

# payments system research briefing

October 2014

FEDERAL RESERVE BANK of KANSAS CITY

## Interchange Fees and Network Rules: A Shift from Antitrust Litigation to Regulatory Measures in Various Countries

By Fumiko Hayashi, Senior Economist, and Jesse Leigh Maniff, Payments Research Analyst

Card payments have become increasingly popular in many countries. More consumers have adopted general purpose credit, debit, or prepaid cards and are using those cards more than ever. At the same time, more public authorities have intervened or initiated investigations in the payment card industry concerning interchange fees and rules set by payment card networks, such as no-surcharge and honor-all-cards rules.

Another recent trend is a shift in public authority involvement from pursuing antitrust litigation to employing regulatory and legislative measures to address policy issues raised by payment card pricing or rules. Interchange fees and network rules are increasingly determined by laws or regulatory authorities such as central banks instead of through settlement agreements with competition authorities or the decisions of competition courts. This *Briefing* summarizes the trends of public authority involvement in interchange fees and network rules, examines reasons for the shift to regulatory measures in Canada and the European Union (EU), and considers potential implications for the United States.

### Trends in public authority involvement

In our most recent report, “Public Authority Involvement in Payment Card Markets: Various Countries, August 2014 Update,” we documented the 38 countries (or

areas) where public authorities have intervened or initiated investigation in payment card networks’ interchange fees or merchant service fees.<sup>1</sup> Seven of these countries were added to the list in 2010 or after. Public authorities have also intervened in or investigated no-surcharge or no-discrimination rules in 36 countries. In eight of these 36, public authorities took actions in 2005 or earlier, while in all other countries, actions were taken in or after the late 2000s.

Competition authorities and competition tribunals made many of the early interventions, and primarily pursued them on three grounds. The first was collectively-set interchange fees that did not meet conditions to receive an exemption from the competition law. For example, the Spanish Competition Tribunal refused to grant the exemption sought by three Spanish card schemes for collectively-set interchange fees in 2005. The second ground for intervention was excessive interchange fees or merchant service fees that competition authorities viewed as abuses of the dominant position of card networks, issuing banks, or merchant acquirers. In one of the earlier cases of this, the Netherlands Competition Authority fined Interpay, the operator of a Dutch debit card system, and its member banks for charging excessive merchant service fees for PIN debit transactions in 2004. The third ground for intervention dealt with card networks’ rules—such as no-surcharge or honor-all-cards rules—that impose restrictions

on merchant practices and thus are anticompetitive. For instance, the Israel Antitrust Authority banned card networks' no-surcharge rules in 1993.

Together, these court decisions and settlement agreements typically resulted in a fine or a set of conditions the parties agreed to follow. However, neither fines nor settlement conditions have provided participants in the payment card industry, such as networks, issuers, and acquirers, with a clear set of standards going forward.

More recent interventions, in contrast, have increasingly used regulatory and legislative measures, adding some clarity to the payment card industry's legal landscape. While two central banks, the Reserve Bank of Australia and the People's Bank of China, have regulated interchange fees and merchant fees, respectively, since the early 2000s, four central banks joined them in the late 2000s or after. The Central Bank of Venezuela set limits on merchant fees in 2009, the U.S. Federal Reserve Board capped debit card interchange fees received by large debit card issuers in 2011, the Reserve Bank of India capped merchant fees in 2012, and the South African Reserve Bank set interchange fee levels in 2014. Other regulatory authorities or legislation have also set interchange fees or merchant fees. In Denmark and Argentina, merchant fees have been regulated by law as early as the 1990s. Recent additions to these countries include Poland (in 2012) and Spain (in 2014), where the interchange fee caps were set by law or the government. Regulations limiting interchange fees have been proposed in three additional countries or areas—Hungary, Romania, and the EU. Card networks' no-surcharge or no-discrimination rules have been lifted by law in several EU countries from 2009 to 2010, and by the Reserve Bank of Fiji in 2012.

Several countries issued regulations after judicial interventions, regardless of whether these interventions were successful or unsuccessful. For example, in South Korea, the competition commission ruled on collectively set interchange fees in 2005. The revised Credit Finance Law, which determines merchant fees, was later approved in 2012. After a series of interventions by the competition authority and competition tribunal, Spain's government approved caps on interchange fees in 2014. A similar transference from litigation to regulation can be observed in the EU, where the European Parliament and Council are currently considering a European Commission (EC) proposal to cap interchange fees after over a decade of litigation, mostly brought by the EC. Competition

authorities' interventions were unsuccessful in Canada and Poland, but an amended law now limits interchange fees in Poland, and the Canadian government is working to curb these fees.

## Reasons for the shift from antitrust litigation to regulatory measures

Public authorities as well as researchers on payment card markets have pointed out several shortcomings of an antitrust approach to interchange fees and network rules as compared with a regulatory and legislative approach.

The Canadian Competition Tribunal explicitly expressed a preference for a regulatory approach, as opposed to judicial relief, in its dismissal decision statement on a case the Commissioner of Competition brought against Visa and MasterCard.<sup>2</sup> The Commissioner alleged that agreements the two card networks respectively entered into requiring their acquirers to impose rules on merchants influenced upward or discouraged the reduction of merchants' card acceptance fees (that is, interchange fees). Although the Tribunal dismissed the case based on the inapplicability of the section of the competition law under which the Commissioner filed it, the Tribunal extended its analysis and found that no-surcharge rules imposed by the card networks had an adverse effect on competition. Nonetheless, the Tribunal would have declined to grant discretionary relief because it was convinced that the proper solution to these legitimate concerns is a regulatory approach, given experiences in other countries such as Australia and the United Kingdom. In these countries, public authorities lifted card networks' no-surcharge rules and as a result, merchants were allowed to freely impose surcharges on their customers. Due to more recent regulatory interventions, however, they now have some limitations on imposing surcharges (for example, the surcharge amount should not exceed the merchants' card acceptance costs). The Tribunal also noted that it is exceptional for it to decline to exercise its discretion in favor of regulation. Taking up the mantle, the 2014 budget of the government of Canada includes provisions to help lower credit card acceptance costs for merchants.

In contrast to the Canadian judiciary, the EC views its currently proposed interchange fee regulation as a complement to its investigations and decisions under EU competition law that addresses the drawbacks of the EU's antitrust framework.<sup>3</sup> One important drawback they point out is that even though

the General Court judgment confirms the EC's assessment that interchange fees set by one card network are anticompetitive, such a judgment does not necessarily induce other card networks to proactively adjust their practices. Another drawback is that although National Competition Authorities work closely with the EC, their different timelines and procedures may lead to an even more fragmented market, preventing the European payments market from achieving desired integration and innovation. To address these drawbacks, the EC now proposes common rules for interchange fees in the EU to provide legal clarity and a level playing field among Europe's complicated payments landscape.

A recent paper by Malaguti and Guerrieri elaborates further on the downsides of an antitrust framework.<sup>4</sup> The authors investigated whether a regulatory, rather than a purely competition policy, approach would be more appropriate in retail payments, especially with respect to interchange fees. They reference a variety of reasons for advocating regulation: first, litigation usually takes too long to resolve the issues; second, litigation does not necessarily give industry participants the legal certainty they need to operate in the market; and third, given the very complex retail payment market structure, a regulator has more flexibility than a competition authority in designing structural reforms necessary to enhance competition and can evaluate issues such as interchange fees and no-surcharge rules in a wider context.

### **Potential implications for the United States**

This global trend away from litigation and toward regulation might affect the payment card industry in the United States. As noted earlier, this trend is evident in the U.S. debit card industry. Until the Durbin Amendment to the Dodd-Frank Wall Street Reform and Consumer Protection Act, litigation had been a major tool to resolve issues in the U.S. debit card industry. For example, the honor-all-cards rules of Visa and MasterCard requiring merchants to accept both credit and signature debit cards of the network were lifted in 2003 as a condition for the settlement of a lawsuit brought by a group of merchants.<sup>5</sup> The settlement also required the card networks to reduce signature debit interchange fees for a certain period of time. After that period, however, the interchange fees went up again, at least for smaller merchants. In 2010, the Durbin Amendment gave authority to the Federal Reserve Board to implement Regulation II to cap interchange fees received by large debit card issuers. The cap took effect in

October 2011.

In contrast to debit card interchange fees, credit card interchange fees are not regulated in the United States. Except for a few failed attempts to implement legislation to curb credit card interchange fees, issues in the U.S. credit card industry have been investigated through litigation.<sup>6</sup> For example, the Justice Department (DOJ) filed a lawsuit in 2010 against American Express, Visa, and MasterCard, alleging their rules on merchant practices violated antitrust law.<sup>7</sup> Visa and MasterCard reached a settlement with the DOJ and eliminated rules preventing merchants from flexibly offering payment discounts to their customers; however, American Express refused to settle and its trial began in July 2014.

A large group of merchants also filed a class action suit in 2005 against Visa, MasterCard, and several large issuers, alleging they unlawfully fixed interchange fees and engaged in anticompetitive activities.<sup>8</sup> The case was settled and required the card networks to allow merchants to impose surcharges on credit card transactions under certain circumstances (subject to a cap and other consumer protection measures). However, it was not approved until late 2013, and the effectiveness of eliminating no-surcharge rules depends on other card networks' rules and state laws.<sup>9</sup> For some, the case is still not over. A number of merchants and their trade associations have appealed the settlement and for those merchants that opted out of the settlement and filed their own lawsuits, it will take years before there is any resolution.

Judge John Gleeson mentioned the limitation of antitrust lawsuits in his final approval order of the aforementioned class action settlement.<sup>10</sup> He expressed doubts that the courtroom is the appropriate venue for merchant recourse, saying "a lawsuit is an imperfect vehicle for addressing the wrongs the plaintiffs [a group of merchants] allege in their complaint." He mentioned the court would be in no position to grant the sweeping relief such as the regulation of interchange fees. He also stated that several features of the industry landscape, which the court again could not address, may undermine the efficacy of the agreed-upon relief, namely the elimination of Visa and MasterCard's no-surcharge rules.

The question remains unanswered as to whether the credit card industry in the United States will take a similar path from litigation to regulation given Judge Gleeson's order. In the EU, Canada, and some other countries, a shift from antitrust litigation to regulatory and legislative measures

occurred after the competition authority or the competition tribunal acknowledged shortcomings of an antitrust approach compared with a regulatory/legislative approach.

## Conclusion

Issues surrounding the payment card industry are becoming even more complex. In a number of countries, competition issues alone were deemed complicated enough to justify a comprehensive regulatory approach instead of a purely antitrust approach. In addition to competition, other issues such as card payments security and innovations using

payment cards as funding sources (for example, for mobile and digital payments) are becoming increasingly important, requiring public authorities to consider the issues in an even wider context. In some countries, a single public authority, such as a central bank, has authority to regulate many aspects of the payment card industry. In other countries, however, including the United States, different public authorities are responsible for different aspects (such as competition, security, and consumer protection). Their close cooperation is thus indispensable to maximize social welfare and minimize adverse effects of public authority interventions.

## Endnotes

<sup>1</sup>All references and sources for this section can be found within the updated report, available at: [http://kansascityfed.org/publicat/psr/dataset/pub-auth\\_payments\\_var\\_countries\\_August2014.pdf](http://kansascityfed.org/publicat/psr/dataset/pub-auth_payments_var_countries_August2014.pdf).

<sup>2</sup>Competition Tribunal. 2013. Reasons for Order and Order Dismissing the Commissioner's Application. In Re: The Commissioner of Competition v. Visa Canada Corporation and MasterCard International Incorporated, CT-2010-10.

<sup>3</sup>European Commission. 2013. Proposal for a Regulation of the European Parliament and of the Council on interchange fees for card-based payment transaction, COM (2013) 550 final – 2013/0265 (COD).

<sup>4</sup>Malaguti, Maria Chiara, and Alessandra Guerrieri. 2014. "Multilateral Interchange Fees: Competition and Regulation in Light of Recent Legislative Development," European Credit Research Institute Research Paper, No. 14, January.

<sup>5</sup>*Wal-Mart Stores Inc. v. Visa U.S.A. Inc.*, 396 F.3d 96 (2d Cir. 2005).

<sup>6</sup>For these attempts, see Hung, Christian. 2009. "An Update of

Interchange Legislation in the United States," Federal Reserve Bank of Kansas City, *Payments System Research Briefing*, December.

<sup>7</sup>*U.S. and Plaintiff States v. American Express Company, et al.*, No. 10-CV-04496 (NGG) (EDNY 2010).

<sup>8</sup>*In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation*, 05-MD-1720 (JG) (JO) (EDNY 2005).

<sup>9</sup>American Express does not allow merchants to impose surcharges to its card users and treat its card users differently from users of other card brands. Some states prohibit merchants from surcharging the use of credit cards. See Hayashi, Fumiko. 2012. "Discounts and Surcharges: Implications for Consumer Payment Choice," Federal Reserve Bank of Kansas City, *Payments System Research Briefing*, June.

<sup>10</sup>Memorandum and Order. *In re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation*, 05-MD-1720 (JG) (JO), p. 9 (EDNY 2013).

# payments system research

Website: <http://www.kansascityfed.org/research/bankingandpayments/>

The Payments System Research Department of the Federal Reserve Bank of Kansas City is responsible for monitoring and analyzing payments system developments. Staff includes:

## **Terri Bradford**

Payments Research Specialist  
[Terri.R.Bradford@kc.frb.org](mailto:Terri.R.Bradford@kc.frb.org)  
816-881-2001

## **Jesse Leigh Maniff**

Payments Research Analyst  
[Jesse.Maniff@kc.frb.org](mailto:Jesse.Maniff@kc.frb.org)  
816-881-2091

## **Richard J. Sullivan**

Senior Economist  
[Rick.J.Sullivan@kc.frb.org](mailto:Rick.J.Sullivan@kc.frb.org)  
816-881-2372

## **Joshua Hanson**

Research Associate  
[Joshua.Hanson@kc.frb.org](mailto:Joshua.Hanson@kc.frb.org)  
816-881-4762

## **Zach Markiewicz**

Payments Research Specialist  
[Zach.Markiewicz@kc.frb.org](mailto:Zach.Markiewicz@kc.frb.org)  
816-881-2860

## **Fumiko Hayashi**

Senior Economist  
[Fumiko.Hayashi@kc.frb.org](mailto:Fumiko.Hayashi@kc.frb.org)  
816-881-6851

## **Jackie Nugent**

Assistant Vice President  
[Jackie.Nugent@kc.frb.org](mailto:Jackie.Nugent@kc.frb.org)  
816-881-2462

*The views expressed in this newsletter are those of the authors and do not necessarily reflect those of the Federal Reserve Bank of Kansas City or the Federal Reserve System.*

