfully challenged MasterCard and Visa
5 rules, which prohibited their member banks from
6 issuing American Express and Discover cards. Is that
7 true?

8 MR. FLOUM: That's correct, Mr. Chairman.

9 CHAIRMAN SPECTER: Isn't that pretty
10 heavy-handed for that kind of market pressure to be
11 brought on banks so that they don't issue other credit
12 cards from companies as prominent as American Express
13 and Discover?

14 MR. FLOUM: At the time we thought not,
15 Mr. Chairman. And the reason is that we believe that
16 what our system does is promote vigorous what we call
17 intra-system competition, competition between the
18 banks. Now, I know that --

19 CHAIRMAN SPECTER: I thought you thought
20 that was not a violation but the Department of Justice
21 disagreed with you on it.

22 MR. FLOUM: That's correct, Mr. Chairman.

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1 We did petition to the Supreme Court for certiorari,
2 which was denied. And we, of course, rescinded that
3 rule in accordance with the court decision.

4 CHAIRMAN SPECTER: Mr. Cannon, does that
5 sound like an antitrust violation to you that member
6 banks prohibited from issuing other companies' credit
7 cards?

8 MR. CANNON: Well, it does and it is. In
9 fact, that was a 34-day trial before the federal judge
10 in New York. It went up to the Second Circuit. The
11 Second Circuit found that, in fact, there was market
12 power that had been exercised.

13 And that's now the law of the land. And
14 I'm glad to say at this point Visa was required to
15 abrogate those rules. And, therefore, they had to --
16 and now competition is beginning to flourish on that
17 side as well.

18 But if I can say one thing about Mr.
19 Muris' response on saying that this isn't a simple
20 price-fixing case? This is a simple price-fixing
21 case. And everyone is doing a lot to try to make you
22 think that it is really complicated.

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1 The problem is that it involves 2 players
2 in this industry that control 80 percent of the
3 market. So it is price fixing. It just happens to be
4 done by two people with a large market share.

5 PARTICIPANT: Can I respond to that? No
6 one who raises AT&T as the appropriate remedy I think
7 can credibly claim this is a simple price-fixing case.
8 The unraveling of AT&T in extraordinary efforts of
9 Judge Greene, the 1996 Act, the efforts that are
10 needed now to rewrite that show that this is miles
11 differently than the simple price-fixing case as if
12 two lawyers in town are making two otherwise competing
13 lawyers fix prices.

14 The remedy is simple for that. Just tell
15 them not to fix prices. You don't make an analogy to
16 AT&T and get the Congress involved in oversight for
17 dozens of years.

18 PARTICIPANT: That makes my point
19 precisely, which is this is an industry. It's an
20 industry that needs attention. And I would posit that
21 everybody in Congress thought that the period of 14
22 years would have been a lot better if Congress were

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1 making competition policy and telecommunications
2 policy, as opposed to Judge Greene, not to give Judge
3 Greene due deference, but that is the position that
4 industry and everybody on the Hill found themselves
5 in.

6 CHAIRMAN SPECTER: The red light went on
7 during that lively exchange, which I did not want to
8 interrupt.

9 (Laughter.)

10 CHAIRMAN SPECTER: Senator Leahy?

11 SENATOR LEAHY: No objection here, Mr.
12 Chairman. I thought it was helpful.

13 Now let me ask you. We have heard someone
14 said, "Well, retail. We just don't accept credit
15 cards. If some other store doesn't want to pay these
16 interchange fees, well, they shouldn't accept credit
17 cards."

18 Tell me how practical that would be in
19 Elmore.

20 MS. MILLER: It would not be practical.
21 More and more of my customers come in. They're going
22 on those little bicycle tours. I mean, they're not

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1 carrying cash in their pockets. They've got a card.

2 They come in to get a bottle of water. I
3 make 30 cents on a bottle of water. I've got to swipe
4 their card. It costs me 20 cents plus the transaction
5 fee.

6 So in some instances, like candy bars,
7 they're on sale 3 for a dollar. If somebody buys a
8 candy bar, I might as well just give them the candy
9 bar, rather than swiping the card.

10 But it's a matter of survival. It's what
11 customers expect. It's what I need to do to have my
12 business to survive. If a customer is in my store
13 just because he is using plastic, he is not going to
14 buy more.

15 There is a deli. You're going to buy one
16 sandwich. You're not going to buy two. If you're
17 camping at the Elmore State Park, you need a fishing
18 license. You're not going to buy two.

19 But the expectation is there. They're in
20 Elmore. I appreciate the business, like you said.

21 SENATOR LEAHY: Well, in Mr. Douglass'
22 testimony, he said that, if I'm quoting this

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1 correctly, Mr. Douglass, "Congress has not yet had
2 enough information about these fees to come up with a
3 solution to this problem."

4 Well, we're holding this hearing. It's
5 the first step to get that information. What further
6 do you think we should have?

7 MS. MILLER: I don't have all the answers,
8 but I know you people have the capability to look into
9 this issue. It's very huge. It's very real. It's a
10 wonderful dialogue that's started.

11 Even if I had access to the rules on the
12 internet, I don't have time to sit down and read 1,300
13 pages worth of information. I probably wouldn't
14 understand them, and I couldn't print them off.

15 SENATOR LEAHY: Well, what if you had the
16 interchange fees here on the customer's bill? Would
17 that be helpful?

18 MS. MILLER: According to the bank that I
19 do business with, that is not legal for me to do. I
20 can't pass that on.

21 SENATOR LEAHY: Okay. Well, Mr. Floum,
22 Mr. Peirez, why not just have the interchange fees

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1 associated with the credit card transactions appear on
2 the bill? And why shouldn't consumers know what it's
3 actually costing them to get the free airline miles,
4 which may or may not be available, or the lower
5 interest rate or the annual fee rate? Shouldn't they
6 know what it is ultimately costing?

7 MR. FLOUM: Mr. Chairman and Senator
8 Leahy, it is important to understand that the
9 interchange fees are akin to wholesale rates. They
10 are not fees which are paid by the merchant or paid by
11 the cardholder. They're fees that are paid by the
12 merchant bank.

13 SENATOR LEAHY: Well, why not let us know?

14 MR. FLOUM: Well, it would be like --

15 SENATOR LEAHY: I would be interested in
16 knowing. And all of this stuff is computerized. It
17 would be very easy to do.

18 MR. FLOUM: The fee schedules are
19 available online, Senator, but it would be like going
20 to the Macy's store in Pentagon City and expecting to
21 see the wholesale charges for the various items --

22 SENATOR LEAHY: I'm just asking what it

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1 would be to put these fees. Let's not get off the
2 subject.

3 Mr. Peirez?

4 MR. PEIREZ: Yes?

5 SENATOR LEAHY: Why not do it?

6 MR. PEIREZ: Well, Mr. Leahy, Ms. Miller
7 is perfectly allowed under our rules to post that on
8 the receipt. We do not restrict that. She should
9 discuss it with her bank.

10 SENATOR LEAHY: How do you get it?

11 MR. PEIREZ: She could ask her bank for
12 it. They're not prohibited from providing it. She
13 can also search on the internet, and they're there.

14 SENATOR LEAHY: Ms. Miller?

15 MS. MILLER: Just a little example of
16 something that happened in my store the other day.
17 We're still very small. We run in-house charge
18 accounts. Some customers come in. They pay by the
19 week.

20 I had a woman in, Ms. Raggerty
21 (Phonetic.). She bought \$108 worth of raspberries.
22 She's going to go home. She wants to make raspberry

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1 jam. She goes to get her wallet and pocketbook, "Oh,
2 I forgot it, but I've got my card in the car, and I
3 want to pay my slip. Would you rather have me go get
4 my card and swipe it or would you like me to pay cash
5 tomorrow?"

6 I say, "Have a good night, Alex. Good
7 home. Make your drinks. Come by. Bring me the cash
8 tomorrow." It's just what's happening.

9 SENATOR LEAHY: I still don't understand
10 why we can't get these fees. I mean, you're able to
11 do everything else, including inundate us with free
12 credit cards or offers of free credit cards. And my
13 five-month-old grandson, he could get those. The
14 former Chief of Staff's dog could get one. You're
15 sure willing to spend money on that to be able to
16 open.

17 Let me ask you one other area: the issue
18 of piracy. There's a Web site in Russia called
19 allofmp3, sells copyrighted material without
20 permission of the copyright owners. All the customers
21 are here in the Untied States. The Web site is in
22 English. It features American music, none of which

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1 has been licensed to them.

2 So they're selling this, in fact,
3 illegally, but they accept Visa and MasterCard. In
4 fact, those are the only two that are on the site.
5 It's such a degree of concern and may be one of the
6 reasons why Russia has failed to go in the World Trade
7 Organization. They won't shut it down.

8 Now, why don't Visa and MasterCard just
9 pull the plug on that and agree to suspend the
10 services to alfofmp3? You do this on some child
11 pornography sites. Why not do it on alfofmp3 in
12 Russia?

13 MR. FLOUM: We intend to do so, Senator
14 Leahy. Visa deplores any illegal use of its cards.
15 And, as you mentioned, whether the issue is internet
16 pornography, online pharmaceuticals, illegal
17 downloading of music, our rules expressly forbid the
18 unlawful use of the card.

19 Now, it gets more complicated when there
20 are different jurisdictions involved and we are trying
21 to enforce that in Russia in the case that you
22 specifically mentioned. And we hope to be able to

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1 shut down that merchant very soon.

2 SENATOR LEAHY: Mr. Peirez?

3 MR. PEIREZ: We prohibit and deplore the
4 use of our system for any illegal activities,
5 including this activity.

6 SENATOR LEAHY: On this Russian site?

7 MR. PEIREZ: Yes. We're working on it.

8 PARTICIPANT: Senator, may I add one thing
9 about your question about the receipt? We believe
10 that the rules of Visa and MasterCard actually
11 prohibit merchants from doing exactly that, which
12 raises the entire question about all of the rules that
13 are hundreds and hundreds of pages long that the
14 associations essentially keep hidden from the
15 merchants.

16 They have told us time and time again,
17 they have been asked time and time again to make rules
18 available. And now even, frankly, this Committee is
19 not going to be able to get them unless they have a
20 change of heart.

21 They announced this week they would make
22 them available online to merchants but, in fact, would

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1 exclude things dealing with interchange fees, of all
2 things. So it would be very helpful if the merchants
3 could actually see these rules.

4 CHAIRMAN SPECTER: Thank you, Senator
5 Leahy.

6 Senator Kyl?

7 SENATOR KYL: Thank you, Mr. Chairman.

8 I appreciate holding this hearing. I can
9 trust that this is a subject that is very confusing to
10 I think a lot of us, including me. And I think it is
11 wise to at least try to understand it better. And,
12 for that reason, I'd like to go back to a more basic
13 or fundamental point.

14 People have told me that the reason for
15 concern here is that fees have gone up rapidly, I
16 gather much more rapidly than other kind of
17 cost-of-living increases. And it has created a
18 suspicion that there must be some reason for this
19 other than market factors, like collusion, for
20 example. And, of course, there is a series of
21 lawsuits that have been discussed here that attempt to
22 reach that.

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1 The question, the fundamental question,
2 that I have is what market protections are in place to
3 ensure that, at least over time, pricing adjustments
4 are made to truly reflect the state of competition,
5 the value of these interchanges, the value of the
6 product, in fact? How does the market work? Is there
7 a place where it is not working? And if not, why?

8 I pose this to all of you. And I think it
9 would be good to get both points of view.

10 PARTICIPANT: Senator, I would be happy to
11 try to respond. We call it a two-sided market. So
12 then when we ask the question about the marketplace,
13 we look at both merchant demand and cardholder demand.
14 And unless you have enough cardholders, merchants
15 won't be interested in accepting the card. Unless
16 there are enough merchants that accept it, cardholders
17 won't use it.

18 So we need to try to balance so that the
19 product is attractive to both. If interchange rates
20 are too high, merchants will not use the product.

21 We heard the example of raspberries with
22 cash the next day demonstrates that merchants do have

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1 a choice to use the card products or to use other
2 payment devices.

3 On the card-issuing side, if cardholders
4 are asked to pay too much in terms of annual fees,
5 interest rates, other devices that financial
6 institutions use to recoup their costs on the
7 cardholder side, then cardholders won't be interested.

8 So I think there is an inherent balance
9 that's built into this two-sided market.

10 MS. MILLER: Could I just say something?

11 CHAIRMAN SPECTER: Ma'am, go ahead.

12 (End of Tape 1, Side A.)

13 (Beginning of Tape 1, Side B.)

14 MS. MILLER: So yes, I did have the option
15 in that situation, but nine times out of ten, that
16 option isn't there. You're busy. Your store is full
17 of people. You're scooping ice cream cones. You're
18 making sandwiches. You're pumping gas. You're just
19 doing business, and it's costing us way too much.

20 Thank you.

21 MR. CANNON: Two times four. It makes no
22 difference. We have to keep this simple and keep

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1 focused on exactly what is going on today.

2 It is not complicated. It is price
3 fixing. It is in the open. It is not secret. It is
4 not collusive. The question is, is it a violation of
5 the law? And it truly is.

6 So in a situation where people are
7 conducting or involved in an antitrust violation and
8 they are then deemed to be in violation of the law,
9 they have to stop doing that illegal activity.

10 So the question is, if you can't fix
11 prices, what else can you do? Every other business in
12 the United States manages to do their business without
13 fixing prices. And surely Visa and MasterCard could
14 as well.

15 CHAIRMAN SPECTER: Or anyone else, Mr.
16 Muris, maybe. There is a legal remedy here. There
17 are plenty of lawsuits that are resolving this. And
18 it just takes a couple of them to establish the law in
19 this area. Is that the preferable remedy here to any
20 kind of congressional action?

21 MR. MURIS: Well, I think obviously the
22 issue is in courts. And if they think this is an

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1 antitrust violation, they have that forum.

2 To respond to the basic questions, I have
3 one of every kind of card. And these are Discover and
4 American Express. From the standpoint of merchants,
5 they're identical because the merchants pay a merchant
6 discount, as they do with Visa and MasterCard, but
7 because they're not organized as joint ventures,
8 they're not part of these lawsuits, even though they
9 do the exact same thing. They're organized as
10 individual companies in the way that MasterCard is now
11 just recently organized.

12 The reason that Visa and MasterCard are
13 organized the way they are is an historical anomaly.
14 And, as I mentioned in my testimony, when Visa began
15 and MasterCard began, the law prohibited interstate
16 banking.

17 So if you, Bank of America in California,
18 had this great idea, you couldn't take the idea to
19 America by having Bank of America across the country.
20 You had to form this cooperative.

21 And the last point is in this joint
22 venture, a legal joint venture, just as the law firm

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1 analogy I said where it's completely legal to fix
2 prices, in this joint venture, interchange fees are
3 used to fuel the enormous competition between the
4 thousands of issuers.

5 Interchange fees result in the benefits,
6 in the enormous benefits. I have my Cap One miles
7 card. I have a MasterCard that gets me cash back.
8 It's double cash back at gas stations, which is
9 particularly valuable at the moment.

10 These fees result in benefits to
11 consumers. I get the float. I get the convenience.
12 I don't have to carry cash. It's something that we do
13 that is enormously beneficial.

14 And this is why it's -- this is one of the
15 great innovations for the last century, this payment
16 card system. And it costs millions of dollars to put
17 it to where it is today.

18 MR. CANNON: Senator, if I may respond to
19 Mr. Muris? He's made my point for me. These are
20 miles and other benefits and things. Ask yourself who
21 pays for these. And the answer is you pay for them.
22 Not only do you pay for them as the credit card

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1 customer, every single customer of every single
2 retailer and every single merchant pays for it as
3 well.

4 So it's pretty clear and undisputed that
5 that price gets baked into the price of what we pay
6 every day for everything. So when you think you're
7 getting a great deal for your miles, you really ought
8 to ask yourself, "Gee, if I'm making that much, how
9 much is going out of my other pocket?"

10 MR. MURIS: But, Senator and my good
11 friend Steve -- and he has been a friend for a long
12 time -- the merchants if they want could say, "I'll
13 give you a better deal if you pay me cash." They
14 could discount for cash. It's perfectly legal.

15 Almost none of them do. The gas stations
16 tried a long time ago for a while. And they don't
17 because it's less convenient and because many
18 consumers would resent it.

19 We have a system where the consumer is
20 king, and the consumers like their plastic.

21 CHAIRMAN SPECTER: Well, I have a couple
22 of hands up at the end of your questioning. Well, Mr.

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1 Douglass, proceed.

2 MR. DOUGLASS: Mr. Chairman, I thank you
3 for the chance to do this.

4 The difference between American Express
5 and Discover and Visa and MasterCard is Visa and
6 MasterCard have 80 percent of the market. They are
7 just the dominant leader. I mean, they control the
8 market.

9 And back to Senator Leahy's question about
10 can we post the price, the problem is we only get the
11 average price of what they're charging us. We can't
12 tell if they're charging us for one of these reward
13 cards when they swipe that card in our dispensers at
14 the pump. That's a different rate than if they have
15 a on-reward card.

16 So they have all of these different rates.
17 We get an average. So we would have to have a
18 computer to determine whether they're using a PIN
19 number or whether they're using a remote slicing
20 device. It's very complicated.

21 And back to the point that the counsel
22 here has a card that gives him double the money back

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1 at his pump. We pay for that at the pump. It takes
2 50 percent of our gross margin at the pump to pay that
3 credit card charge for that particular refund.

4 CHAIRMAN SPECTER: Mr. Cannon, you had
5 your hand up in response to Senator Kyl.

6 MR. CANNON: I do, Senator. Mr. Muris, in
7 responding to the other question, saying, "Gee, the
8 rules say you can discount for cash," well, our
9 merchants, the impression or understanding they have
10 is you can't do that unless you're willing to post a
11 cash price and a credit price on every single item in
12 that store.

13 Now, I will tell you what would be great
14 and what might end this argument and this debate is if
15 we could see the rules. It would be a great thing.
16 But, unfortunately, that hasn't been the case. And
17 the merchants are given very thin documents, very
18 short summaries of things, to be able to say, "Oh,
19 here's what you have to do."

20 Now, I'll tell you if a merchant violates
21 the rules, they're the first to tell you very quickly,
22 "But, gee, having a copy of the rules to begin with is

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1 a much harder thing."

2 CHAIRMAN SPECTER: Mr. Peirez, did you
3 have your hand up in response to Senator Kyl's
4 question?

5 MR. PEIREZ: Thank you, Mr. Chairman. I
6 actually wanted --

7 CHAIRMAN SPECTER: We may turn out to have
8 a 15-minute round here.

9 (Laughter.)

10 MR. PEIREZ: Thank you, Mr. Chairman. I
11 actually wanted to respond to a couple of points.

12 First of all, all of the MasterCard rules
13 that apply to the merchant side of the business are
14 available in their entirety online on our Web site,
15 mastercardmerchants.com, including our discounting for
16 cash rule, which says nothing about posting two
17 separate prices.

18 We have heard that allegation before. I
19 can tell you right here right now if a merchant wants
20 a sign at the cash register saying "A discount of"
21 blank "afforded for the use of cash," our rules do not
22 prohibit that. And that is available to the

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1 merchants.

2 Secondly, I would like to respond to what
3 is a convenient shorthand for people when they try to
4 refer to this alleged market power of saying there's
5 this 80 percent figure.

6 MasterCard and Visa are fierce
7 competitors. We are currently a public company in
8 majority public hands with all voting stock in hands
9 independent of the financial institutions that
10 participate in our system. And we are simply not an
11 overlap or proxy for our competitor Visa.

12 And to lump us together like that, even
13 the court in the Department of Justice case that you
14 mentioned, Mr. Chairman, has recently found that
15 MasterCard alone does not have market power.

16 And so it is simply untrue. And when we
17 set our interchange rates, we do so as an independent
18 public company today. We believe the way we did it in
19 the past was justifiable, as it was upheld in the
20 NaBanco decision and other court cases. So thank you
21 for your time.

22 CHAIRMAN SPECTER: We had gone to Senator

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1 Kyl before Senator Durbin, although Senator Durbin was
2 here earlier to take us to the rule alternating. But
3 we will await Senator Durbin's return. I know he had
4 other commitment, but we would like to -- we will keep
5 going a while longer here to give him a chance to
6 return.

7 Mr. Douglass, staff advises me that you're
8 not permitted to have a surcharge for people who use
9 credit cards. Would you like to be able to have the
10 freedom if you chose to have a surcharge for people
11 who use MasterCard or Visa?

12 MR. DOUGLASS: Mr. Chairman, no. No, I
13 would not like to be able to have a surcharge. That
14 would just drive the customers off. People really
15 have been sold on plastic, and it's a real
16 convenience. And we're on that system.

17 The dilemma we have is the charges just
18 keep escalating. As I say, my costs have gone up 33
19 percent this year because of the escalating price of
20 fuel primarily.

21 CHAIRMAN SPECTER: Is it true, Mr. Peirez,
22 that there cannot be a surcharge?

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1 MR. PEIREZ: You're not allowed
2 surcharging.

3 CHAIRMAN SPECTER: Well, why can you get
4 a discount for cash but you can't allow a surcharge?
5 Just six of one and half a dozen of another.

6 MR. PEIREZ: It economically should be the
7 same equivalent to a merchant that's looking to drive
8 people to cash. However, we don't like having people
9 using our cards feeling that they're being
10 discriminated against.

11 It's a rule, however, that we continue to
12 look at. We do allow surcharging in Europe and in
13 Australia today. The U.S. is our largest and most
14 important market. We tend to be a little slower than
15 --

16 CHAIRMAN SPECTER: I'm glad to hear that
17 you're looking at it because it's exactly the same
18 thing.

19 Mr. Cannon, the MasterCard and Visa have
20 made some structural changes here. They have
21 transferred control of operations from the member
22 banks to public stockholders. Member banks can still

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1 have a minority interest, but it's nonvoting.

2 MasterCard has made a change to Visa,
3 created a committee composed exclusively of
4 independent members of the board of directors, not
5 member banks, which make all the decisions regarding
6 interchange fees.

7 Have these changes eliminated the control
8 so that there is not a violation of antitrust laws
9 under existing law?

10 MR. CANNON: Yes, sir, it is. And what
11 they're trying to do is simply promote a little form
12 over substance. It's very clear -- and I devote about
13 two pages in my written testimony about this, Senator
14 -- that yes, it does not make a difference. The
15 activity that is going on is still unlawful and should
16 be stopped.

17 CHAIRMAN SPECTER: Why is it unlawful if
18 they have structured it so that the banks do not have
19 control over the fee setting?

20 MR. CANNON: Well, Senator, in fact, I'll
21 be glad to submit this for the record. If you look at
22 the S-1, which is the registration statement that

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1 MasterCard filed, it is very educational on this
2 point.

3 And it says clearly and unambiguously that
4 the banks still, by the way, hold 44 percent of the
5 stock of MasterCard, the new company. And, in fact,
6 it says our success or failure will still be dependent
7 upon our customers. And who are our customers? Our
8 customers are banks.

9 And so I can tell you there is every
10 incentive for this activity to continue, regardless of
11 the forum. And the fact that MasterCard now says it
12 has an independent board making this decision, what is
13 the definition of independent?

14 I think that everyone in business wants to
15 make sure that they bring as much to the bottom line
16 as they can. And that's exactly what will still
17 happen.

18 CHAIRMAN SPECTER: Mr. Peirez says that
19 all of the rules of his public company are known. Is
20 that true, too, Mr. Floum, with your company?

21 MR. FLOUM: It is, Mr. Chairman.

22 CHAIRMAN SPECTER: Well, where is the

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1 discrepancy?

2 MR. CANNON: I haven't seen them. I'd
3 love to see them. And my understanding, Senator, was
4 that Visa was --

5 CHAIRMAN SPECTER: Don't you have a Web
6 site, Mr. Cannon?

7 MR. CANNON: Oh, we do. We do. My
8 understanding was that Visa was going to announce this
9 week --

10 CHAIRMAN SPECTER: But they say you can
11 look on their Web site and find out. This is a pretty
12 simple question of fact.

13 MR. CANNON: It is. I don't think it's
14 there, Senator. I was told that Visa was going to
15 announce this week it was going to make their rules
16 available. However, they are going to be accessible
17 online. They couldn't be printed off.

18 And, more importantly, if you are a
19 merchant and getting these rules like that, you had to
20 sign a nondisclosure agreement that you couldn't share
21 them with anybody else. That doesn't seem like fully
22 --

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1 CHAIRMAN SPECTER: Is that, Mr. Floum, on
2 the nondisclosure agreement?

3 MR. FLOUM: That is correct, Mr. Chairman.
4 Our --

5 CHAIRMAN SPECTER: Why?

6 MR. FLOUM: Our rules govern the operation
7 of our 14,000 member banks. They address those banks
8 and what those banks are supposed to do to participate
9 in the system.

10 CHAIRMAN SPECTER: Could they disclose
11 them to the Senate Judiciary Committee?

12 MR. FLOUM: Yes, of course. And we would
13 be happy to make those available. However, the rules
14 you need to understand --

15 CHAIRMAN SPECTER: Make them available to
16 the Committee, Mr. Peirez, and we can show them to Mr.
17 Cannon.

18 MR. CANNON: We will, Mr. Chairman.

19 CHAIRMAN SPECTER: Senator Leahy?

20 SENATOR LEAHY: Mr. Chairman, your last
21 question was the only question I was going to ask. I
22 like the answer. I have no further questions.

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1 CHAIRMAN SPECTER: What is the projection
2 to Senator Durbin's return? Senator Kyl, do you have
3 any further questions? Senator Durbin will be
4 submitting questions for the record.

5 Thank you very much, Ms. Miller, Mr.
6 Douglass, Mr. Floum, Mr. Peirez, Mr. Muris, and then
7 Mr. Cannon. This is a very important subject. And I
8 think that we have learned a good bit about it,
9 notwithstanding its complexity.

10 That concludes our hearing.

11 (Whereupon, the foregoing matter was
12 concluded.)

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