Testimony of

Mr. Bill Douglass

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On Behalf of
The National Association of Convenience Stores
Before the
U.S. Senate Committee on the Judiciary
On Credit Card Interchange Rates: Antitrust Concerns?
July 19, 2006

Good morning, Mr. Chairman and Members of the Committee. My name is Bill Douglass and I am Chief Executive Officer of Douglass Distributing Company.

My company, which is headquartered in Sherman, Texas, operates 15 convenience stores and supplies gasoline and diesel fuel to other retail locations in the Dallas- Fort Worth area.

I am here today representing the National Association of Convenience Stores (NACS). NACS is an international trade association representing the convenience store industry. The industry as a whole includes about 140,000 stores in the United States, sold 145.8 billion gallons of motor fuel in 2005, and employs about 1.5 million workers across the nation. It is truly an industry for small businesses; 60 percent of convenience stores are owned by one-store operators. NACS helped found the Merchants Payments Coalition, which includes about 20 trade associations from diverse industries, to help promote a more competitive and transparent system of credit card interchange fees.

I want to thank you, Mr. Chairman, and the Members of the Committee for holding this hearing. Credit card interchange fees hurt my customers - who, in the end, pay for them - and hurt my business. The rise in these fees in recent years has made them the third highest operating cost for my business and for my industry as a whole. Only payroll and rent cost more than these fees.

As difficult as this cost is to bear for my business, I know these fees are a terrible burden for my customers - and most of them do not even know these fees exist and take money out of their pockets. I compete with other retailers to try to make my prices attractive to customers. But when these fees are tacked on, prices don't look as attractive. This is a big problem in my industry. We put our prices on the street for everyone to see. No other industry so completely and transparently empowers customers to shop for the best price without even leaving their cars. And our customers are perhaps the most price sensitive of all. They will drive far out of their way just to save a couple of cents per gallon on gas. Well, right now credit card companies charge about 5 cents in interchange on a gallon of gas purchased with their cards. That is a big number; when it is tacked onto our prices it hurts our customers and our business. For many of our customers that is nearly $2 per fill up that goes straight to Visa and Master Card banks. These charges are an outrage, especially at current gasoline prices.

Just one look at a list of the interchange fees that are charged when a consumer fills up any of several 2006 American-made SUV s and pick up trucks shows how bad this problem has become. And this list doesn't include all the older models of cars or trucks with large gas tanks, vehicles that are used milions of times a day by small businesses or by farmers, but it does give you an idea of how much more in credit card charges have come directly from consumers' pockets in just the last 2 years simply from the increase in the price of one product, gasoline.

Interchange fill-
Gas tank up (gas=$3per
Model Type (2allons) 2allon)
Chevy Suburban (three quarter ton $1.9110 model) SUV 39
GMC Yukon (XL) 2500 SUV 39 $1.9110
2006 Ford F-350 Lariat 4x4 SD Pickup $1.8620
Crew Cab truck 38
2006 Ford E-350 Super Duty Van 35 $1.7150
Pickup $1.6666
GMC Sierre (Longbox) truck 34
Pickup $1.6666
Chevy Silverado (Longbox) truck 34
2006 Dodge Ram 3500 SLT Pickup $ 1 .6666
(Mega Cab) truck 34

Interchange fees are just like an excise tax or sales tax getting added to the cost of our product. But at least people know that taxes are part of their purchase because taxes get discussed publicly and folks get to vote based on their views about whether it is worth it to increase prices with taxes. Unfortnately, the credit card companies won't even let me know the different rates that I can get charged for taking their cards so there is no way for me to inform my customers . . . and they are left in the dark. They have no say in this increase in the cost of everyhing they buy. I hope that the Committee's hearing can begin to raise some awareness about what is happening.

I want to emphasize that the market by which interchange fees are set is broken and something must be done to fix it. The cours have said that Visa and MasterCard have market power and I will tell you that the agreements among their member banks to fix and charge the same fees are outrageous. While I am not a lawyer, I know I can't agree with my competitors about what I wil charge because it is against the law. That should be just as true for banks. Not only that, but the only type of competition that does exist is when Visa and MasterCard compete by raising, not lowering, their fees to get more banks to issue their cards. Competition ought to work in the opposite direction - and does when customers know the facts and have some bargaining power. We don't have either one. They keep us almost completely in the dark about the fees and their rules and we have no bargaining power with these dominant companies.

The card companies and banks have said that merchants like me want price controls. There is something odd about that claim because the only people who have raised it are credit card companies and banks. I haven't asked for it, and I haven't heard any other retailer or trade association ask for it. I would also note that we already have price controls because Visa and MasterCard members banks fix prices and all agree to charge the same thing. Maybe that is why they talk about it - because they have experience with their own price controls.

In our view, the Congress does not yet have enough information about these fees to come up with a solution to this problem. As I'll explain, the card associations have worked hard to keep these fees and their operating rules secret. In fact, they have lobbied very hard in both the House and the Senate against proposals for simple studies of these markets and their behavior. The result is we all need more investigation and information before we can prescribe the right solution. The bottom line is this: The situation is as bad as I can imagine right now. Just about anything you could do would be an improvement.

With that in mind, I want to explain four basic points that layout how dire the situation is for us. First, retailers have no choice about whether they accept cards because of the market power of Visa and MasterCard. Second, the card companies use their power in the market to raise fees and keep the fees and their rules secret.

Third, these fees hurt consumers and tend to hurt lower income consumers worse than others. Fourth, U.S. consumers pay a lot more for interchange than most other countries, with no justification whatsoever.

1. Retailers Have No Choice
Over 60 percent of today' s motor fuel sales are paid for with credit or debit cards.

That is a staggering number. It means one simple thing - I have to take these cards or I wil go out of business. I have no option.

The comparison that fits is with the old AT&T - before the breakup. Visa and MasterCard's dominance is very similar to the dominance ofMa Bell before the breakup of AT&T. And protestations by Visa and MasterCard that merchants do not need to accept cards rings just as hollow as someone saying we could just choose not to have telephone service. It simply ignores how business is done in this country. Accepting cards is as necessary as having a phone and other basic utilities. And the numbers show that the vast majority of consumers use either Visa or MasterCard. Together they have about 80 percent of the market. As recently as 2003, the Second Circuit Court of Appeals held in the U.S. Department of Justice's case against Visa and Mastercard that the two card associations - both jointly and separately - had market power. When we pay the fees we are paying now, all of us know Visa and MasterCard have market power.

When prices rise, consumers are more likely to use a card to pay for goods. This is exactly what has happened in my industry. As gasoline prices increased and the cost of the average fill-up went above $20 or so, card usage rose dramatically averaging 12.5% increases in dollar volume in each of the last 3 years.

Maybe this is because U.S. consumers get more than 6 bilion mail solicitations for credit cards each year. That is more than 20 solicitations for every man, woman and child in our country. And then there are the phone calls. I was somewhat offended to hear Tim Muris testify in February and try to somehow attack retailers by talking about the Do Not Call rule. Well, I don't know about you, but if anyone was interrpting my dinner hour with telemarketing calls it was to give me credit card offers. I appreciate Mr. Muris' work on that rule and just wish he had done something about the junk mail his clients send me.

No matter how we ended up with all these cards, though, the prevalence of them makes this market completely different than other "two-sided markets" that the card associations like to talk about. No newspaper, for example, has the nationwide dominance that Visa and MasterCard have. And newspaper executives do not meet to agree on the rates they wil charge for advertising - yet that is just what some banks do as members of Visa and MasterCard. The market choices and competitive pricing in these other industries make them different than the market for cards. But with merchants captive to Visa's and MasterCard's market power, the normal market checks on price increases just aren't there.

There are many situations in which people have no choice but to accept cards though the fees charged do not make sense or are contrary to good public policy.

One example is what happens in the wake of hurricanes and other disasters. This is a big concern because many retailers work hard to open and serve people quickly after disasters. That was certainly the case last year after Hurricanes Katrina and Rita, among others. After these disasters, many retailers had to operate without electricity and phone service or with only limited service. But they got an unpleasant surprise. The credit card companies charged them among the highest interchange rates possible because without electricity or phone service retailers could not swipe cards or call to get preauthorization before completing a transaction. Retailers had to use paper, carbon receipts or whatever means they had to do business, but they - and, ultimately, the consumers who were hit so hard by the hurricanes - had to pay the exorbitant, higher rates. These rates were almost 60% more than standard rates. Some retailers asked the card associations to waive interchange fees in the affected areas, but these requests were ignored or refused.

In fact, the credit card companies even charged interchange on the stored value cards that FEMA gave to hurricane survivors to allow people to make basic purchases after Hurricane Katrina. Again, many of these fees were at the highest rates because of the limited phone and electricity services in the area. It made no sense to hurt the people and businesses that suffered in these disasters by adding what amount to penalty charges.

One other thing I need to address is the card companies' talk about the benefits of cards to retailers. The point here is not whether credit cards should be eliminated because they have no benefit, the issue is how the card companies are inappropriately taking advantage of their market position to extract far more in fees than can be justified. And while the card companies say that individual purchases are higher due to credit cards, they have never done a scientific study to determine whether that is real or is just a byproduct of people with higher incomes having and using more credit cards. Without a controlled study, their claims have little factual foundation. Plus, common sense tells us that their claims are not true for things like gasoline sales. Simply put, consumers do not buy more gasoline just because they have a credit card.

2. Card Associations Drive Up Fees and Keep Them and Their Rules
Secret

The card companies are effectively controlled by their member banks and the member banks must agree to charge the same interchange rates. As I mentioned, the only competition is by the card companies to raise the rates to get bans to issue more of their cards. Recent changes in the governance structures at Visa and MasterCard have not changed this basic problem. The supposedly "independent" directors at Visa are appointed by member banks. This means the member banks still have effective control of the organization. MasterCard has similar problems.

Its public offering was structured to allow member banks to maintain effective control. In fact, the member banks still name some of the members of MasterCard's board. None of this is real change.

The Committee, courts, and antitrust lawyers can debate the legal technicalities of this system, but I will tell you that it makes no sense and is costing consumers a lot more than it should.

American consumers paid more than $26 billion in interchange fees in 2004. That is more than double what the card companies charge consumers in late fees and more than six times what they charge for ATM fees.

The average convenience store paid about $39,730 in credit card fees in 2005.

That same store only made $42,196 in pre-tax profits in 2005. The fact that businesses in my industry are paying almost as much to the credit card companies each year as they are making before they pay Uncle Sam gives you a sense of just how broken this market is.

I cannot overstate how difficult this is for business and how rapidly the card companies have increased how much money they take on every gasoline purchase.

Between 2004 and 2005 the card companies' take from convenience store sales increased 145% more than the convenience stores' take. This has meant that the card companies are quickly taking away our businesses. After expenses and taxes, they make more money on each sale than we do. In effect, I am working for the card companies.

It is shocking what Visa and MasterCard wil do to drive up rates. For example, in May 1998, Visa announced that it would increase its offline debit interchange fee by about 20 percent. The increase was to take effect in April 1999. In November 1998, however, MasterCard announced a 9 percent increase (also to take effect in April 1999) that was enough to keep its fee higher than Visa's. In most competitive markets it would have been a chance for MasterCard to hold or lower prices to gain market share - but the reality is just the opposite when both card brands enjoy merchant acceptance of over 98 percent. In fact, those increases were just the start. In January 1999, Visa announced it would increase its fee by an additional 6 percent. Then MasterCard announced another increase five days later.

All of these increases were made before the first rate increase even took effect.

When the dust finally settled, Visa's rates went up 26 percent and MasterCard's went up 17 percent. Overall, these increases alone cost U.S. consumers an additional $300 million per year.

All of this is made far worse because Visa and MasterCard have designed the system to hide these fees. The operating rules enforced by Visa and MasterCard members prohibit disclosing interchange fees on receipts and include a web of rules - including prohibitions on discriminating between types of cards - that effectively keep consumers and retailers in the dark about interchange fees. , This conspiracy enforced by the credit card companies to keep information from consumers is a key element of the problems in this market. How can consumers possibly decide what is in their interest if the card companies keep this information secret?

As a retailer, I do not get a full disclosure of my rates. I understand that the card associations have a complex set of over 75 interchange rates that vary based on the type of card used and many other aspects of the transaction - but I have never seen the schedule of rates in all my years doing business. The rates can range from about 5 cents plus 1.15% for each transaction to 10 cents plus 2.7% of the transaction. But I have no way to know why I get charged a particular rate for a particular transaction. I am simply left to figure out what I have lost based on my own accounting.

Not only are the rates hidden from me, but so are the rules that affect my business.

MasterCard has a summary of its rules on its Website. Immediately following a House Energy and Commerce Subcommittee hearing in February, Visa put a summary of its rules on its website as well. But both summaries are clearly inadequate - leaving out hundreds and hundreds of pages of rules - and do not give retailers the information they need.

Just prior to this hearing, of course, Visa anounced that it would make its rules available to retailers on the Internet starting September 1 st. But that doesn't tell you the whole story. They plan to let you see the rules only if you have a merchant number and accept Visa. That seems sensible at first, but as a practical matter what it means is that you can't see the rules that you have to agree to until after you sign an agreement to follow them. What would happen if I treated my customers that way and only told them what they were buying after they paid for it? I wouldn't last too long. Not only that, but Visa isn't going to let retailers print the rules. We wil have to read more than 1,000 pages on the computer screen. I sure hope that something on page 900 doesn't refer to something on page 100 - or I might just crash along with my computer. On top of all that, we will only be able to see the rules under Visa's plan if we sign a non-disclosure agreement. That means to see the rules I wil have to agree not to tell this Committee or anyone else what is in them. I won't be able to tell my trade association about the rules and get advice about what they mean and how to react to them.

This plan may have made a good press release for Visa, but it will keep the shroud of secrecy over this market. Coming five months after Tim Muris testified that the rules were already available on Visa's and MasterCard's websites, this doesn't give me the impression that the card companies are taking seriously the concerns that have been raised about the anti competitive market of interchange fees.

I want to assure you that these secret rules negatively impact consumers and businesses every day. In my industry, the best example of this - or perhaps I should say the worst example - is something called "reason code 96." This code has come up for retailers of motor fuels when a purchase exceeds $50 for a Visa transaction or $75 for a MasterCard transaction.

With the gas prices we have had lately, exceeding these limits has become more common. But Visa and MasterCard say somewhere in their hidden rules that if a gas purchase exceeds these pre-approved levels, they can deny payment to the retailer for the entire transaction. This is true even if the consumer pays and does not dispute the bill.

Visa and MasterCard banks have refused to credit retailers' accounts for the entire $51 or more for many of these transactions. Yet, this rule is never disclosed to retailers - they just have to accept that Visa and MasterCard are essentially granting themselves a license to steal the retailer's money. The chart shows just how these so-called "chargebacks" jumped and stayed much higher than previous levels after gasoline prices rose last falL. This rule, as well as its secrecy, is abusive and inexcusable.

3. These Fees Are Bad for Consumers
Let me emphasize that this is very unfair for our customers because they end up paying for it. The average American family paid $231 in interchange and related fees in 2004. And that is true whether or not that family uses a single credit or debit card. Because these fees are hidden in the cost of virtually everything we buy, even cash-paying consumers ultimately pay for them.

Consumers who do not have credit or debit cards - often because they have lower incomes or poor credit - have to pay for this just like people who have credit cards.

But these folks don't get a line of credit or any other benefits for it. In February, Ed Mierzwinski testified on this topic on behalf of the U.S. Public Interest Research Group and the Consumer Federation of America. He said:
"As consumer advocates, we are gravely concerned about the fairness and legality of bank schemes to increase credit and debit card fee income, especially because an underlying bank goal is also to encourage greater consumer use of plastic payments. As more consumers pay with plastic instead of cash, due to bank incentives such as rewards cards, but merchant fee income is buoyed by potentially anti-competitive practices, all consumers will pay more than we should at the pump, and more than we should at the department store, even those of us who still pay with cash. This is especially troubling as a matter of public policy due to the estimated 10- 1 2 millon unbanked American families forced to absorb these higher costs even though they pay with cash. "

Mr. Mierzwinski was exactly right. The card companies like to tout the rewards they give their customers, but we should be sure to recognize that the vast majority of consumers do not get rewards or airline miles with their cards. Convenience store customers who use cards, in fact, only use a rewards card for about lout of 7 transactions. And what about the annual fees, interest payments, late fees, and multiple other charges that credit card holders must pay directly? Just more profits for the credit card companies who get consumers coming and going. The bottom line, of course, is that those who get the least from the system pay for those who get some benefits. This is like a secret, regressive tax and this aspect of the problem must be taken into account.

One of the reasons this problem has become so dire is that it is kept secret. A TM fees provide a good comparison. Some have advocated for strong limitations or even abolition of A TM fees. Yet interchange fees are about six times higher than ATM fees. The difference is that consumers see the ATM fee every time they pay it. That gives them some awareness and some ability to change their behavior to the card companies' efforts to keep them hidden.

Why should Americans pay higher prices to use plastic than consumers pay in other countries similar to ours? As you can see in chart 2, U.S. interchange fees average 1.74%, while other industrialized countries such as Britain typically pay 0.7% and Australia averages only 0.45%. The difference translates into hundreds of dollars in added costs to the average American family annually for no added benefit.

It's the same Visa and MasterCard everyhere - in fact in Britain, according to a report Visa commissioned on interchange, has a higher per capita incidence of credit card use than we do, so clearly low interchange rates haven't hurt Visa and MasterCard at all. We have the highest overall volume of transactions, which should lead to significant economies of scale and lower interchange rates. We also have the best technology for processing these transactions and we have very low rates of fraud. Yet U.S. rates are higher than in other countries and they are rising - while the rates in most other countries are flat or declining.

It is one thing for us to pay about double the rate paid in places like Great Britain, the European Union, and Australia. The credit card companies will spend a great time complaining about the regulatory systems in those places. Of course, those places even before their regulators took action. But how can anyone think it makes sense for us to pay higher interchange rates than people in Malaysia or Brazil?

Does the United States really have a riskier and costlier credit system than those countries?

We don't of course, but the anticompetitive problems with this market that I have described allow the card companies to get away with charging more here - so they do. The result is that the United States pays 60 percent of all of the interchange fees collected around the globe. That is simply wrong.

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In truth, this is just a brief glimpse of the problems with this market. We and the Congress need to know more about it so that we can design the right ways to fix it.

I look forward to working with the Members of this Committee and the Congress to do just that. I welcome your questions.