

ORAL TESTIMONY

BEFORE HOUSE JUDICIARY COMMITTEE ANTITRUST TASK FORCE

Good Afternoon. My name is Mallory Duncan, and I am Senior Vice-President and General Counsel for the National Retail Federation. I am also chairman of the Merchants Payments Coalition, which represents virtually every type of retail operation, from corner stores to the nation's largest retail chains. I want to thank the Chairman, and Ranking Member, for allowing me to appear here today on behalf of the M P C.

We want the Committee to appreciate what's happening here. This market is broken and needs to be fixed. The card industry has told you that the market is functioning and this is so complicated it would be best if you just ignored it. But the truth is this is a very simple scheme, privately regulated by a set of rules they won't make available to this or any other Committee.

[Competition Chart]

The banks that are members of Visa and MasterCard will tell you the card business is competitive. On one side, that's true. The banks compete for customers. Each tries to get consumers to carry *their brand* of card. The piles of credit card offers in your mailboxes attest to that.

But on the merchants' side, the opposite is true. For example, Visa and its banks get together and decide how much they are going to charge to process card payments. *All* issuing

banks agree to charge same fees, regardless of which bank's name is on the card. These otherwise competing banks, under the Visa and MasterCard banners, insist that merchants accept their cards, fees and rules on a take it - or leave it – basis, with no opportunity to negotiate. And even though the fees are outrageous and the rules harsh, no merchant can stand up against that kind of power. (MasterCard recently changed its structure, but the net result is the same.)

We believe the two card associations each operate as illegal price-fixing cartels in clear violation of federal antitrust law.

Who's in this cartel? Almost everyone. Citi, Chase and B of A's card divisions are each nearly the size of American Express. What business do those three banks have being in a price fixing arrangement with each other, not to mention with thousands of smaller banks? If Kroger, Safeway and Publix agreed with every other grocer to set the price of milk at \$10 a gallon, would anyone here believe this was a fine, functioning market delivering value to consumers?

The banks also fix the rules: rules designed to support the cartel and to hide its operation from the consumers who *ultimately* pay most of these fees. Let me give you one example.

Retailing is very competitive. The average net profit – after wages, rents, goods and taxes - is only about 2 percent. For grocery stores it's just over 1%. The card company rules say the “regular” price we offer to the public must be the credit card price. But 1 or 2 % percent retail profit margins aren't large enough to absorb another 2% in interchange fees, so a shopping cart of back-to-school clothes, that we would willingly sell for \$99 cash, has to be priced at around \$101 because of their rules.

But look what has happened – \$101 has become the “regular” price for \$99 worth of cash merchandise. And, regardless of whether one uses cash, check, credit or food stamps, we all end up paying the credit card company price.

And, merchants are not allowed to show the interchange fee on receipts the way they would a sales tax, for example, which essentially is what interchange is.

[Fee Comparison Chart]

Interchange fees are growing at about 17 percent a year, and we expect them to top \$40 billion in 2007. That’s more than annual fees, cash advance fees, late fees and over-limit fees *combined*. It amounts to more than \$300 in hidden fees per household, each year.

[Diamond Chart]

What does interchange pay for? Last year, Diamond Consulting Group independently studied interchange and discovered that only 13% of interchange actually goes to pay for processing transactions. Most of the remainder taxes consumer prices to provide *profits* for the cartel, and rewards for a relative few.

Although we may disagree on the benefits, in his written testimony, Mr. Buhrmaster accurately describes what’s happening here. He essentially said the big banks the rates, and they set them high. So high that even inefficient banks can make a profit while the big banks make a killing. This is *not* the workings of a competitive market.

[Retail Sales versus Interchange Chart]

These ever rising fees also have consequences for other businesses. At Balliet's, a highly regarded \$7 million-a-year women's clothing store in Oklahoma City, interchange fees rose to more than \$80,000 last year, topping the \$60,000 the owner spent on health insurance for his employees. In order to pay the card companies, this year he was forced to reduce the company's health insurance contribution from 70 percent, to the 50 percent *minimum* required by his carrier. He tells us that next year, Balliet's may actually be forced to stop offering health coverage to its employees if interchange fees continue to rise.

(This market is broken. It needs transparency and genuine competition. Currently, Visa and MasterCard battle to get more banks to issue cards under *their* names by offering to collect more interchange.

This is the only market I know of where the parties compete to *raise* prices rather than to lower them.)

Conclusion

[International Slide]

In conclusion, the collective setting of interchange fees represents an on-going antitrust violation, and it's costing merchants and their customers tens of billions of dollars annually. Competition authorities in the rest of the world have realized this and begun to address it, and rates in those countries are lower.

The credit card system is an important component of our economy, potentially benefiting, consumers, merchants and banks alike. But it has become dramatically tilted in favor of the two cartels that control the market. There are several pending lawsuits. But the courts' remedies are limited. Courts can deliver damages, prohibit *specific* conduct, or become "regulatory Czars." Congress

has much more *nuanced* and *flexible* tools at its disposal. We urge you to study this problem and work with all of the parties on a solution to this anti-competitive market.

Thank you.