



**Statement of the National Grocers Association
to the
United States Senate
Committee on the Judiciary**

Full Committee Hearing

“Credit Card Interchange Rates: Antitrust Concerns?”

July 19, 2006

National Grocers Association
1005 N. Glebe Road, Suite 250
Arlington, VA 22201-5758
703-516-0700
www.nationalgrocers.org

The National Grocers Association (N.G.A.) greatly appreciates the opportunity to submit this statement for the record of this important hearing before the U.S. Senate Committee on the Judiciary. N.G.A. thanks the Committee for holding today's hearing on interchange, a matter of great antitrust importance to the retail community.

N.G.A. is the national trade association that represents exclusively the interests of independent, community-focused grocery retailers and wholesalers. An independent, community-focused retailer is a privately owned or controlled food retail company operating in a variety of formats. Most independent operators are serviced by wholesale distributors, while others may be partially or fully self-distributing. A few are publicly traded, but with controlling shares held by the family and others are employee owned. Independents are the true entrepreneurs of the grocery industry and are dedicated to their customers, associates, and communities. N.G.A. retail and wholesale members accounted for \$200 billion of U.S. grocery sales last year. N.G.A. is a founding member of the Merchants Payment Coalition that is made up of trade associations representing supermarkets, retailers, convenience stores, restaurants, drug stores, gas stations and other businesses that are concerned about increasing interchange fees charged by credit card companies and banks.

An interchange fee, usually in the form of a percentage of the transaction, is charged to the merchant by the card issuing bank and the card association. N.G.A. believes that there are major antitrust problems with the current interchange fee system, causing profound harm to consumers and merchants. For the benefit of the American consumer, federal governmental agencies and members of Congress must exercise oversight of debit and credit card interchange fees and the lack of a competitive market.

I. Interchange: A Market Failure That Harms Consumers and Merchants

Interchange fees charged by MasterCard and Visa, and the rules under which they are levied, are nothing more than a hidden tax on retail grocers and the consumers they serve, including customers using other payment methods who indirectly subsidize cardholders. Interchange fees are hidden from consumers by credit card companies, but consumers ultimately pay them because costs have to be passed along in the form of higher consumer prices. Visa and MasterCard rules require that fees be collected from the merchants, not directly from the card users. These card-based fees are the single most profitable source of income for banks. These fees now exceed \$26 billion annually with contracts that actually prohibit merchants from disclosing the cost to their customers who use the cards.

In a competitive marketplace when costs go down, rates should fall. Interchange fees have increased precipitously even though fraud is down and transaction volume is up significantly. This is because debit and credit card systems and their interchange rates are a private, unregulated money system that has exceeded cash and checks as the favored means of paying for goods and services since 2004. The debit and credit card interchange rates of Visa, MasterCard and their member banks are established collusively by the competing banks that constitute the boards of directors of Visa and MasterCard. This is a clear violation of federal antitrust laws. As a result, interchange rates can be increased at will; they bear no relation to any legitimate charges that arguably should be imposed on merchants and consumers.

The interchange system is a clear example of a market failure. No competitive forces exist to pressure the card associations to lower rates. Rather, competition raises

interchange fees as Visa and MasterCard compete for issuers by offering them higher and higher payouts from interchange fees.

Few issues have received the attention of retail and wholesale grocers, as well as all other retail merchants, as that being given to the high and increasing cost of interchange that retailers must pay to Visa and MasterCard for accepting their debit and credit cards. The United States has the highest credit card interchange fees of any industrialized country, and interchange rates have continued to increase even while costs of processing and fraud have declined. The international precedents for antitrust investigation and government intervention are persuasive and demand serious review and appropriate action by this Committee.

A recent Morgan Stanley report found that the weighted average for Visa and MasterCard interchange had increased from 1.58 percent in 1998 to 1.75 percent in 2004 (an increase of 10.8 percent) and is forecast to grow to 1.86 percent in 2010 (an additional increase of 6.3 percent over 2004 and 17.7 percent since 1998). With the growing use of plastic, interchange fees now exceed \$26 billion annually and are projected to increase more than 22 percent each year.

The vast majority of grocers do not have the ability to overcome the market power of Visa and MasterCard in order to negotiate lower rates. The results of the recent settlement in 2003 of the Wal-Mart case against the credit card companies clearly illustrate the anticompetitive nature of the interchange system. Visa and MasterCard agreed to pay the plaintiff retailers more than \$3 billion, but immediately increased credit card interchange rates to cover the cost of the settlement—and then some.

Except for the very largest merchants, efforts to negotiate lower interchange rates have been rejected, even when retailers have attempted to aggregate. The vast majority of merchants, therefore, have no control over this discriminatory cost of doing business, because it is set by an illegal cartel.

The issue here is about the need for competition, and when it doesn't exist then solutions must be pursued to correct the unfairness and level the playing field. In November 2005 N.G.A., together with some of its members, Affiliated Foods Midwest, Coborn's Inc., D'Agostino's Supermarkets and the Minnesota Grocers Association, filed a class action suit against Visa, MasterCard and a number of banks, alleging the named defendants conspired to fix the interchange fees that are charged to retail grocers and ultimately consumers in violation of the Sherman Act. This action was recently consolidated in the U.S. District Court for the Eastern District of New York with over 47 other actions filed.

One must ask why the United States lags behind other countries in addressing this important issue. Australia in 1998 passed its Payment Systems (Regulation) Act 1998 after an investigation by the Australian Competition and Consumer Commission found against the collective fixing of interchange fees. Consequently, on August 27, 2002, the Reserve Bank of Australia adopted a new cost-based approach to interchange fees and eliminated the no surcharge rule, which prevents retailers from directly charging consumers the cost of interchange when they pay by card. The purpose is to ensure that the setting of interchange fees in designated credit card systems is transparent and promotes efficiency and competition. In the Bank's view, interchange fees in the credit card systems were not subject to the normal forces of competition which pushed fees up,

not down. The Reserve Bank of Australia reported in August 2005 that, “Prior to the reforms, this fee averaged 0.95 percent of the amount spent; it now averages around 0.54 per cent.” The Reserve Bank of Australia also found, “In total, as a result of the Bank’s reforms, merchants’ costs of accepting credit and charge card payments were around \$580 million lower than they would otherwise have been. Given the competitive nature of Australian business, these cost savings are finding their way into lower prices for goods and services, or smaller price increases than would have otherwise have taken place.” On November 25, 2005, the Reserve Bank of Australia announced further amendments that became effective on July 1, 2006. Some observers predict rates will drop to .35 per cent.

On September 6, 2005, the United Kingdom Office of Fair Trading (OFT) found that a collective agreement between members of MasterCard UK Members Forum (MMF), including most banks, setting the multi-lateral interchange fee paid on virtually all purchases using UK-issued MasterCard credit and debit cards between March 1, 2000, and November 18, 2004, restricted competition and infringed Article 81 of the EC Treaty and the Chapter 1 prohibition of the Competition Act. It gave rise to a collective agreement on the level of the multilateral interchange fee and resulted in unjustified recovery of certain costs.

The OFT found the inclusion of extraneous costs provided a large flow of revenue to card issuers and the incentive to induce customers to hold and use MasterCard cards, for example, through loyalty schemes, advertising and funding the interest-free period. The fee was passed on to the retailers by the merchant acquirers through higher merchant service charges. The OFT stated, “Consumers, including those who do not use

MasterCard cards, ultimately picked up the cost for the higher interchange fee through higher retail prices.” Sir John Vickers, OFT Chairman, said, “This unduly high interchange fee was like a tax on UK consumers.”

Although the OFT consented to the Competition Appeal Tribunal’s setting aside of the OFT’s September 2005 decision, the investigation will continue and will include Visa. OFT chief executive John Fingleton stated in June 2006: “We still believe that the interchange fee arrangements that are now in place could infringe competition law and are harmful to consumers, who pay higher prices as a result of these fees. Continuing to defend appeals against the original decision before the Competition Appeal Tribunal diverts us from dealing most effectively with the overall problem of interchange fees. Our resources are better spent in reaching decisions on MasterCard’s and Visa’s current interchange fee arrangements rather than continuing with these appeals that concern only MasterCard’s historic arrangements.”

In September 2000, the European Commission challenged Visa’s anticompetitive multilateral interchange fee, and Visa agreed in 2002 to lower the weighted average fees in stages to 0.7 per cent in 2007. Numerous other countries, such as Sweden, Italy, Netherlands, Switzerland, Spain, Israel and Mexico have addressed the anti-competitive nature of interchange.

Other countries have addressed and reduced anticompetitive interchange fees, and now it is time for Congress and federal agencies to do the same.

The current interchange system is inherently flawed and presents gross inequities for both retailers and consumers. Transparency is a must. All parties involved, especially consumers and merchants, should be made aware of the interchange fees

charged to merchants, and ultimately consumers. The consumer has a right to know how interchange fees affect the prices of goods and services from merchants. Retailers are charged increased interchange fees to cover the incentives given to consumers to use the cards carrying the highest interchange rates. Those incentives by any objective standard should not be part of every consumer's grocery bill; they should be absorbed by Visa, MasterCard and their card-issuing banks, which reap the majority of the huge financial benefits. It is time to end this "hidden tax" on merchants and consumers, including customers who pay by cash or check and thereby subsidize cardholders.

The present system has another major antitrust flaw in addition to interchange rates: anticompetitive card association rules and procedures. For example, imagine yourself as a retailer who wishes to accept Visa and MasterCard as a means of payment by your customers. You sign merchant agreements in which you agree to abide by all of these associations' rules, but a wall of secrecy and nondisclosure hides them from retailers. Those rules must end.

II. Collusive Setting of Interchange Fees and Operating Rules Violate Antitrust Laws

In the Department of Justice case against Visa and MasterCard, the U.S. Court of Appeals for the Second Circuit found that when Visa and MasterCard pass rules, that is the collective action of a cartel of banks that compete to issue cards or sign up merchants to accept Visa and MasterCard. *U.S. v. Visa U.S.A., Inc.*, 2003 WL 22138519 (2d Cir. Sept. 17, 2003). It follows that the setting of interchange rates by those same Visa and MasterCard banks cartelizes the setting of interchange fees and violates Section 1 of the

Sherman Act. The existing system eliminates any incentive for card issuing banks to lower interchange fees in response to the demands of the merchant community, consumers and other participants in the marketplace.

Visa's and MasterCard's complex system of rules amplify the power of this cartel to maintain supra-competitive pricing by restricting merchants' ability to disclose fees to consumers or charge cardholders a different price based on differences in interchange fees for various cards. For example one rule requires merchants to accept all Visa and MasterCard credit cards despite the fact that interchange rates vary by as much as 100% based on the type of card (Platinum Plus®, Visa Signature®, corporate, small business etc.). The sad consequence of this system is that all consumers, regardless of form of payment, end up subsidizing the rewards of select cardholders. This type of cartel rate setting and rule making are clearly in violations of the Sherman Act.

III. Conclusion

N.G.A. strongly believes that action by Congress and federal agencies is needed to end the anticompetitive and illegal price fixing and discriminatory establishment of interchange rates and card association rules. Interchange fees should be set by competitive forces, not by collusion. In addition, anticompetitive rules which harm merchants and consumers and maintain the market power of card associations must be ended, and retailers must be informed in advance of the rules to which they will be subjected.

N.G.A. applauds the Committee for holding this important hearing and urges Congress to continue to investigate and correct the unfairness of the current interchange system.