

EXHIBIT 4

**UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK**

**IN RE PAYMENT CARD
INTERCHANGE FEE AND MERCHANT
DISCOUNT ANTITRUST LITIGATION**

No. 05-MD-1720 (JG) (JO)

This Document Applies to: All Cases.

DECLARATION OF ALAN S. FRANKEL, Ph.D. RELATING TO THE PROPOSED CLASS SETTLEMENT

Table of Contents

1. Introduction and Summary of Opinions 2

2. The Ability to Steer Consumers to Lower Cost Payment Brands and Methods, as Provided by the Proposed Settlement, Enhances Competition and Benefits Merchants 5

 2.1 Steering in Competitive Markets 7

 2.2 Anti-Steering Rules Subvert the Competitive Process and Lead to Higher Prices 8

3. The Proposed Settlement Preserves Reforms Obtained From Dodd-Frank and the DOJ Settlement Which Benefit Merchants and Contribute to the Creation of a More Competitive Marketplace 12

4. The Additional Relief from the Proposed Settlement Will Benefit Merchants and Consumers by Providing Additional Means to Constrain the Networks’ Market Power 17

 4.1 The Evidence Shows That Merchants Benefit From the Ability to Surcharge 17

 4.1.1 Merchants Are Increasingly Likely to Surcharge at Fee Levels Prevailing in the United States 19

 4.1.2 Surcharging Induces Many Consumers to Switch to Non-Surcharged Payment Brands and Methods 23

 4.1.3 Actual and Threatened Surcharging Constrains the Level of Merchant Fees 26

 4.2 The Ability to Surcharge Credit Card Transactions is More Competitively Effective than the Ability to Discount 29

 4.3 Alternative Forms of Surcharging Permitted by the Proposed Settlement 32

 4.4 Some Merchants Can Take Advantage of Selective Acceptance Across Their Different Banners to Reduce Card Acceptance Fees 33

 4.5 Merchant Buying Groups May Help Merchants Negotiate Lower Fees 34

 4.6 The Effects of State Statutes and American Express’ Non-Discrimination Policy 35

 4.6.1 State Surcharge-Related Statutes 35

4.6.2 American Express’ Non-Discrimination Policy 37
4.7 An Illustration of the Benefits from Surcharging 39
5. Conclusion..... 44

1. Introduction and Summary of Opinions

1. I have been asked by counsel for the class plaintiffs to evaluate the likely economic impact of the relief with respect to merchant rules contained in the proposed class settlement (“Proposed Settlement”), and, in particular, whether that relief will benefit the members of the class by reducing the cost to merchants to accept MasterCard or Visa credit card payments from their customers.¹ I have also been asked to provide some estimate of the value of any such benefit to the members of the class. The main aspects of the proposed relief are:

- Reform of MasterCard’s and Visa’s (collectively “the Networks”) “no-surcharge” rules. Subject to certain limitations, merchants may now assess “brand-level” or “product-level” surcharges on use of the Networks’ credit cards;
- Reform of the Networks’ rules to allow merchants to accept the Networks’ cards at fewer than all of the merchant’s “trade names” or “banners;”
- The commitment by each Network to negotiate in good faith with buying groups of merchants over the terms and conditions under which they accept the Network’s cards;
- Recommitment to the relief provided by the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) (*i.e.*, removal of the “no-minimum purchase” and “no-discount” rules) notwithstanding any subsequent modification or repeal of the Dodd-Frank Act;² and

¹ Under the terms of the Proposed Settlement, MasterCard and Visa will also pay up to \$7.25 billion in monetary relief.

² Public Law 111–203 – July 21, 2010, Sec. 1075. The Dodd-Frank Act also authorized the Federal Reserve to regulate debit card interchange fee rates, required that at least two networks can be accessed by a debit card, and forbid networks from prohibiting a merchant from routing a debit card transaction over an alternative network accessible by the card.

- Recommitment to the relief provided by the settlement between MasterCard and Visa and the United States Department of Justice (“DOJ Settlement”) notwithstanding any end to the Networks’ requirements under that settlement.³

2. This litigation commenced in 2005 when the full range of the Networks’ merchant restraints (“Anti-Steering Rules”) was in effect.⁴ Since then, in addition to the reforms to rules required under the Proposed Settlement, some of the Anti-Steering Rules have been reformed as a result of legislation and settlement of litigation against the Networks brought by the United States Department of Justice and certain states. As described above, the Proposed Settlement ensures the continuation of those reforms and further extends them.

3. I have previously submitted two reports in this litigation relating to liability and damages.⁵ In those reports, I explained the anticompetitive nature of Defendants’ rules and actions, including the Anti-Steering Rules used to maintain and enhance their market power and the level of merchant fees. My opinions with respect to the anticompetitive effects of Defendants’ rules remain unchanged. In this report, I examine the benefits to merchants from

³ See, e.g., Competitive Impact Statement in United States of America, et al. v. American Express Company, American Express Travel Related Services Company, Inc., MasterCard International Incorporated, and Visa Inc., Civil Action No. CV-10-4496, October 4, 2010. American Express did not reach a settlement with the Department of Justice and litigation continues between the DOJ (as well as by other parties) and American Express concerning that network’s merchant restrictions, which I discuss further in Part 4.6.2, *infra*.

⁴ I describe the Anti-Steering Rules in detail in Part 5.2 of my initial report.

⁵ Report of Alan S. Frankel, Ph.D., July 9, 2009 (“Frankel Report”); Rebuttal Report of Alan S. Frankel, Ph.D., June 22, 2010 (“Frankel Rebuttal Report”). My background and qualifications regarding the issues in this case are also described in those reports. Since submitting my Rebuttal Report, I have submitted two reports and testified as an expert on behalf of Canada’s Commissioner of Competition in a case against MasterCard and Visa regarding certain of those networks’ merchant rules. I also spoke about related issues at conferences hosted by the Federal Reserve Bank of Kansas City in March 2012, and The Clearing House Association in New York in November 2012. I attach my current CV as Exhibit 1. In preparing this declaration I drew on my extensive research into these issues as described in my earlier reports in this case, the materials cited therein, and in my published writings. I attach a list of materials that I specifically relied on in preparing this declaration in Exhibit 2.

the reforms of those rules resulting from the Dodd-Frank Act, the DOJ Settlement, and the Proposed Settlement. My main opinions are as follows.

4. **Opinion #1: Merchants benefit from the ability to steer customers to less costly payment methods, an ability that is enhanced by the Proposed Settlement.** Interchange fees, the main component of merchant fees, are paid to banks that issue payment cards. As described in my prior reports, MasterCard and Visa Anti-Steering Rules have historically limited competition for merchant transactions between those networks.⁶ By enforcing the Anti-Steering Rules, which impeded or prohibited discounting, surcharging or other mechanisms to incentivize or advise customers to employ less costly payment mechanisms, the Networks stifled interbrand competition at the point of sale that otherwise would have been a countervailing competitive force to the Networks' incentive to increase interchange fees. The ability to steer made possible through reforms of the Networks' Anti-Steering Rules thus creates price transparency to consumers and introduces competition into this marketplace by giving merchants the ability to exert normal competitive pressure on interchange fees, and thus constrains the Networks' market power.

5. **Opinion #2: The relief provided by the Dodd-Frank Act and the DOJ Settlement is helpful to merchants, and the Proposed Settlement's preservation of that relief is therefore valuable.** The changes to no-discount and no-minimum purchase rules affected by the Dodd-Frank Act and the DOJ Settlement provided merchants with additional tools to steer transactions to lower cost forms of payment. However, the relief granted by the Dodd-Frank Act, for example, came through legislation that could be repealed (and that the banks and the

⁶ See, e.g., Frankel Report, Part 6.4; Frankel Rebuttal Report, Part 3.6.

Networks have favored repealing).⁷ The Proposed Settlement ensures that those reforms are not undone.

6. **Opinion #3: The ability to surcharge credit card transactions, refuse to accept cards (or surcharge them) at particular banners, and the requirement for Defendants to negotiate with buying groups of merchants in good faith will generate significant benefits for merchants by providing additional, effective means of constraining the Networks' market power.** The Proposed Settlement provides several additional means of constraining the Networks' market power, including giving merchants the ability to surcharge at either the brand or product level, the ability to refuse to accept cards at particular banners or trade names but not others, and the requirement that the Networks negotiate in good faith with merchant buying groups. Each of these reforms contributes to increasing interbrand competition and providing merchants with more ability to steer customers to less expensive payment methods, thus constraining the Networks' market power.

7. I explain the bases for these three opinions in Parts 2 through 4, respectively. I also provide a range of estimates of the potential impact with respect to the ability to surcharge.

2. The Ability to Steer Consumers to Lower Cost Payment Brands and Methods, as Provided by the Proposed Settlement, Enhances Competition and Benefits Merchants

8. "Steering" in the context of this case refers to strategies merchants use to influence consumer payment choices at the point of sale, to incentivize customers to use lower-cost payment

⁷ In 2011, for example, MasterCard delayed implementing aspects of the Dodd-Frank Act regulations in hopes that the law would be repealed. (<http://www.reuters.com/article/2011/03/01/us-finance-summit-mastercard-debit-idUSTRE72058B20110301>). See also, e.g., <http://www.businessweek.com/news/2012-05-14/jpmorgans-inconvenient-truth-hits-romneys-dodd-frank-repeal-vow>; <http://www.cnn.com/id/45971366>).

methods. Steering by merchants introduces transparency to consumers of the costs of their payment choices and introduces direct competition into the marketplace to lower the costs to merchants and, thus, to their customers. The Networks have long enforced a variety of Anti-Steering Rules designed to minimize that merchant influence and competition.

9. Anti-Steering Rules have blunted the normal competitive consequences which should have resulted from the Networks' merchant fees, which cost merchants more than other payment methods.⁸ The rules ensured that the high merchant fees were opaque to consumers, thereby encouraging them to make costlier (and riskier) payment choices. Other consumers, including those who paid by cash or check, bore the increased costs of the merchants' acceptance of the Networks' cards, including the costs associated with special premium credit cards offered only to the highest income and highest-spending cardholders, which resulted in even higher interchange fee rates and merchant costs.⁹ Through rewards and other benefits, these cardholders are encouraged to use the premium credit cards. But lower income consumers – including those using credit cards without rewards, debit cards, checks, or cash – fund a large portion of those interchange fees (and rewards) and get none of the reward benefits themselves.

10. In a more competitive market, by contrast, merchants can transparently convey to consumers how their choices affect merchant and consumer costs, including by offering discounts for low cost purchases or additional fees for additional or more costly services. However, the Networks have been able to set fees at higher levels than otherwise by using their rules to curtail normal competitive forces, and therefore, more transactions are completed using these high-fee credit cards

⁸ Frankel Report, Part 5.2; Frankel Rebuttal Report, Part 4.2. See also Expert Report of Joseph Stiglitz, Ph.D. ("Stiglitz Report"), ¶127 ("In a competitive system, merchants would be expected to react to a payment network's attempt to charge supracompetitive fees by charging or threatening to charge the users of such cards. This would make it economically less attractive for the payment network to attempt to charge such high fees.").

⁹ For example, see Frankel Report, Part 4.1.5 and note 193.

than would occur in a more competitive market.¹⁰ Merchants have been harmed, but so have their customers, including those who have used lower cost payment brands and methods – and those predominantly low income customers who do not use a credit card – but who nevertheless pay prices elevated by the Networks’ high fees.¹¹

2.1 Steering in Competitive Markets

11. The most important steering mechanism is a transparent price system.¹² The freedom of sellers to set prices transparently lies at the heart of our competitive market economy. In competitive retail markets, individual merchants normally are free to choose what prices they set for sales to their customers, constrained only by competition with other merchants and the responses of their customers. Merchants in competitive markets are also free to change those prices in response to changes in cost and market conditions. Their

¹⁰ See also Reply Report of Joseph Stiglitz, Ph.D., June 22, 2010 (“Stiglitz Reply Report”), p. 2 (“The interference with price signals severs the usual connection between private choices and gains in social welfare. With the Merchant Restraints in place, the market cannot ensure that customers collectively value the benefits of credit card (or premium card) usage by more than its cost. The Merchant Restraints prevent shoppers who choose to use the cards from knowing and incurring the costs of that choice. Without the market discipline of well-informed customer choices, the Defendants can and do raise the interchange fees above the competitive and efficient level.”).

¹¹ Federal Reserve economists Scott Schuh, Oz Shy and Joanna Stavins estimate that “83 percent of banks’ revenue from credit card merchant fees is obtained from cash payers, and disproportionately from low-income cash payers.” Scott Schuh, Oz Shy and Joanna Stavins, “Who Gains and Who Loses from Credit Card Payments? Theory and Calibrations,” Federal Reserve Bank of Boston, Public Policy Discussion Paper No. 10-03 (August 2010), p. 3. See also Stiglitz Reply Report, p. 45 (“The interchange fees will increase the average marginal cost to merchants of selling goods. Basic economic principles imply that merchants are then expected to react to the ‘tax’ on credit card use by raising retail prices. But under the Merchant Restraints, the price will increase to all customers. This will cause some welfare loss to non-credit card using customers.” Notes omitted.).

¹² See, for example, Stiglitz Report, ¶39 (“To interfere with the price mechanism is to interfere with the efficient functioning of a market. Prices are the principal means by which buyers are informed of the social costs of their consumption decisions. The elimination of pricing information at the point of sale nearly guarantees an inefficient allocation of resources; the market’s ‘invisible hand’ cannot function because buyers lack appropriate information and incentives to guide their decisions. With competition among alternative credit card payment networks and alternative payment mechanisms – with the use of price signals to guide buyers’ choices – buyers’ choices of the desired payment form and merchants’ choices to accept and encourage use of the alternatives will be based on their respective costs and benefits.” Notes omitted.).

customers are likewise free to respond to the selection of products offered by different merchants at different prices by making choices from among competing stores and brands. A merchant setting its prices higher than those charged by competitors for comparable goods or services will tend to lose sales to the lower price merchants, all else equal. A high priced *supplier* to the merchant will likewise tend to lose sales to lower priced suppliers as merchants tend to charge higher prices for those higher cost products, and merchants' customers respond by shifting some or all of their purchases to lower priced alternatives.

12. In addition to using simple price differences between products, of course, merchants frequently use other steering strategies. For example, they might promote one brand but not another, provide more prominent shelf space to one brand, offer a free camera case with purchase of one brand of camera, but not with other brands, and so on. In a competitive credit card market unconstrained by the exercise of market power through Anti-Steering Rules, sellers similarly would use such strategies to offer better deals to – and thus share the benefits with – their customers who make lower cost choices. Retailers are highly motivated to increase their sales and reduce their costs, and use many strategies and incentives to accomplish this.

2.2 Anti-Steering Rules Subvert the Competitive Process and Lead to Higher Prices

13. In addition to restricting inter-brand competition at the point of sale, the Anti-Steering Rules also erected an entry barrier by making it difficult for a low cost competitor to

enter and succeed by getting merchants to steer transactions effectively to the entrant's network.¹³

14. In a competitive market, by contrast, if the price to merchants to accept one brand of credit cards is higher than the cost to accept other credit cards (or other payment methods), merchants can be expected increasingly to engage in steering strategies that encourage or reward the use of lower cost payments, and discourage or surcharge the use of the higher cost card. This would constrain the level of the Networks' fees: high fees generate more revenue for a completed transaction, but the aggregate effect of merchant steering causes a loss of transaction volume. That lost volume makes it unprofitable for the Networks to maintain their fees as high as they would if they could continue to enforce the Anti-Steering Rules.

15. All else equal, banks always have an economic incentive to collect higher fees rather than lower, but – in a competitive market – the ability of their customers to make choices from among competing alternatives reduces the profitability of price increases by reducing the volume of sales they will make when they raise their prices. With the Anti-Steering Rules, banks that issued the Network's cards (and therefore collected the resulting interchange fees) faced none of this normal competition.¹⁴

¹³ See also Stiglitz Report, ¶155 (“The Merchant Restraints also help maintain supracompetitive profits by raising the cost of entry and expansion in the EFT [electronic funds transfer] industry. Entry, potential entry, and expansion play an important role in the efficiency of a market system.”).

¹⁴ This is not to say that there can never be circumstances where there might be other, efficiency-enhancing effects from such practices. In this case, I explained that the various defenses offered by the Defendants' experts lacked merit and did not offset the anticompetitive effects of the Anti-Steering Rules. Frankel Rebuttal Report, Part 5.2.

16. If merchants can respond in a normal way to these higher fees with competitive strategies that cause a higher price network to *lose* transaction volume to a lower cost network, this dysfunctional dynamic can be reversed. With the Networks' merchant rules in place, however, merchants were unable to stop the relentless increase in card acceptance fees. On one occasion in the late 1990s, Visa explained to merchants how merchants' inability to steer transactions at the point of sale to lower cost card leads directly to increases in interchange fees:

The differential [between MasterCard and Visa interchange rates] now has reached approximately 17 basis points and banks are no longer willing to accept the difference. ***As long as merchants allow Visa and Mastercard to be treated equally at the point of sale, there is simply not enough reason/incentive for banks to issue the lower priced card.*** They are beginning to switch brands. In fact, Visa share of the debit card market dropped 2 full percentage points in 1997, shifting volume to the higher priced Mastercard product.

Bottom line, Mastercard has failed to win with consumers so they have shifted their attention and resources in an attempt to accomplish the same desired result by appealing to the issuing banks. In order to halt their share decline, they have substantially raised interchange. ***In effect, what MasterCard is doing is reaching right into your pocket - taking your money and handing it to a card issuer to pay for conversions of Visa cards to MasterCard.***

It may sound absurd, but, it is true. Mastercard is using your money to grow their market share. ***How ironic it is that Mastercard is using increased pricing to merchants in order to fund share growth of a higher priced card product that will then detract even further from merchant profits...***

Now, put yourself in our board members' shoes. ***We charge less for our superior products, but are treated exactly the same way as Mastercard at the point of sale. Visa gets absolutely no credit for a lower price! ...***

Importantly, even if we do not raise interchange rates, merchants will still lose because with MasterCard's price advantage, there will increasingly be conversions of lower priced Visa cards to higher priced Mastercards.

In our view, as long as MasterCard maintains a meaningful interchange differential and merchants quietly accept this higher pricing by treating

MasterCard and Visa equally at the point of sale, then a share shift to MasterCard, the higher priced bankcard, will occur. Visa simply can not allow this to happen. We will have to raise our rates.¹⁵

17. Visa correctly recognized that that merchants' identical treatment of MasterCard and Visa transactions at the point of sale, despite a price differences between the brands, caused an increase in the use of the high cost brand and led to increases in interchange fees, increased merchant costs, and reduced merchant profits. But Visa neglected to explain that it, like MasterCard, enforced no-surcharge and other Anti-Steering Rules, which required that Visa be treated "exactly the same way as Mastercard at the point of sale." The Anti-Steering Rules prohibited merchants from engaging in exactly the types of strategies – treating card brands *unequally* – that Visa conceded would favor competitive card networks that charged lower prices to merchants.

18. MasterCard, too, has conceded that merchants' ability to treat customers differently at the point of sale constrains the level at which it sets its interchange fees. In a proceeding before the European Commission, MasterCard explained that in setting the level of interchange fees:

MasterCard tries to answer the question: "How high could interchange fees go before we would start having either serious acceptance problems, where merchants would say: we don't want this product anymore, ***or by merchants trying to discourage the use of the card either by surcharging or discounting for cash[...]***"¹⁶

19. The more competitive tools that merchants have available to them to discourage the use of the Networks' high-priced cards, the more competitive pressure those tools will tend

¹⁵ Visa "Merchant Presentation Messages," VUSAMD00153736 (emphasis added).

¹⁶ Judgment of the General Court (Seventh Chamber), Case T-111/08, May 24, 2012, ¶158; available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62008TJ0111:EN:HTML> (emphasis added).

to put on the networks to keep their fees low. In Part 3, I explain that the Dodd-Frank Act and the DOJ Settlement provided some such tools. In Part 4, I explain why the additional relief provided by the Proposed Settlement is likely to have a significant additional constraining effect on the level of interchange fees relative to those which would be charged in the absence of that relief, by providing the merchant with additional steering tools.

3. The Proposed Settlement Preserves Reforms Obtained From Dodd-Frank and the DOJ Settlement Which Benefit Merchants and Contribute to the Creation of a More Competitive Marketplace

20. This litigation commenced in 2005. Since then, certain of the Networks' Anti-Steering Rules have been reformed as a result of legislation and settlement of litigation against the Networks brought by the United States Department of Justice. In June 2010, Congress passed and the President signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act. Among the provisions of the Dodd-Frank Act were reforms of certain of the Networks' Anti-Steering Rules – the “no minimum purchase” and “no discount” rules – which had been challenged by the class plaintiffs in this case. In particular, the Dodd-Frank Act required that the Networks permit merchants to:

- post minimum purchase amounts (up to \$10) for the use of credit cards; and
- offer discounts or in-kind incentives for use of payment methods other than credit cards, including cash, checks, or debit cards.¹⁷

21. Many (typically small) merchants have long shown their willingness to set minimum purchase amounts even though such minimums were prohibited by the Networks' rules. For very small purchases (e.g., a cup of coffee), the fees merchants pay to accept

¹⁷ Public Law 111–203 – July 21, 2010, Sec. 1075. The Dodd-Frank Act also authorized the Federal Reserve to regulate debit card interchange fee rates and other aspects of debit cards and debit card networks.

MasterCard and Visa credit cards can represent a substantial fraction of the merchant's expected profit.¹⁸ By letting individual merchants set a minimum purchase amount if they choose to do so, each merchant can evaluate the gains and losses from this strategy. The higher MasterCard and Visa interchange fees and network fees are, the more likely additional merchants are to take advantage of the ability to set minimum purchase amounts, causing more of a decline in transaction volume (and thus a greater competitive constraint) than if merchants could not set minimums. Reducing interchange fees reduces the incidence of merchants setting minimum charge amounts, which increases the incentive to reduce the fees. Merchants that choose to set minimum purchase amounts benefit directly by shifting some transactions to lower cost payments, but all merchants – whether they set minimums or not – will benefit to the extent that merchants in the aggregate have an additional tool to make the demand for credit card acceptance more elastic, altering the incentives facing MasterCard and Visa when they set their interchange fee rates.

22. Originally, Network rules prohibited any differential pricing at the point of sale. In the United States, Federal legislation in the early 1980s permitted merchants to offer discounts for the use of cash (and the Networks thereafter did not prohibit such cash discounts even after the original legislation expired). But Visa had another rule, which required that a merchant's posted or advertised prices be the price available to a Visa card customer. If a merchant's strategy was to increase its posted prices slightly but offer a discount to cash customers sufficient to reduce those prices below those charged by non-discounting

¹⁸ Starbucks, for example, has indicated that credit cards are relatively expensive for it and for other small-ticket-item merchants. In 2005 the cost to Starbucks of accepting a credit card for payment was three times the cost of accepting cash. "Forces Shaping the Payments Environment: A Summary of the Chicago Fed's 2005 Payments Conference," The Federal Reserve Bank of Chicago, Chicago Fed Letter No. 219a, October 2005, p. 4.

merchants, under Visa's rule it had to promote the higher credit card price, not the lower cash price. Some merchants, particularly gas stations which could easily post both cash and credit card prices, nonetheless took advantage of the ability to offer cash discounts.

23. The Dodd-Frank Act ensured that merchants could offer discounts for (generally low cost) cash, checks, or debit cards. (As a result of other aspects of that legislation, debit cards typically have a relatively low, fixed interchange fee.) Over time, some merchants are likely to find the ability to offer discounts for debit cards to be a useful steering strategy, especially if credit card interchange fees remain at high levels relative to debit card interchange fees.

24. The Dodd-Frank Act, however, did not forbid the Networks from enforcing their "no-discrimination" rules which prevented merchants from offering different discounts or in-kind benefits at the point of sale for different *brands* of credit cards, and which the class plaintiffs challenged in this case. The Act also did not eliminate Visa's posted price rule which may have limited the ability of merchants to profitably use discounting strategies. In October 2010, the DOJ Settlement accomplished these reforms by requiring the Networks to permit merchants to encourage the use of alternative brands of credit cards through discounts and other benefits at the point of sale.¹⁹

25. The Department of Justice explains the anticompetitive effects of the no-discrimination rules that it challenged as follows.

¹⁹ Under the terms of the DOJ Settlement, merchants were also permitted to display two prices (one for credit cards and one for cash or, e.g., debit) at the point of sale without having to mark each item with two prices. See Response of Plaintiff United States to Public Comments on the Proposed Final Judgment, in *United States of America, et al. v. American Express Company, American Express Travel Related Services Company, Inc., MasterCard International Incorporated, and Visa Inc.*, June 14, 2011, pp. 25-26.

The Complaint alleges that Defendants' Merchant Restraints suppress price and non-price competition by prohibiting a merchant from offering discounts or other benefits to customers for the use of a particular General Purpose Card. These prohibitions allow Defendants to maintain high prices for network services with confidence that no competitor will take away significant transaction volume through competition in the form of merchant discounts or benefits to customers to use lower cost payment options. Defendants' prices for network services to merchants are therefore higher than they would be without the Merchant Restraints.

Absent the Merchant Restraints, merchants would be free to use various methods, such as discounts or non-price benefits, to encourage customers to use the brands of General Purpose Cards that impose lower costs on the merchants. In order to retain merchant business, the networks would need to respond to merchant preferences by competing more vigorously on price and service to merchants. The increased competition among networks would lead to lower merchant fees and better service terms.

Because the Merchant Restraints result in higher merchant costs, and merchants pass these costs on to consumers, retail prices are higher generally for consumers. Moreover, a customer who pays with lower-cost methods of payment pays more than he or she would if Defendants did not prevent merchants from encouraging network competition at the point of sale. For example, because certain types of premium General Purpose Cards tend to be held by more affluent buyers, less affluent purchasers using non-premium General Purpose Cards, debit cards, cash, and checks effectively subsidize part of the cost of expensive premium card benefits and rewards enjoyed by those cardholders.

The Complaint also alleges that the Merchant Restraints have had a number of other anticompetitive effects, including reducing output of lower-cost payment methods, stifling innovation in network services and card offerings, and denying information to customers about the relative costs of General Purpose Cards that would cause more customers to choose lower-cost payment methods. Defendants' Merchant Restraints also have heightened the already high barriers to entry and expansion in the network services market. Merchants' inability to encourage their customers to use less-costly General Purpose Card networks makes it more difficult for existing or potential competitors to threaten Defendants' market power.²⁰

26. According to the Department of Justice, the settlement it reached with the Networks²¹ benefits merchants:

²⁰ Competitive Impact Statement in United States of America, et al. v. American Express Company, American Express Travel Related Services Company, Inc., MasterCard International Incorporated, and Visa Inc., Civil Action No. CV-10-4496, October 4, 2010 ("Competitive Impact Statement"), pp. 9-10.

²¹ The DOJ explains that the relief it obtained "prohibits Visa and MasterCard from adopting, maintaining, or enforcing any rule, or entering into or enforcing any agreement, that prevents any merchant from: (1) offering the customer a price discount, rebate, free or discounted product or service, or other benefit if the customer uses a particular brand or type of General Purpose Card or particular form of payment; (2) expressing a

Merchants that currently accept only Visa or MasterCard, or both, will benefit immediately from the Final Judgment by having the freedom to encourage their customers to choose the merchants' preferred method of payment. Merchants will have several new options available to accomplish this, such as offering customers a price discount, a rebate, a free product or service, rewards program points, or other benefits; placing signs that encourage customers to use particular payment methods; prompting customers to use particular General Purpose Cards or other forms of payment; or communicating to customers the costs of particular forms of payment.²²

27. American Express, also a defendant in the DOJ action, has not yet agreed to these provisions and litigation by the government and other parties continues against that network. I discuss the effects of American Express' anti-steering policy in Part 4.6.2 below.

28. By providing additional steering tools to merchants, the Dodd-Frank and DOJ Settlement relief benefitted merchants and consumers and contributed to introducing competition into the general purpose card acceptance (network) services market; and, by ensuring that those benefits remain in effect, the Proposed Settlement's provisions also provide a benefit in the event that the original bases for those rule changes are eliminated.

preference for the use of a particular brand or type of General Purpose Card or particular form of payment; (3) promoting a particular brand or type of General Purpose Card or particular form of payment through posted information; through the size, prominence, or sequencing of payment choices; or through other communications to the customer; or (4) communicating to customers the reasonably estimated or actual costs incurred by the merchant when a customer pays with a particular brand or type of General Purpose Card." *Id.*, pp. 10-11.

²² *Id.*, p. 14. Another aspect of the Networks' no-discrimination rules was that a merchant could not favor customers presenting cards issued by a particular card issuing member bank of a Network over customers presenting cards issued by another of the Network's member banks. Subsequent to the Proposed Settlement, Visa altered its rules to permit merchants to offer discounts for use of a particular issuer's cards, and announced a new initiative to facilitate such arrangements. "Chase/Visa Network Partnership," Nilson Report #1013, March 2013, pp. 1, 7. This generates an increased economic incentive for a particular credit card issuing bank to enter into a favorable low-cost arrangement with a merchant for acceptance of that bank's Visa credit cards, because the bank can expect to gain increased transaction volume from the merchant's steering to that bank's cards. Prior to the rule change, a low cost arrangement with a merchant could not result in such steering to a particular bank's credit cards.

4. The Additional Relief from the Proposed Settlement Will Benefit Merchants and Consumers by Providing Additional Means to Constrain the Networks' Market Power

29. Although the Dodd-Frank Act and the DOJ Settlements provided additional useful steering tools to merchants, they did not address the Networks' no-surcharge rules. No-surcharge rules have a different, more significant competitive effect in the marketplace than no-discount rules because consumers react differently (and more strongly) to surcharges than they react to discounts.²³ In addition to reaffirming the previously obtained relief, the Proposed Settlement reforms the MasterCard and Visa no-surcharge rules. It also enables merchants to accept the Networks' credit cards at some of their chains ("banners") without having to accept those cards at all of their banners, so that, for example, a merchant might choose not to accept the Network's credit cards in a discount store banner it operates while continuing to accept the cards in its other stores. Finally, the Proposed Settlement requires MasterCard and Visa to negotiate in good faith with merchant buying groups over the terms and conditions under which they accept the Networks' card transactions. These reforms can be expected to benefit merchants that take advantage of those newly permitted strategies and benefit merchants generally whether or not they do so.

4.1 The Evidence Shows That Merchants Benefit From the Ability to Surcharge

30. Experience shows that there is a long history of merchants using fees or surcharges to steer customers to lower cost payment methods and recoup the additional costs when customers

²³ See also Stiglitz Report, ¶142 ("Placing an explicit price on use of a card (what the networks call 'surcharging') can be an effective merchant response to above-competitive interchange fees. Some cardholders will respond to the price signal by continuing to use the card, and the price will allow the merchant to recover some of the interchange fees. Other cardholders will respond to the price signal by switching to an alternative, less-costly means of payment. This elasticity of user response to the price signal will cause the profit-maximizing interchange fee to the merchant to fall. Thus, by preventing 'surcharging,' Visa and MasterCard have reduced the elasticity of demand for the usage of the cards and reduced the cross-elasticity of demand between alternative payment mechanisms." Notes omitted.).

nevertheless impose higher costs on the merchant.²⁴ For example, as long ago as 1902, Sears allowed customers to pay for their orders with postage stamps but with a 5 percent surcharge, so if “you order an article priced at \$2.00 and send stamps you should send \$2.10. If a \$3.00 article you should send \$3.15 in stamps.”²⁵ And many U.S. merchants have already taken advantage of existing exceptions to the Networks’ no-surcharge rules to charge “convenience fees” – a euphemism for surcharges for use of the Networks’ credit cards.²⁶

31. When MasterCard voluntarily eliminated its no-surcharge rule in Europe in 2004, it explained that permitting surcharges “is in tune with the spirit of moving to more open competition and greater choice for merchants and consumers” and expressed its belief that if Visa followed, it would create “a level competitive environment built on the true benefits that card payments offer both to merchants and consumers.”²⁷

32. There are three main ways that merchants and their customers benefit from merchants’ ability to surcharge credit card transactions. First, by surcharging credit card payments, the merchant recovers all, or a significant portion, of the costs associated with accepting credit card transactions.²⁸ Second, by surcharging, merchants will steer a significant number of their customers to use alternative, lower cost and non-surcharged payment methods or brands. This will reduce the merchant’s overall average cost (and the average prices paid by consumers), which, all else equal, can be expected to

²⁴ See also Stiglitz Report, ¶127 (“In a competitive system, merchants would be expected to react to a payment network’s attempt to charge supracompetitive fees by charging or threatening to charge the users of such cards. This would make it economically less attractive for the payment network to attempt to charge such fees.”).

²⁵ Sears, Roebuck and Co. 1902 Catalog, p. 4.

²⁶ See, e.g., Frankel Report, ¶162 (many colleges and universities apply surcharges – the University of Illinois, for example, explains that if interchange fees decline, so will the amount of the surcharge).

²⁷ MCI_MDLO2_10577117.

²⁸ At the same time, the merchant’s posted shelf price will tend to decrease. Frankel Report, Part 5.3; Frankel Rebuttal Report, Part 4.6.2. This will help surcharging merchants to increase sales to customers who pay with cash, check, and debit cards (who benefit from the lower prices as they no longer subsidize the additional cost of serving credit card customers).

increase total merchant sales.²⁹ This benefits merchants that surcharge, but it can also benefit other merchants to the extent that some consumers alter their payment habits and use credit cards less frequently even at non-surcharging merchants. Third, because the Networks will lose more transactions if they maintain high interchange fees with surcharging than without surcharging, they will have an economic incentive to set lower interchange fees (and network fees) when merchants have the ability to surcharge. This will benefit all merchants, whether or not they surcharge.

4.1.1 Merchants Are Increasingly Likely to Surcharge at Fee Levels Prevailing in the United States

33. For surcharging to have these beneficial effects for merchants, at least some merchants must be willing to surcharge (or credibly threaten to surcharge) the Network's credit card transactions at the level of fees that would prevail absent of the ability to surcharge. The evidence (along with common sense) indicates that the likelihood that a merchant will surcharge use of a particular form of payment increases with the cost of that form of payment.³⁰ Surveys performed on behalf of the European Commission, for example, found that surcharging was more common in the Netherlands, where merchant fees were higher, than in Sweden, where merchant fees were lower.³¹

34. The Australian experience provides useful evidence as to what might be expected in the United States. Since 1999, the Reserve Bank of Australia ("RBA") has been actively involved in reforming the competitive structure of Australia's payment systems, including its credit card networks. The RBA

²⁹ To illustrate, a typical \$100 credit card transaction might cost a merchant more than \$2.00, while use of a debit card to complete the same transaction today might cost a merchant \$0.50 or less. For each \$100 transaction that migrates from credit to debit as a result of merchant surcharges on credit cards, merchants will then save more than \$1.50 in fees.

³⁰ MasterCard has agreed with this proposition. See "Payments System Regulation: Response by MasterCard Worldwide to the Issues for the 2007/08 Review," (Submission to the Reserve Bank of Australia), August 31, 2007, pp. 16-17 ("Merchants will have a higher incentive to surcharge the higher merchant fees are... An increase in merchant service fees will clearly raise the gains from surcharging relative to the costs, and hence make it more likely that surcharging will occur.").

³¹ Frankel Rebuttal Report, ¶1269. Moreover, in the Netherlands, more merchants were surcharging than knew that it was legal to do so.

studied the effects of no-surcharge rules intensively before deciding to eliminate those rules. In 2000, the RBA (together with the country's competition authority) concluded that no-surcharge rules were "not desirable."³² At the end of 2001, the RBA concluded from its economic analysis that it should eliminate no-surcharge rules,³³ and it used its regulatory powers to do so, effective in 2003.³⁴

35. The RBA has continued to study and monitor the effects of its elimination of no-surcharge rules. In 2008, the RBA concluded, again following a review of the economic evidence, that "[t]here was no case for allowing schemes to reimpose their no-surcharge rules."³⁵ In that review, the RBA considered permitting card networks to limit the amount of surcharges, but it did not do so. It took up that issue again in 2011, at which time it permitted card networks to limit surcharges to amounts reasonably related to the cost of card acceptance.³⁶ At the same time, the RBA again affirmed its view that permitting merchants to surcharge has had competitive benefits:

The removal of the no-surcharge rules was expected to have a number of benefits for the efficiency of the payments system. First, it was expected to improve price signals to

³² Reserve Bank of Australia and Australian Competition and Consumer Commission, *Debit And Credit Card Schemes In Australia: A Study Of Interchange Fees And Access*, October 2000, p. 55 ("The study's view is that 'no surcharge' rules suppress price signals that guide the efficient allocation of resources. They result in cross-subsidisation of cardholders by consumers who do not use credit cards; they restrict competition between merchants by limiting the range of pricing strategies they can use; and they prevent end-users exerting competitive pressures on merchant service fees and interchange fees. On balance, the study concludes that 'no surcharge' rules are not desirable. Merchants should not be prevented by the credit card schemes from passing on some or all of the merchant service fee through surcharges, even if some merchants do not avail of the flexibility for their own commercial reasons.").

³³ Reserve Bank of Australia, *Reform of Card Schemes in Australia I: A Consultation Document*, December 2001, p. 78 ("In the Reserve Bank's opinion, restrictions imposed by credit card schemes on the freedom of merchants to set their own prices are not in the public interest. These restrictions harm consumers who do not use credit cards because they pay higher prices for goods and services than they would otherwise. By distorting the relative prices of payment instruments, the restrictions are not conducive to efficiency in the payments system. In addition, the restrictions undermine the competitive pressure which merchants might impose on interchange fees and merchant service fees by limiting them to an 'all or nothing' choice about taking cards.").

³⁴ Reserve Bank of Australia, *Reform of Card Schemes in Australia IV: Final Reforms and Regulation Impact Statement*, August 2002, p. 46.

³⁵ Reserve Bank of Australia, *Reform of Australia's Payments System, Conclusions of the 2007/08 Review*, September 2008, p. 7.

³⁶ Reserve Bank of Australia, *A Variation to the Surcharging Standards: A Consultation Document*, December 2011.

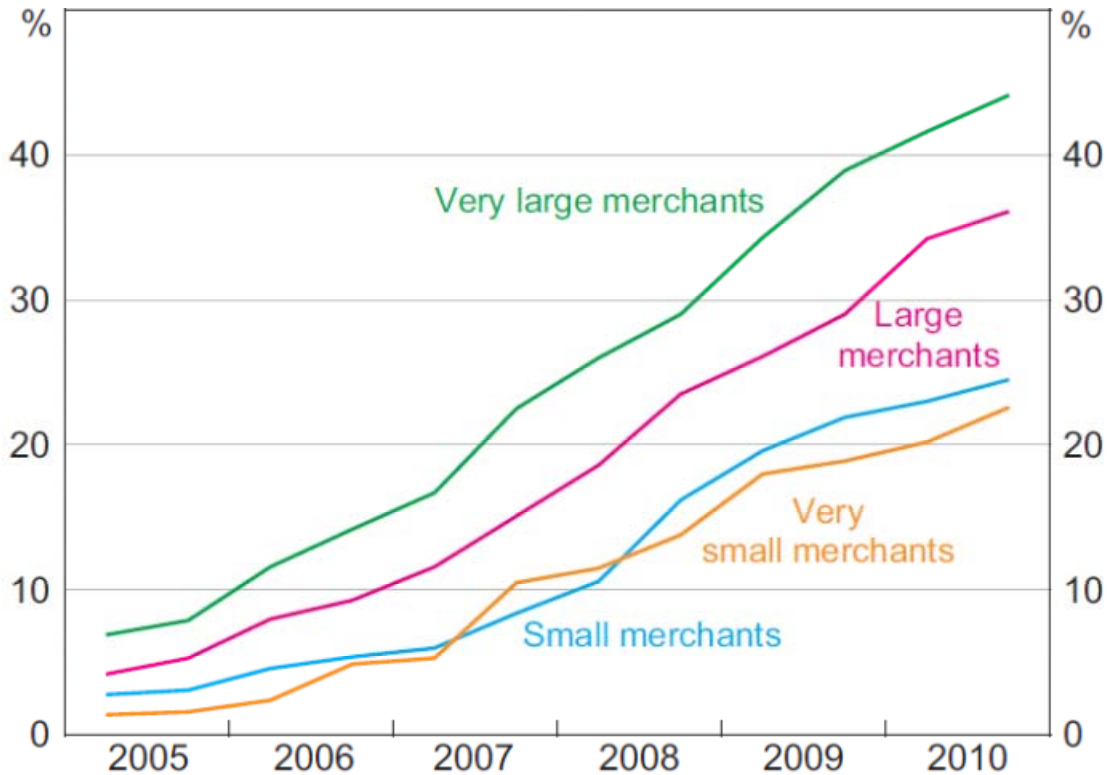
cardholders about the relative costs of different payment methods... Second, the ability to surcharge provides a negotiating tool for merchants who might use the threat of surcharging to negotiate lower fees. Third, with the ability to surcharge, merchants no longer need to build the costs of accepting card payments into the overall prices of their goods and services; hence, customers who choose alternative payment methods are no longer subsidising credit card users. The Payments System Board is satisfied that surcharging has been successful in achieving these benefits...³⁷

36. At first, relatively few merchants in Australia surcharged credit card transactions. It can take time for significant numbers of merchants to surcharge because it is difficult for merchants to be among the first to surcharge while most of their competitors still do not. The same negative reaction by consumers that provides the market discipline on the Networks over the level of their fees can create a “first-mover” disadvantage for merchants imposing surcharges, thus risking the loss of some credit card customers to rival merchants that do not surcharge (although surcharging merchants will tend to attract more cash and debit card users). Experience has shown, however, that some merchants are nonetheless willing to surcharge, and the public learns to accept and adapt to surcharging.³⁸ Although the RBA has found it difficult to assemble reliable, comprehensive data on the extent of surcharging, it has cited the trends shown in Figure 1 to illustrate how merchants gradually increased their willingness to surcharge credit card transactions.

³⁷ Reserve Bank of Australia, A Variation to the Surcharging Standards: A Consultation Document, December 2011, p. 2.

³⁸ For example, this occurred in the United States in 1996, when ATM owners first began assessing surcharges on a substantial basis. Public reaction was quite negative at first, but, over time, the public backlash subsided and consumers adapted by increasingly using their own banks’ terminals and economizing on cash withdrawals.

Figure 1
Merchant Surcharging in Australia since No-Surcharge Rules Lifted in 2003



Source: Reserve Bank of Australia, Review of Card Surcharging: A Consultation Document, June 2011, p. 2 (citing East & Partners' Merchant Acquiring & Cards Market program).

37. As the RBA explains:

Surcharging was slow to develop among merchants in the first few years following the removal of no-surcharge rules. This likely reflected inertia on the part of merchants and the strong expectation by cardholders that no surcharges would apply, given the history of these practices being prohibited. In recent years, though, the rate of surcharging appears to have grown significantly; data from East & Partners' semi-annual survey of the merchant acquiring business suggest that almost 30 per cent of merchants imposed a surcharge on at least one of the credit cards they accepted in December 2010.³⁹

³⁹ Reserve Bank of Australia, Review of Card Surcharging: A Consultation Document, June 2011, p. 2.

4.1.2 Surcharging Induces Many Consumers to Switch to Non-Surcharged Payment Brands and Methods

38. In Australia, it has been more common for merchants to surcharge American Express or Diners Club cards than MasterCard and Visa cards,⁴⁰ and, when all are surcharged, merchants sometimes charge higher surcharge amounts for American Express and Diners Club than for MasterCard and Visa. The reason is that merchants generally pay much higher fees to accept American Express and Diners Club cards than they pay to accept MasterCard or Visa cards, because MasterCard's and Visa's interchange fees are regulated in Australia. In December, 2009, for example, the average fees in Australia to accept American and Diners Club cards were more than double the amount that merchants paid to accept MasterCard and Visa credit cards, with average MasterCard and Visa merchant fees of 0.86% (due to the regulated interchange fee rate of 0.50%), while American Express and Diners Club were 1.94% and 2.13%, respectively.⁴¹

39. In the United States, the average fees merchants pay to accept MasterCard and Visa credit cards exceed the average fees paid in Australia to accept American Express and Diners Club (and exceed by far the average fees to accept MasterCard and Visa credit cards in Australia) due to the much higher interchange fee rates prevailing in this country on the Networks' credit card transactions. The average MasterCard credit card interchange fee in December 2009, for example, was 1.99% in the United States.⁴² Total merchant fees (of which the interchange fee is a component) generally exceed

⁴⁰ According to one survey, 63.7% of merchants that accepted Diners Club and 73.1% of merchants that accepted American Express in December 2009 applied a surcharge to at least some cards, compared to the overall average of 24.5% which surcharge at least some credit cards among all merchants that accept Visa and MasterCard credit cards. East & Partners, Australian Merchant Payments: Market Analysis Report, February 2010, Table 31.

⁴¹ Reserve Bank of Australia, Merchant Fees for Credit and Charge Cards, <http://www.rba.gov.au/statistics/tables/xls/c03hist.xls?accessed=2013-03-17-14-09-41>.

⁴² MasterCard Systemwide Interchange Report_GCMS Cleared Purchase Vol_US Issued Acquired 2009.xls.

this amount – one Visa data source suggests by an average of roughly 0.35%.⁴³ So average merchant fees to accept MasterCard and Visa credit cards were roughly 2.34% (with many small merchants likely paying well above this amount). Thus, the experience of American Express and Diners Club in Australia with respect to merchants' ability to surcharge is a useful benchmark for providing information about the likely effects of surcharging of MasterCard and Visa credit cards in the United States. That is, in Australia, merchants have an incentive to surcharge American Express and Diners Club cards because those cards are priced substantially (more than 1% of the transaction amount) above the rate-regulated MasterCard and Visa credit cards (and even farther above the cost of accepting debit cards). In the United States, merchants will have a similar incentive to surcharge all credit cards, so long as those cards are priced substantially above the rate-regulated debit cards, as they currently are.

40. When merchants do surcharge in Australia, many of their customers switch to alternative payment brands or methods that are not surcharged. Diners Club, for example, reported to the RBA that “[t]he effect of surcharging Diners Club has been to significantly reduce the number of transactions that are paid for using Diners Club cards...”⁴⁴ This experience is consistent with the reported effects of surcharging of debit cards in the Netherlands. A study in that country concluded that “a large minority of retailers” assessed surcharges.⁴⁵ Merchants that did so experienced a significantly lower share of payments on the surcharged cards, and, again not surprisingly, the higher the level of the surcharge, the less likely customers were to use the surcharged cards.⁴⁶

⁴³ Remarks of Bill Sheedy, (then) Executive Vice President, Interchange Strategy, Visa U.S.A., in “Interchange Fees in Credit and Debit Card Industries: What Role for Public Authorities?,” Federal Reserve Bank of Kansas City (2005), Chart 4, p. 180.

⁴⁴ “Review of Reform of Australia’s Payments System: Regulation of Credit Card Payments and the role of Diners Club,” September 6, 2007, Report to Diners Club (commercial-in-confidence version) by the Allen Consulting Group, p. 12.

⁴⁵ Wilko Bolt, Nicole Jonker and Corry van Renselaar, Incentives at the Counter: An Empirical Analysis of Surcharging Card Payments and Payment Behaviour in the Netherlands, *Journal of Banking & Finance* (2009), p. 2.

⁴⁶ *Id.*, p. 5.

41. Overall, the RBA concluded that in Australia “consumers appear to respond to price signals by avoiding surcharges where possible.”⁴⁷ The Australian market research firm East & Partners similarly concluded that “[t]he effect of lifting restrictions on merchant surcharging has seen cardholders refusing to absorb the higher costs of using their credit cards and increasingly opting for cheaper debit cards to make payments.”⁴⁸ The results of an RBA payment choice study “suggest that around half of consumers that hold a credit card will seek to avoid paying a surcharge by either using a different payment method that does not attract a surcharge (debit card or cash) or going to another store.”⁴⁹ Moreover, “consumers respond to differential surcharging: when faced with a surcharge that is higher on one type of credit card than another, only around 10 per cent of consumers indicated that they would complete the transaction with the card attracting the higher surcharge, while around 40 per cent indicated that they would complete the transaction with the card attracting the lower surcharge.”⁵⁰ Thus, higher merchant fees lead to higher surcharges, on average, which steers consumers to switch to lower cost cards. It is this ability for surcharges to align consumer incentives with those of merchants that makes the practice a potentially powerful constraint on otherwise escalating credit card fees.

42. The limited experience with surcharging in the United States is consistent with the history of surcharging in Australia. The Networks here have made some exceptions to their no-surcharge rule policies. In particular, they have permitted certain higher education, government, and utility merchants to impose surcharges (euphemized as “convenience fees”) on credit card

⁴⁷ Reserve Bank of Australia, Review of Card Surcharging: A Consultation Document, June 2011, p. 3.

⁴⁸ “Merchant Surcharging in Australia,” East & Partners, February 2007, p. 7.

⁴⁹ Reserve Bank of Australia, “A Variation to the Surcharging Standards: Final Reforms and Regulation Impact Statement,” June 2012, p. 3.

⁵⁰ *Id.*, p. 4.

transactions.⁵¹ When merchants have been permitted to charge these “convenience fee” surcharges, many customers have switched to alternative payment methods.

[O]ur more significant issue relates to the fact that surcharges suppress usage and undermine the considerable investment the Membership has made in the Visa brand. The colleges and universities that have dropped Visa are the very schools that have provided us the data to support these statements. For example, when Indiana University dropped Visa and imposed a percentage-based surcharge, card usage dropped 80%.⁵²

Another Visa document explained:

[A]ll additional charges result in suppressing usage. Convenience fees suppress usage because they increase the cost of a good or service to a consumer. Consumers will actively seek a cheaper payment alternative or shop for the good or service at a competing store.⁵³

43. When a merchant surcharges, therefore, experience shows that many of its customers shift from using credit cards to using debit cards (or cash), saving the merchant the substantial differential costs, for which interchange fees are primarily responsible.

4.1.3 Actual and Threatened Surcharging Constrains the Level of Merchant Fees

44. Because surcharging causes many consumers to switch to alternative lower-cost payment brands or methods, merchants need not actually surcharge for the *ability* to surcharge to have a constraining effect on the level of merchant fees.⁵⁴ Woolworths, one of the largest merchant chains in

⁵¹ They also offer utilities lower interchange fees in exchange for not surcharging. See, e.g., Visa International Operating Regulations, 15 October 2012, <http://usa.visa.com/download/merchants/visa-international-operating-regulations-main.pdf> (visited March 28, 2013), pp. 1014-1015 (“To qualify for the Visa Utility Interchange Reimbursement Fee Program, a U.S. Merchant must... [n]ot charge a Convenience Fee to a Cardholder for processing a Visa Transaction. This restriction also applies to a third-party agent that processes Transactions for a utility Merchant.”).

⁵² VUSAMDL1-00748463 (12/14/2004).

⁵³ Visa U.S.A. White Paper, VUSAMDL1-09042437, p. 5.

⁵⁴ For example, a MasterCard expert in a European proceeding recognized that “[p]rice competition of payment systems for merchants is enhanced by the fact that surcharges (and cash discounts, etc.) are possible. From the point of view of the payments system, surcharging of the system by many merchants is to be avoided. The attractiveness of cards among cardholders is negatively affected by widespread surcharging[...] Therefore the risk of increased surcharging after an increase of fees is one of the most powerful forces to keep merchant fees low. We would expect that actual surcharging is rather infrequent because payment systems have a great interest to avoid merchant surcharging of their system. But nevertheless, merchants’ right to surcharge

Australia, used the threat of surcharging to negotiate lower merchant fees from American Express without ever actually surcharging the cards.⁵⁵ Woolworths explained that “surcharging results in downward pressure on merchant service fees/interchange fees because [networks]/acquirers are concerned that surcharging will result in decreased use of the payment method on which a surcharge is placed.”⁵⁶ In a deposition in this case, a MasterCard witness testified, “Surcharging is one of the elements if it were to become significant practice that would actually raise our attention to the reaction of merchants to interchange fees, yes.”⁵⁷

45. As Figure 2 shows, despite the fact that American Express and Diners Club merchant fees were not directly regulated by the RBA (while the RBA did regulate MasterCard and Visa interchange rates), the former networks have faced competitive pressure to reduce their merchant fees. American Express has recognized this fact, explaining in Australia that “[t]he Reserve Bank has applied a consistent regulatory policy to American Express with the explicit intention – and actual effect – of driving down its merchant pricing.”⁵⁸

imposes substantial downward pressure on merchant fees.” C. Christian von Weizsäcker, “Economics of Credit Cards - Expert Report on behalf of MasterCard International Incorporated and Europay International SA” dated 23 January 2002, p. 19-20. “MasterCard considers that the ability of merchants to discourage card use, by such means as cash discounts and surcharging, should be more than sufficient to avoid excessive interchange fees. Credit card schemes have an interest in avoiding discouragement by merchants, because it lessens card use. It should not, therefore, be surprising that schemes will set interchange fees to dissuade widespread discouragement practices by merchants...The threat of discouragement has value to the merchant (in restraining merchant fees) as long as it is credible, even if it is not exercised” (note omitted) in “Payments System Regulation: Response by MasterCard Worldwide to the Issues for the 2007/08 Review,” (Submission to the Reserve Bank of Australia), August 31, 2007, pp. 16-17.

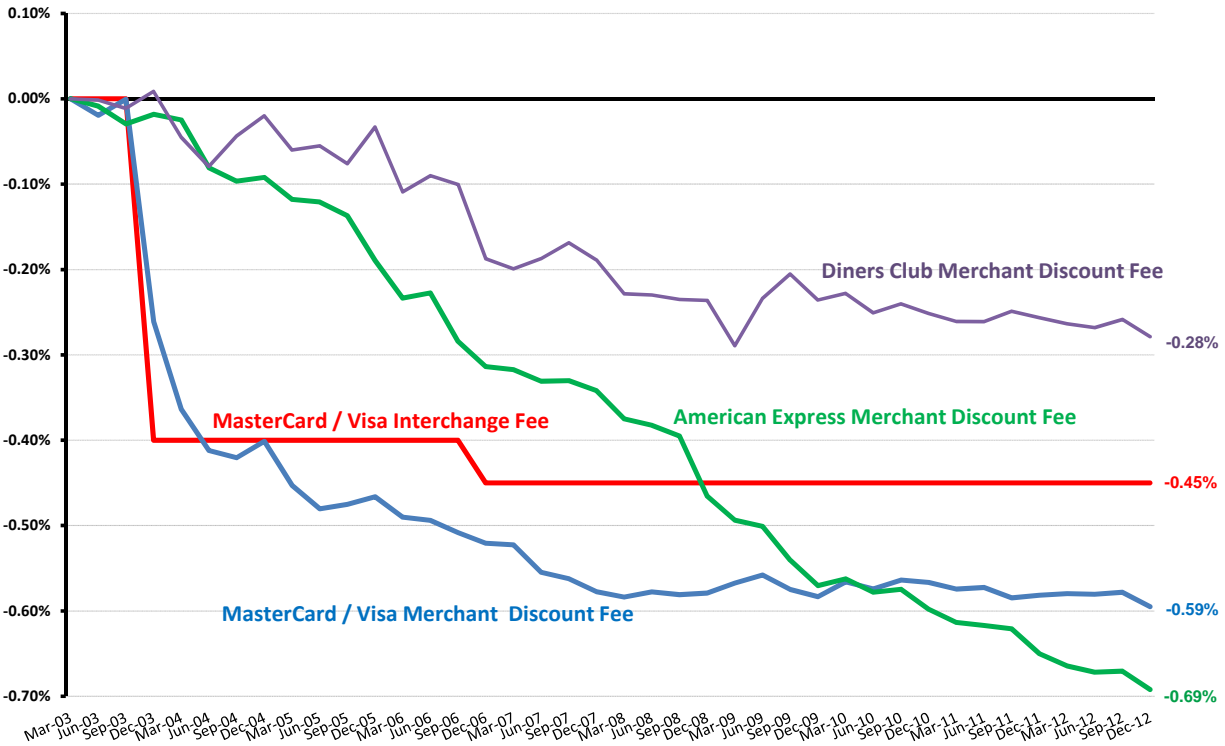
⁵⁵ Declaration of Dhun Karai, head of Group Financial Services for Woolworths, September 22, 2009, ¶¶5.5-5.19.

⁵⁶ Declaration of Dhun Karai, head of Group Financial Services for Woolworths, September 22, 2009, ¶5.1.

⁵⁷ Deposition of Etienne Goosse, October 22, 2008 (MasterCard 30(b)(6) witness on UK rules), p. 198.

⁵⁸ American Express Australia Limited, “Review of Payment System Reforms: A Submission to the Reserve Bank of Australia,” August 2007, p. 16.

Figure 2
Cumulative Change in Level of Interchange Fee and
Merchant Discount Fee Rates in Australia Since March 2003



Source: <http://www.rba.gov.au/statistics/tables/xls/c03hist.xls>.

46. The ability for merchants in Australia to surcharge American Express and Diners Club transactions played an important role in the reduction of those networks’ merchant fees. American Express explained that:

[O]ur merchant service fees have declined sharply in response to competition from the lower merchant fees of our competitors and pressure from merchants following the implementation of the Interchange Standard by the dominant schemes...

The effect of sustained competitive pressure on American Express, driven by price reductions in the dominant schemes, and the effects of merchant surcharging – or the threat of surcharging – have prevented the three-party schemes from achieving anything more than a transitory high-water mark increase in market share...⁵⁹

⁵⁹ American Express Australia Limited, “Review of Payment System Reforms: A Submission to the Reserve Bank of Australia,” August 2007, pp. 11-12.

Diners Club similarly reported that “competitive forces have led to falls in Diners Club [merchant fee rates] over time,” that “[f]rom the time that merchants have been permitted (but not obligated) to surcharge, these falls have been particularly large” and that “[t]he effect of surcharging Diners Club has been to significantly reduce the number of transactions that are paid for using Diners Card cards.”⁶⁰

47. After reviewing the experience in Australia, the New Zealand Commerce Commission brought a case against and reached settlements with MasterCard and Visa, under which the Networks ceased enforcing their no-surcharge rules in New Zealand. As the Commission explained in announcing its settlement with MasterCard:

Merchants will no longer be prevented from applying surcharges to payments made by credit cards or by specific types of credit cards. Any surcharges will be disclosed to cardholders at the time of sale and bear a reasonable relationship to the merchant's costs of accepting MasterCard products. Merchants will also be able to encourage customers to pay by other means...

“The agreed changes to the MasterCard rules will boost competition in the provision of credit card services to retailers in New Zealand,” said Commerce Commission Chair Dr. Mark Berry. “The Commission is pleased that MasterCard has agreed to settle the Commission's claims on the same basis as Visa.”

“The settlement can be expected to reduce overall costs to consumers of payment systems by driving down interchange fees and facilitating merchant steering towards lower cost payment methods. It will also ensure that costs of credit card use fall to a greater extent on the card users themselves, who can make informed choices about payment methods, and less on other consumers,” said Dr. Berry.⁶¹

4.2 The Ability to Surcharge Credit Card Transactions is More Competitively Effective than the Ability to Discount

48. While it is possible to craft a combination of shelf prices with a list of discounts for various low cost payment methods that is *algebraically* equivalent to a (lower) shelf price

⁶⁰ The Allen Consulting Group, "Review of Reform of Australia's Payments System: Regulation of Credit Card Payments and the role of Diners Club," September 6 2007, <http://www.rba.gov.au/payments-system/reforms/review-cardreforms/pdf/dc-06092007.pdf>, pp. 11-12.

⁶¹ “Commerce Commission and MasterCard Agree to Settle Credit Card Interchange Fee Proceedings,” press release, August 24, 2009, <http://www.comcom.govt.nz/media-releases/detail/2009/commercecommissionandmastercardagr>.

with a list of surcharges for more costly credit card transactions, it has long been recognized that the two potential merchant strategies are not *economically* equivalent. In the real world, consumers react differently to higher versus lower posted prices, and they react differently to perceived penalties (such as a surcharge) than they do to perceived rewards of equal magnitude. With respect to credit card surcharges, this reality was noted by economist Richard Thaler in 1980.⁶² Visa has agreed with Thaler's explanation, stating that "it is much more difficult to depict surcharges in a positive light, since they represent a penalty to credit purchasers."⁶³ American Express similarly explained that while surcharges and discounts may be equivalent "from a theoretical or mathematical viewpoint,"⁶⁴ there is in fact "a world of difference between a discount for cash and a surcharge for credit card use. Any similarity exists in theory only because the two are not functionally equivalent in the marketplace."⁶⁵

⁶² Richard Thaler, "Toward A Positive Theory Of Consumer Choice," 1 *Journal of Economic Behavior and Organization* 39, 45 (1980) ("Credit cards provide a particularly clear example [of the economic difference between rewards and penalties]. Until recently, credit card companies banned their affiliated stores from charging higher prices to credit card users. A bill to outlaw such agreements was presented to Congress. When it appeared likely that some kind of bill would pass, the credit card lobby turned its attention to form rather than substance. Specifically, it preferred that any difference between cash and credit card customers take the form of a cash discount rather than a credit card surcharge. This preference makes sense if consumers would view the cash discount as an opportunity cost of using the credit card but the surcharge as an out-of-pocket cost.").

⁶³ Prepared Testimony of Visa USA, Inc., before the Committee on Banking, Finance and Urban Affairs, Subcommittee on Consumer Affairs and Coinage, United States House of Representatives, "Hearing on Credit Card Surcharges," March 27, 1984, pp. 107-08. In his testimony before the U.S. Senate, Visa U.S.A.'s then President Charles Russell was asked, "[i]f you're concerned about confusion and having both cash discount and credit card surcharge programs operating at the same time, how would you feel about prohibiting cash discounts but permitting credit surcharges?" Russell responded, "I think that's a giant step backward... [T]he benefits all seem to favor cash discount as opposed to surcharges." Testimony of Charles Russell, President, Visa U.S.A., Inc., Before the Committee on Banking, Housing and Urban Affairs, Subcommittee on Consumer Affairs, United States Senate, "The Cash Discount Act," February 7, 1984, p. 161.

⁶⁴ Prepared Testimony of Hugh H. Smith, Senior Vice President, Government Affairs, on behalf of the American Express Co., before the United States House of Representatives, Committee on Banking, Finance and Urban Affairs, Subcommittee on Consumer Affairs and Coinage, The Cash Discount Act, February 5, 1981, p. 27.

⁶⁵ Testimony of Hugh H. Smith, Senior Vice President, American Express Company, Before the Committee on Banking, Housing and Urban Affairs, Subcommittee on Consumer Affairs, United States Senate, "The Cash Discount Act," February 7, 1984, p. 105. Smith criticized those who claimed the practices were equivalent and

49. As Federal Reserve economists noted with respect to the DOJ Settlements, which resulted in expanded discounting options for merchants but did not alter the Network's no-surcharge rules:

Although cash discounts and card surcharges may have equivalent arithmetic representations in some situations, they are not equivalent from a behavioral perspective. As first shown by Kahneman and Tversky's (1979) work on prospect theory, individuals perceive a bigger impact of losses than of gains, even when the monetary value is the same (a phenomenon known as loss aversion). As a result, consumers are likely to respond differently to discounts than to surcharges even if their value is nominally arithmetically equivalent...

Consumers view them differently because consumers are loss averse. If surcharges on credit card transactions are allowed, credit card use may decline, resulting in lower revenues for credit card issuers and networks. This may be why banks and credit card networks are opposed to surcharges.⁶⁶

50. Surcharges pose a more substantial threat to the value of the Network's brands than do discounts, because consumers react more negatively to surcharges than to the offer of discounts.⁶⁷ This greater threat to the Networks is why surcharges have a greater constraining effect on the level of merchant fees than do discounts.

both should therefore be permitted, testifying that "what they're doing is trying to apply some abstract ivory tower theory to the real world, without taking into account what happens in that real world." Statement of Hugh H. Smith, Senior Vice President, American Express Co., Before the Subcommittee on Consumer Affairs and Coinage of the Committee on Banking, Finance and Urban Affairs, March 27, 1984, p. 131. He further testified, "I also want to challenge the notion that a cash discount and a surcharge for credit card use are equivalent or interchangeable. There is a substantial difference in the marketplace." *Id.*, p. 140.

⁶⁶ Scott Schuh, Oz Shy, Joanna Stavins, and Robert Triest, "An Economic Analysis of the 2010 Proposed Settlement between the Department of Justice and Credit Card Networks," Federal Reserve Bank of Boston, Public Policy Discussion Paper No. 11-4 (2011), <http://www.bostonfed.org/economic/ppdp/2011/ppdp1104.pdf>.

⁶⁷ See, e.g., Report of Kenneth G. Elzinga, December 14, 2009, pp. 65-78. Expert Report of Dr. Benjamin Klein, December 14, 2009, p. 4, ¶150. Report of Professor Barbara E. Kahn, December 14, 2009 (generally). MasterCard claims that surcharges are "not consumer friendly." See, e.g., Reserve Bank of Australia, Proceedings of Payments System Review Conference, 29 November 2007, p. 195. MasterCard and Visa have argued that their cardholders react more negatively to surcharges than to discounts so that surcharging threatens the Networks more than discounting. See, e.g., Closing Argument of MasterCard International Inc., in The Commissioner of Competition [Canada], Applicant, And Visa Canada Corporation And MasterCard International Incorporated, Respondents, And The Toronto-Dominion Bank And Canadian Bankers Association, Intervenor, <http://www.ct-tc.gc.ca/CMFiles/CT-2010->

51. Because surcharges permit a merchant to set lower shelf prices and more effectively steer customers to use lower cost payments, the ability to surcharge under the terms of the Proposed Settlement benefits merchants and their customers in addition to the benefits realized from the concurrent ability to offer discounts for lower cost payment methods.

4.3 Alternative Forms of Surcharging Permitted by the Proposed Settlement

52. The Proposed Settlement permits merchants to implement either “brand-level” or “product-level” surcharges.⁶⁸ A brand-level surcharge would apply to all MasterCard-branded credit card transactions or all Visa-branded credit card transactions (and those surcharge amounts could be different if the cost to the merchant of those brands differed). A product-level surcharge permits a merchant to differentially surcharge different types of Visa or MasterCard credit cards (such as by surcharging differently for Visa’s high interchange fee “Signature Preferred” or commercial credit cards than for traditional Visa credit cards that impose a lower interchange fee).⁶⁹ As the RBA pointed out in Australia:

A transaction made with a premium/platinum card will, therefore, at many merchants incur a higher merchant service fee than a transaction on a standard card because premium/platinum cards attract a higher interchange fee. Reflecting this, the merchant

[010_Closing%20Argument%20of%20Mastercard%20International%20Inc. 300 45 6-29-2012 5632.pdf](#). ¶1212 (“Credit card companies oppose surcharging because it poses a threat to brand reputation, and, in contrast, implementation of discounting poses no immediate threats to the brands.”); ¶1516 (“Comparatively, consumers love discounts and display little affection for other steering mechanisms.”). In the same case, Visa similarly argued that “The hostile consumer reaction to surcharging undermines the Visa brand” and “[t]his hostile reaction to surcharging and its impact on Visa’s brand is different from the brand effect of discounting.” Closing Argument of Visa Canada Corporation, ¶47.

⁶⁸ Proposed Settlement, ¶¶42, 55.

⁶⁹ The details of these surcharge options described in the Proposed Settlement vary with respect to the maximum surcharge amount the merchant may assess. For brand-level surcharges, the Networks may limit the surcharge amount to the merchant’s cost of acceptance, up to a cap currently set at 4%. For product-level surcharges, the Networks may limit the amount of a surcharge on a product to the differential between that product’s cost and the merchant’s cost to accept debit cards.

may choose to signal the different costs of acceptance for different card types by imposing card-specific surcharges.⁷⁰

53. Some merchants have been particularly unhappy with the proliferation of premium credit cards carrying significantly higher interchange fees. Banks, meanwhile, have sometimes switched cardholders (unprompted) to premium cards or aggressively marketed premium cards or commercial cards to existing cardholders. Under the settlement, a merchant would now have the option to use product-level surcharging to surcharge business customers presenting commercial credit cards, but not other consumers presenting personal credit cards. In addition to the benefits from being able to steer customers away from such high cost cards as discussed in the prior section, this may help to deter the Networks and their member banks from continuing their strategy of encouraging the issuance of premium, high cost (to merchants) credit cards. The ability to engage in product-level surcharging thus provides an additional option for merchants to specifically steer customers away from using the Networks' highest cost cards, and can be expected to benefit the merchants that use that option and other merchants by reducing the economic incentive for the Networks to set very high interchange fees on their premium cards and for their card issuing member banks to issue those credit cards.

4.4 Some Merchants Can Take Advantage of Selective Acceptance Across Their Different Banners to Reduce Card Acceptance Fees

54. Some merchant companies operate multiple store brands or "banners," and they may operate a discount banner at which they would prefer not to accept credit cards in order to keep costs (and prices) as low as possible. Under Visa's rules and fee schedules, a merchant could face far higher interchange fees across all of its store banners if it did not agree to accept Visa cards at one or more banners, as Visa generally made substantial volume discounts available to large merchants, but only if the merchants accepted Visa credit cards at all of their

⁷⁰ Reserve Bank of Australia, "Review of Card Surcharging: A Consultation Document," June 2011, pp. 8-9.

outlets and banners. Thus, merchants lost the practical ability to use lower costs to help lower prices at their discount outlet banners. Under the terms of the Proposed Settlement, the Networks agree to permit merchants to selectively accept the Networks' credit cards at some, but not all, of the merchants' banners, without losing access to generally available volume-based discounts.⁷¹ Because a merchant's willingness to refuse acceptance of a card brand at a banner is greater if the level of the brand's fees are greater, this rule change will tend to further increase the elasticity of demand with respect to merchant fees, and thus intensify the competitive constraints facing the Networks over the level of their merchant fees.

4.5 Merchant Buying Groups May Help Merchants Negotiate Lower Fees

55. The Proposed Settlement also contains provisions under which MasterCard and Visa agree to negotiate in good faith with merchant buying groups.⁷² MasterCard and Visa generally have set relatively lower interchange fees for larger merchants and merchants that can more easily steer consumers to use alternative payment methods or brands.⁷³

56. Buying groups may facilitate the ability of smaller merchants to obtain the scale economies, organizational efficiencies and negotiating ability of large merchants. For example, authors of a national survey of participants in hospital buying groups found that such groups "serve to contain rising health care costs by reducing product prices" by "brokering, negotiating and aggregating supply

⁷¹ Proposed Settlement, ¶¶41, 54.

⁷² Proposed Settlement, ¶¶43, 56.

⁷³ See, e.g., Alan S. Frankel, "Interchange Fees in Various Countries: Commentary on Weiner and Wright," in *Interchange Fees in Credit and Debit Card Industries: What Role for Public Authorities?*, Federal Reserve Bank of Kansas City (2005), pp. 51-61.

contracts between manufacturers and hospitals... [and] thus enable hospitals to achieve purchasing economies of scale.”⁷⁴

57. To the extent that merchant buying groups enable their member merchants the opportunity to steer a significant volume of transactions toward or away from one of the Networks, they may be especially effective at contributing towards enhancing the competitive constraints on the level of merchant fees.

4.6 The Effects of State Statutes and American Express’ Non-Discrimination Policy

58. I have explained that the ability to surcharge can be expected to introduce more competition in the credit card acceptance (network) services market and hence impose a more significant competitive constraint on the pricing decisions of the Networks than has existed before, and that merchants will generally be more willing to surcharge a credit card brand the higher that the fees are to accept that brand. This is not to say that there are no restrictions on surcharging other than the Networks’ rules. I understand that some U.S. states currently have statutory provisions which may restrict merchants’ ability to surcharge credit card transactions. I also understand that American Express – a generally higher cost brand to accept – enforces a “no-discrimination” policy and that the Proposed Settlement has provisions that link a merchant’s ability to surcharge the Networks’ card transactions on the merchants’ surcharging of American Express transactions (assuming they are more costly to the merchant). I address below the effects of these dynamics on the likelihood of effective surcharging.

4.6.1 State Surcharge-Related Statutes

59. Ten U.S. states currently have statutes which may affect the ability of merchants to surcharge credit card transactions in those states.⁷⁵ These statutes do not eliminate the benefits from

⁷⁴ “Hospital Purchasing Alliances: Utilization, Services and Performance,” Health Care Management Review, July-September 2008, pp. 203-215, at p. 213.

merchants' ability to surcharge under the terms of the Proposed Settlement, even in a state that may forbid any surcharging of credit card transactions.⁷⁶ There was no dispute in this case that the relevant geographic market is the United States (e.g., not a worldwide market or separate state-specific markets). MasterCard and Visa set different interchange fee rates in the United States versus other countries, but they do not set different interchange fees for merchants located in different states or geographic areas within the United States. Indeed, multi-state merchants account for a large fraction of total retail sales. With common interchange fees throughout the United States, the constraining effect of surcharging and potential surcharging in states where it is possible to surcharge will benefit even merchants which operate only in states in which surcharging is not possible. Moreover, a general shift in payment preferences due to surcharging where it is permitted can be expected to reduce credit card usage in other states for travel-related payments, Internet payments, and other payments if, for example, there is a general migration by some consumers towards habitual use of lower-cost debit cards instead of credit cards.

60. Any state statutes which restrict credit card surcharges have existed to date in a competitive vacuum. The Network rules prohibited surcharges, so state statutes were not subject to any significant marketplace challenge, such as might occur if, for example, Internet and other merchants operating in states in which merchants cannot surcharge begin to lose sales or profits relative to merchants operating in states in which merchants can surcharge. Analogously, states which enforced strict usury limits on credit card interest rates found themselves losing card issuing and servicing businesses, market share, and employment to states that repealed usury laws, ultimately leading to

⁷⁵ Elzinga Report, p. 67; Kahn Report, ¶110; Klein Report, ¶¶80, 111; Topel Report, ¶15d; Wecker Report, ¶73. See also, http://usa.visa.com/personal/using_visas_checkout_fees/index.html.

⁷⁶ Frankel Rebuttal Report, Part 5.2.2.4.

additional states relaxing their own usury laws.⁷⁷ A similar phenomenon may occur with state surcharge laws. In the meantime, however, while merchants in states in which statutes may prohibit credit card surcharges may not be able to use surcharges to steer transactions to lower cost payments, they will benefit from the overall enhanced constraining effect on the Networks' interchange fees from the relief as discussed above.

4.6.2 American Express' Non-Discrimination Policy

61. The Proposed Settlement contains clauses which limit a merchant's ability to surcharge MasterCard and Visa credit card transactions so that a merchant does not treat customers who use higher cost credit cards more advantageously than customers who use a MasterCard or Visa card.⁷⁸ Primarily, the issue relates to the fact that American Express maintains a practice of requiring "non-discrimination" by merchants between customers who use American Express cards and customers who use alternative credit or debit card brands.⁷⁹ Under the provisions of the Dodd-Frank Act, American Express must permit merchants that accept American Express cards to offer discounts for debit cards, but American Express otherwise has not altered its policy. Under that policy, a merchant may only surcharge an American Express card transaction if the merchant also surcharges all other credit and debit card transactions by at least as much as the merchant surcharges American Express transactions.

62. I understand that American Express' policy is being challenged in separate litigation by merchants, states, and the United States Department of Justice. Merchants and their customers would

⁷⁷ See, e.g., David S. Evans and Richard Schmalensee, *Paying With Plastic* (2nd ed. 2005), pp. 69-70 ("[I]n an attempt to attract or retain such movable card operations, some states began to modify their usury laws.").

⁷⁸ Proposed Settlement, ¶¶42a(iv-v), ¶¶55a(iv-v),

⁷⁹ According to the complaint filed by the U.S. Department of Justice, American Express generally requires that "[m]erchants must not... impose any restrictions, conditions, [or] disadvantages... when the [American Express] Card is accepted that are not imposed equally on all Other Payment Products, except for ACH funds transfer, cash, and checks..." and that American Express "defines 'Other Payment Products'... as 'any charge, credit, debit, stored value or smart cards, account access devices, or other payment cards, services, or products other than the [American Express] Card.'" Complaint, in *United States of America, et al. v. American Express Company, et al.*, CV10-4496, October 4, 2010, pp. 10-11.

benefit more if American Express' non-discrimination policy were eliminated. As a generally higher cost brand, American Express would be more likely to be surcharged, and at higher rates, if its "non-discrimination" policy were no longer in effect. By forcing a merchant to surcharge even low-cost debit card transactions in order to surcharge American Express cards, American Express' policy prevents merchant that accept American Express cards from using surcharging to encourage or steer their customers to use debit cards instead of credit cards, or to use lower cost credit cards instead of high cost credit cards.

63. Nevertheless, although American Express' policy, while it persists, reduces the ability of merchants to use surcharge strategies to lower their costs, it does not eliminate it.

- Some merchants do not accept American Express cards, so are unaffected by the American Express policy.⁸⁰
- Some merchants might choose to *drop* acceptance of American Express so that they can surcharge MasterCard and Visa card transactions under the terms of the Proposed Settlement, or may credibly threaten to do so in exchange for rate reductions from American Express. For some merchants, American Express represents a small percentage of their transaction volume or the benefits from surcharging may outweigh the benefits of accepting American Express cards. The ability to surcharge may cause such merchants to consider dropping American Express.
- Some merchants receive few debit card transactions, and could decide to accept only credit cards with a surcharge in addition to, e.g., cash or checks, thus steering customers to those lower cost alternatives.

64. The linkage in the Proposed Settlement of a merchant's surcharging of MasterCard and Visa transactions to surcharging American Express transactions likely has little significance with respect to merchants' benefits from the settlement: the competitive problem stems from the American Express rule, not from the linkage of surcharging of MasterCard and Visa credit card transactions to surcharging American Express transactions. Absent the linkage, it would be *contractually* possible for a merchant to surcharge MasterCard and Visa credit card transactions, but not American Express transactions. But this

⁸⁰ American Express cards are reportedly accepted at about one-third fewer merchant locations in the United States than MasterCard and Visa credit cards. See, The Nilson Report No. 1011, February 2013, p. 10.

is unlikely to have been a desirable competitive strategy for merchants even without the linkage provision, because surcharging steers customers to non-surcharged alternatives, and few merchants would likely want to steer customers to use more costly American Express cards.⁸¹

4.7 An Illustration of the Benefits from Surcharging

65. Estimating the aggregate dollar value to U.S. merchants from the new relief contained in the Proposed Settlement is difficult. Unlike a damages calculation, which is retrospective in nature, this prospective value depends on forecasting a number of parameters and conditions. Just focusing on the value to merchants from surcharging, these include at least the following:

- The aggregate amount of credit card charge volume each year if there are no surcharges.
- The amount by which surcharging would depress the level of interchange fees relative to those which otherwise would exist.
- The percentage of merchant dollar charge volume that would be in states that may forbid surcharges.
- The percentage of merchant dollar charge volume that would be at merchants that will surcharge.
- The average amount of surcharges that merchants would choose.
- Shifts in usage between payment methods from the factors above and from other changes in the economy.⁸²

66. Nevertheless, it is possible to show that even modest responses to the threat of surcharging or modest amounts of surcharging will result in substantial savings and recoupment of costs by merchants.⁸³

⁸¹ If the cost to a merchant of accepting American Express happens to be lower than the cost to the merchant of accepting MasterCard and Visa, then, under the Proposed Settlement, the merchant may surcharge MasterCard and Visa without surcharging American Express.

⁸² Note that these parameters in turn depend on a variety of other factors. For example, the percentage of volume subject to surcharging may depend on a range of commercial, legal, and contractual factors, such as merchants' business considerations, the evolution of state laws on surcharging, and other contractual restrictions on surcharging such as American Express' no-discrimination policy currently being challenged in other litigation.

⁸³ See also Stiglitz Reply Report, pp. 50-51 ("If, however, the merchant could steer its customers to alternative payment means in response to a high interchange fee without losing the customers to its rivals, the merchant would have greater expected profits from such steering than from rejection of the card. Because such

67. A total of \$1.5 trillion in MasterCard and Visa credit card charges were transacted at U.S. merchants in 2012.⁸⁴ Since the end of the recent recession, dollar charge volume has resumed robust growth of 8.5% per year in 2011 and 2012 (similar to pre-recession growth rates). If growth continues at an 8% annual rate, over the next ten years (2014-2023) there will be another \$25.6 trillion in MasterCard/Visa credit card transactions. For every basis point (0.01%) reduction in interchange fee rates due to competitive pressure resulting from surcharging or the threat of surcharging, therefore, merchants throughout the United States will save about \$2.6 billion over the next decade.

68. Merchants that surcharge (or those who use the threat of surcharging to negotiate lower fees) will realize the greatest savings. To illustrate, suppose the difference between the cost to merchants of accepting debit cards and credit cards were 1.00% of the transaction amount, and surcharging merchants set the credit card surcharge equal just to that difference between the two payment types.⁸⁵ In that case, if a \$100 transaction would have been made using a credit card, and the merchant applies a 1.00% surcharge, then the merchant will recoup the \$1 difference in payment cost from the credit card customer. If, alternatively, the customer chooses to pay with a debit card instead, the merchant will again save the \$1 due to the lower fees on debit.⁸⁶ Using those assumptions, for every one percent of merchant charge volume that is actually surcharged over the next decade, merchants will

steering through, for example, surcharging causes significant adverse effects on the network and issuing banks, the ability to steer will likely result in a reduction in the equilibrium profit maximizing interchange fee.” Notes omitted.).

⁸⁴ Based on quarterly operating data releases issued by MasterCard and Visa.

⁸⁵ This assumption simplifies the computations. To the extent that some merchants are likely to set credit card surcharge amounts at levels similar to their cost of accepting credit cards, this will tend to result in more significant altering of cardholder payment patterns towards lower cost alternatives and generate more complete recoupment of merchants’ credit card acceptance costs.

⁸⁶ By assuming that the surcharge amount equals the difference between credit and debit, the result to the merchant is financially identical with either choice. For simplicity, I assume that customers are paying with either credit or debit. The basic point is simply that merchants can either recoup some of their costs through surcharging or can benefit from lower fees through successful steering. Merchants will consider the possibility that customers faced with a surcharge will not make a purchase at all when deciding whether to surcharge, but merchants that do choose to surcharge will presumably have concluded that relatively few customers would do so.

recoup or save an additional \$2.6 billion (roughly 1% savings on each 1% of total charge volume over that period).⁸⁷

69. Finally, increased surcharging by merchants may induce consumers to rely more generally on debit cards.⁸⁸ This permits even merchants that do not surcharge to benefit from a change in payment usage patterns. The amount of this benefit depends on the proportion of merchants that surcharge and the effect of surcharging on payment usage generally.

70. Projecting the amount by which merchants will potentially benefit thus requires estimates of the amount by which interchange fees will be depressed by merchants' ability to surcharge, the percentage of charge volume for which merchants will in fact apply surcharges, and the shift of transactions at non-surcharging merchants from credit to debit. Although these factors cannot be predicted with precision, the experience in Australia provides some useful benchmarks, because surcharging of American Express transactions is now permitted in Australia and American Express' merchant fee rates in Australia have been similar to the level of MasterCard and Visa rates in the United States.

71. The first source of savings to (all) merchants in the United States will be the competitive pressure that can be expected to reduce the level of MasterCard and Visa credit card interchange fees. For the past few years, the average cost to Australian merchants to accept American Express cards has exceeded the cost to accept MasterCard or Visa cards by about 1% of the transaction amount⁸⁹ – similar to the assumed gap in this country between the cost of accepting credit and debit card transactions. But

⁸⁷ This amount will be impacted by changes in the difference between credit and debit card interchange fee rates. I take this factor into account in the example I describe below.

⁸⁸ Consumers tend to develop strong preferences to use favorite cards either overall or for particular types of transactions. Although, as I explained in Part 3 of my initial report, debit card acceptance has not been a sufficiently good substitute from the perspective of merchants to be considered part of the same relevant product market as credit card acceptance, surcharging can be expected to induce more substitution by some customers, to the benefit of merchants and consumers alike.

⁸⁹ The average gap was 1.04% (and declining) during the 2009-2012 period.
<http://www.rba.gov.au/statistics/tables/xls/c03hist.xls?accessed=2013-03-17-14-09-41>.

the competitive effects from surcharging continue to pressure American Express to reduce its merchant fees in Australia. For the past three years, the gap between American Express and MasterCard/Visa has narrowed by about four basis points (0.04%) per year. If that pattern is repeated here for MasterCard and Visa credit card interchange fee rates, it will generate the savings shown in column 3 of Table 1, which total \$62.8 billion over the next ten years.

Table 1
Illustration of Potential Surcharging Benefits
 (\$ Billions)

	Credit Charge Volume (\$ Billions, No Surcharging) (1)	Assumed Reduction in Interchange Rates Due to Surcharging (2)	Savings From Lower Interchange Rates (3) = (1) x (2)	Percentage of Merchants (by Volume) That Surcharge (4)	Savings/Recoupment by Merchants That Surcharge (5) = (1) x (1%-(2)) x (4)	Portion of Credit Volume Switched to Debit at Non-Surcharging Merchants (6)	Savings From Shift to Debit at Non-Surcharging Merchants (7) = (1-(4)) x (6) x (1) x (1%-(2))	Total Savings (8) = (3) + (5) + (7)
2013	\$1,636.2	0.00%	\$0.0	0%	\$0.0	0%	\$0.0	\$0.0
2014	\$1,767.1	0.04%	\$0.7	2%	\$0.3	1%	\$0.2	\$1.2
2015	\$1,908.5	0.08%	\$1.5	4%	\$0.7	2%	\$0.3	\$2.6
2016	\$2,061.1	0.12%	\$2.5	6%	\$1.1	3%	\$0.5	\$4.1
2017	\$2,226.0	0.16%	\$3.6	8%	\$1.5	4%	\$0.7	\$5.7
2018	\$2,404.1	0.20%	\$4.8	10%	\$1.9	5%	\$0.9	\$7.6
2019	\$2,596.4	0.24%	\$6.2	12%	\$2.4	6%	\$1.0	\$9.6
2020	\$2,804.2	0.28%	\$7.9	14%	\$2.8	7%	\$1.2	\$11.9
2021	\$3,028.5	0.32%	\$9.7	16%	\$3.3	8%	\$1.4	\$14.4
2022	\$3,270.8	0.36%	\$11.8	18%	\$3.8	9%	\$1.5	\$17.1
2023	\$3,532.4	0.40%	\$14.1	20%	\$4.2	10%	\$1.7	\$20.1
Total			\$62.8		\$22.0		\$9.5	\$94.3

72. The second type of savings accrues to merchants that actually surcharge, thereby realizing cost savings as customers switch to debit cards or recouping the cost of accepting credit cards when customers use their credit cards. It is likely that the percentage of merchants that surcharge, as in Australia, will increase over time. In Australia, the RBA reports that “almost 30 per cent of merchants imposed a surcharge on at least one of the credit cards they accepted in December 2010” (i.e., seven years after surcharging was permitted).⁹⁰ (See also Figure 1.) As I explained in Part 4.1.2 above, moreover, American Express cards may be surcharged significantly more frequently than average. But even if surcharging of MasterCard and Visa credit card transactions in the United States grew steadily to 20% of merchant charge volume over a ten year period (and surcharges continue to equal the savings

⁹⁰ Reserve Bank of Australia, “Review of Card Surcharging: A Consultation Document,” June 2011, p. 2.

each year of debit relative to credit, adjusting for a declining spread between the two), then merchants will save or recoup an additional \$22.0 billion from this source. Finally, if there is a gradual change in the overall mix of credit and debit card use, even at merchants that do not surcharge, as shown in column (6), then non-surcharging merchants will benefit by an additional \$9.5 billion over ten years from these changing payment patterns, for total savings of \$94.3 billion.⁹¹

73. Further, as noted above, the projected benefits will depend on a variety of factors, including the effect of American Express' non-discrimination policy (should its enforcement of that policy persist). The American Express no-discrimination policy might cause some merchants to drop American Express cards, which could permit merchants to save by not paying American Express' typically higher fees, but, as I have explained, it will also prevent other merchants from fully realizing the potential benefits from competition at the point of sale. In addition, ten states have statutes that may affect merchants' ability to surcharge credit card transactions in those states. Exactly how these factors will affect the magnitude of the benefits to merchants is difficult to predict, but Table 2 shows that even if they are assumed to cause a large (three-quarters) reduction in each of the assumed factors (the reduction in interchange, the percent of merchants surcharging and the portion of volume switched to debit at non-surcharging merchants), merchant benefits over the next decade would total \$26.4 billion (Table 2).

⁹¹ This amount represents about 18% of the interchange fees which would otherwise be collected (at current rates of about 2%) on MasterCard and Visa credit card transactions over the next decade as shown in column 1 of Table 1.

Table 2
Illustration of Potential Surcharging Benefits With Assumed Attenuated Effects
(\$ Billions)

	Credit Charge Volume (\$ Billions, No Surcharging) (1)	Assumed Reduction in Interchange Rates Due to Surcharging (2)	Savings From Lower Interchange Rates (3) = (1) x (2)	Percentage of Merchants (by Volume) That Surcharge (4)	Savings/Recoupment by Merchants That Surcharge (5) = (1) x (1%-(2)) x (4)	Portion of Credit Volume Switched to Debit at Non-Surcharging Merchants (6)	Savings From Shift to Debit at Non-Surcharging Merchants (7) = (1-(4)) x (6) x (1) x (1%-(2))	Total Savings (8) = (3) + (5) + (7)
2013	\$1,636.2	0.00%	\$0.0	0.0%	\$0.0	0.00%	\$0.0	\$0.0
2014	\$1,767.1	0.01%	\$0.2	0.5%	\$0.1	0.25%	\$0.0	\$0.3
2015	\$1,908.5	0.02%	\$0.4	1.0%	\$0.2	0.50%	\$0.1	\$0.7
2016	\$2,061.1	0.03%	\$0.6	1.5%	\$0.3	0.75%	\$0.1	\$1.1
2017	\$2,226.0	0.04%	\$0.9	2.0%	\$0.4	1.00%	\$0.2	\$1.5
2018	\$2,404.1	0.05%	\$1.2	2.5%	\$0.6	1.25%	\$0.3	\$2.1
2019	\$2,596.4	0.06%	\$1.6	3.0%	\$0.7	1.50%	\$0.4	\$2.6
2020	\$2,804.2	0.07%	\$2.0	3.5%	\$0.9	1.75%	\$0.4	\$3.3
2021	\$3,028.5	0.08%	\$2.4	4.0%	\$1.1	2.00%	\$0.5	\$4.1
2022	\$3,270.8	0.09%	\$2.9	4.5%	\$1.3	2.25%	\$0.6	\$4.9
2023	\$3,532.4	0.10%	\$3.5	5.0%	\$1.6	2.50%	\$0.8	\$5.9
Total			\$15.7		\$7.3		\$3.5	\$26.4


5. Conclusion

74. In articles that Dennis Carlton and I published in the mid-1990s, we first explained that no-surcharge rules and other Anti-Steering Rules reduce competition over the level of merchant fees, ensure that cash customers (who are on average poorer than credit card customers) bear the costs of the higher fees along with credit card customers through the higher retail prices which result, and that no-surcharge rules have a different and more significant competitive impact than no-discount rules.⁹²

⁹² Dennis W. Carlton and Alan S. Frankel, "The Antitrust Economics of Credit Card Networks," 63 Antitrust Law Journal 643 (1995), at p. 660 ("The credit card companies themselves often prohibit surcharges or any actions by retailers that 'discriminate' against users of their credit card brand relative to users of other credit cards... The existence of such restrictions likely reduces competition on merchant discounts."); and pp. 660-61 ("Interchange fees can be viewed as a way to raise costs to merchants who then pass those costs on to cash and credit customers alike by charging the same higher price to both."); Dennis W. Carlton and Alan S. Frankel, "Antitrust and Payment Technologies," 77 Federal Reserve Bank of St. Louis Review 41 (1995), at p. 49 ("[A]ntitrust policy should probably encourage the relaxation of restrictions on merchants' abilities to influence the choice of payment method at the point of sale."). See also, Alan S. Frankel, "Monopoly and Competition in the Supply and Exchange of Money," 66 Antitrust Law Journal 313 (1998), at p. 348 ("merchants should be given the freedom to pass payment system costs along to consumers through whatever surcharges, rebates, or multi-tier pricing systems they choose, as long as there is full disclosure to consumers of their pricing policies.") and p. 346 (absent that freedom, cash customers subsidize the use of credit cards, and "[t]he interchange fee 'tax' on cash paying customers that funds the benefits provided to credit card customers is probably regressive, because the poor use cash relatively more and credit cards relatively less than the wealthy.")

From an economic perspective, it is an important achievement that merchants have obtained the ability to surcharge in the United States as a result of the Proposed Settlement. The more tools that merchants have to steer transactions to lower cost payments, the lower will be their costs, the lower will be their prices, and the more credit card networks will be pressured to reduce their fees. Although it is difficult to quantify how much merchants will save as a result of the relief contained in the Proposed Settlement, the savings are likely to be substantial.

April 10, 2013

A handwritten signature in black ink, appearing to read "Alan S. Frankel", written over a horizontal line.

Alan S. Frankel



Exhibit 1

ALAN S. FRANKEL

Coherent Economics LLC
2800 Acacia Terrace
Buffalo Grove, Illinois 60089
(847) 913-8187
alan.frankel@coherentecon.com

EDUCATION

UNIVERSITY OF CHICAGO, Chicago, Illinois
Ph.D., Economics, December 1986.
M.A., Economics, March 1985.
B.A., Economics, March 1982.

PRESENT POSITIONS

COHERENT ECONOMICS, LLC,
Founder and Director, 2008 -

COMPASS LEXECON, Chicago, IL.
Senior Advisor, 2008 -
Senior Vice President, 2004 – 2008.
Vice President, 1989 - 1996.
Economist, 1985 - 1989.

ANTITRUST LAW JOURNAL
Senior Editor, 1999 -
Associate Editor 1998 - 1999
Assistant Editor 1996 - 1998

PROFESSIONAL AND ACADEMIC EXPERIENCE

LECG, Evanston, Illinois.
Director, 1998-2004
Principal, 1996-1997

UNIVERSITY OF CHICAGO, GRADUATE SCHOOL OF BUSINESS, Chicago, IL, 1983 - 1984.
Research Assistant

UNIVERSITY OF CHICAGO, COMMITTEE ON PUBLIC POLICY STUDIES,
Chicago, IL, 1983
Teaching Assistant

UNIVERSITY OF CHICAGO, DEPARTMENT OF ECONOMICS, Chicago, IL, 1980 - 1982.
Research Manager for U.S. Environmental Protection Agency contract research project.
Various consulting work, including National Association of Realtors and Synergy Inc., 1981 - 1983.

FIELDS OF SPECIALIZATION

Industrial Organization, Antitrust, Intellectual Property, Applied Econometrics, Regulation, Financial Institutions, Payment Systems, Damages.

PUBLICATIONS

"Towards a Competitive Card Payments Marketplace," in Reserve Bank of Australia, Payments System Review Conference, Proceedings of a Conference held in Sydney on 29 November 2007 (2008).
"Economic Effects of Interchange Fees," with Allan Shampine, 73 *Antitrust Law Journal* 627 (2006).
"Transaction Costs, Externalities, and 'Two-Sided' Payment Markets," with Dennis Carlton, 2005 *Columbia Business Law Review* 617 (2005).
"Interchange Fees in Various Countries: Comment on Weiner and Wright," in Interchange Fees in Credit and Debit Card Industries: What Role for Public Authorities?" Federal Reserve Bank of Kansas City (2005).
"The Control of Externalities in Sports Leagues: An Analysis of Restrictions in the National Hockey League," with Dennis Carlton and Elizabeth Landes, 112 *Journal of Political Economy* S268 (2004).
"Editor's Note: EFT Networks And The Canadian Experience" 67 *Antitrust Law Journal* 385 (1999)
"Monopoly and Competition in the Supply and Exchange of Money," 66 *Antitrust Law Journal* 313 (1998).
"Cash Machines: Fee Disclosure and Competition vs. Regulation," with James Langenfeld, *The Global Competition Review* (August/September 1997).
"'Sea-Change' or 'Submarkets?'" (Federal Trade Commission v. Staples, Inc. and Office Depot, Inc.), with James Langenfeld, *The Global Competition Review* (June/July 1997).
"Antitrust and Payment Technologies," with Dennis Carlton, 77 *Federal Reserve Bank of St. Louis Review* 41, December 1995.
"The Antitrust Economics of Credit Card Networks: Reply to Evans and Schmalensee Comment," with Dennis Carlton, 63 *Antitrust Law Journal* No. 3, Spring 1995.
"The Antitrust Economics of Credit Card Networks," with Dennis Carlton, 63 *Antitrust Law Journal* No. 2, Winter 1995.
Countervailing Effects of Automobile Emission Control Regulations, Ph.D. dissertation, University of Chicago, Department of Economics, 1986.

SPEECHES

"Interchange Regulation – A Pitched Battle of Ideas," panelist, The Clearing House annual meeting, November 2012.
"Payment Innovation: Competitive Impediments and Opportunities," presented at *Consumer Payment Innovation in the Connected Age*, Federal Reserve Bank of Kansas City, March 2012.

“Does Disclosure Matter?,” American Bar Association Section of Antitrust Law, Panel on the Proposed Consumer Financial Protection Agency, Washington, DC, April 2010.

“The MasterCard Decision: An Economic Review,” Organization for Economic Cooperation and Development, Paris, France, June 2008.

“Towards a Competitive Card Payments Marketplace,” Reserve Bank of Australia and Melbourne Business School, Sydney, Australia, November 2007.

“Evaluating Self-Regulation of Interchange Fees,” Organization for Economic Cooperation and Development, Paris, France, June 2006.

“A More Competitive, Deregulated Market Structure: The Role of Networks vs. the Role of Banks,” International Cards & Payments Council, Rome, Italy, October 2005

“House of Cards: The Economics of Interchange Fees,” Presented at *Antitrust Activity in Card-Based Payment Systems: Causes and Consequences*, Federal Reserve Bank of New York, September 2005.

“Dysfunctional Competition in Retail Payment Systems,” Presented at *Innovations, Incentives, and Regulation: Forces Shaping the Payments Environment*, Federal Reserve Bank of Chicago, May 2005

“Interchange Fees in Various Countries: Comments on Weiner and Wright,” Presented at *Interchange Fees in Credit and Debit Card Industries: What Role for Public Authorities?* Federal Reserve Bank of Kansas City, Santa Fe, New Mexico, May 2005.

Columbia University School of Law, *Conference on Two-Sided Markets*, April 2005.

Chicago Bar Association Antitrust Committee speaker, *Credit Card Issues*, February 2002.

“Anticompetitive Effects of Interchange Fees,” Econometrics Society Australasian Meetings, Auckland, New Zealand, July 2001

American Bar Association Antitrust Section, Financial Markets Committee *Brownbag Seminar* on interchange fees, Washington, DC, March 2001

“The Economic Analysis of Intellectual Property Damages,” Panel discussion moderator, Chicago, Illinois, October 1998

Spring Antitrust Developments panelist, Vedder, Price, Kaufman & Kammholz, P.C., May 1997.

Credit Card Pricing and Competition: The Environment Today and Future Marketplace and Regulatory Trends, before the American Bar Association, Consumer Financial Services Committee, November 1995

“Antitrust and Payment Technologies,” presented at *Antitrust and Payment Systems*, Federal Reserve Bank of St. Louis, May 1995

FELLOWSHIPS

Olin Foundation Fellowship, Center for the Study of the Economy and the State, Graduate School of Business, University of Chicago, 1984.

University of Chicago Graduate Economics Fellowship, 1982 - 1984.

PROFESSIONAL AFFILIATIONS

Member, American Economic Association, 1984 - present.

Associate Member, American Bar Association, 1991 - present. (Section of Antitrust Law)

TESTIMONY AND OFFICIAL PROCEEDINGS

Report, Reply Report and Testimony in The Matter Between The Commissioner of Competition and Visa Canada Corporation and MasterCard International Incorporated.

Joint Report, Rebuttal Report, and Deposition in Best Buy Co., Inc., v. AU Optronics Corp., et al., In Re LCD (Flat Panel) Antitrust Litigation, United States District Court, Northern District Of California, San Francisco Division

Testimony before the European Commission in Visa Europe.

Brief of Evidence and Reply Brief of Evidence, in New Zealand Commerce Commission v. Cards NZ Limited and Others, DSE (NZ) Limited and Others.

Report to the Reserve Bank of Australia in its *Review of Payment Systems Reforms.*

Brief of Evidence, in New Zealand Commerce Commission v. American Express International (NZ) Incorporated

Testimony before the European Commission in MasterCard.

Brief of Evidence, in New Zealand Commerce Commission v. Westpac Banking Corporation, District Court, Auckland, New Zealand.

Brief of Evidence, in New Zealand Commerce Commission v. Bank of New Zealand, Limited, District Court, Auckland, New Zealand.

Joint Report, In the Matter of the Decision of the Office of Fair Trading dated 6 September 2005 No. CA 98/05/05 of 6 September 2005 in Case CP/0090/00/S (MasterCard Multilateral Interchange Fee), Competition Appeal Tribunal (U.K.)

Declaration, Report, Rebuttal Report, and Deposition, In Re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation, U.S. District Court, Eastern District of New York.

Brief of Evidence, in New Zealand Commerce Commission v. ANZ National Bank Limited, New Zealand Commerce Commission v. Bank of New Zealand, Limited, District Court, Auckland, New Zealand.

Declaration in David Salkin v. MasterCard International, Court of Common Pleas, Philadelphia County, Pennsylvania.

Report in CFS-Related Securities Litigation, U.S. District Court, Northern District of Oklahoma, and District Court for Tulsa County, State of Oklahoma.

Report in Commercial Financial Services, Inc., v. Mayer Brown Rowe & Maw, P.A., f/k/a Mayer Brown & Platt, and J.P. Morgan Securities, Inc., f/k/a Chase Securities, Inc., Civil Action No. CJ 2002 03028, District Court of Tulsa County, State of Oklahoma.

Rebuttal Testimony and Affidavit in TDS Metrocom, LLC v. Wisconsin Bell, Inc. d/b/a SBC Wisconsin, Public Service Commission Of Wisconsin Docket No. 6720-TI-175.

Affidavit and Deposition in Elizabeth A. Fischer and Jennifer Herbst, on Behalf of Themselves and All Others Similarly Situated, v. MasterCard International, Inc.

Direct Testimony and Rebuttal Testimony on Behalf of SBC Illinois Before The Illinois Commerce Commission, Docket No. 03-0553.

Report in V.P. Intellectual Properties, L.L.C. v. Nobel Biocare USA, Inc., Implant Innovations, Inc. And Implant Innovations International Corporation v. Leonard I. Linkow, And Anthony W. Rinaldi.

Report and Trial Testimony in Enrique Calva-Cerqueira v. United States of America.

Report, Deposition, Amended Report, and Direct Testimony in Charter Federal Savings Bank v. United States of America

Declaration, Deposition, Trial Testimony, and Rebuttal Testimony in Adam Schwartz vs. Visa International, Inc., Visa International Service Association, Inc., Visa USA, Inc., and MasterCard International, Inc.

Report in Cardiac Pacemakers, Inc., Guidant Sales Corporation, and Eli Lilly and Company v. St. Jude Medical, Inc., Pacesetter, Inc., and Ventritex, Inc.

Testimony before the European Commission in Visa International.

Declaration, Report, Deposition, and Supplemental Report in Columbia First Bank, FSB v. United States of America

Affidavit in Century Shopping Center Fund I, Limited Partnership v. Frank Pio Crivello

Report and Deposition in Gregory F. Daniel, et al. v. American Board of Emergency Medicine, et al.

Report and Declaration in 1st Home Liquidating Trust v. Unites States of America

Report and Deposition in Pi Electronics Corp. v. United States of America

Report in WDP Limited v. Gelatin Products International, Inc. and R.P. Scherer Corp.

Joint Declaration, Joint Report, Deposition, Trial Testimony, and Rebuttal Testimony in C. Robert Suess, et al. v. United States of America.

Declaration and Supplemental Declaration in Robert Johnstone, et al. v. First Bank National Association, et al.

Testimony in Keisha Johnson, Shapearl, et al. v. Aronson Furniture Co. and Heilig-Meyers Co.

Report, Deposition and Trial Testimony in ProtoComm Corporation v. Novell Advanced Services (Formerly Fluent)

Joint Affidavit in Kahn v. Emerson Electric Co., Hazeltine Corporation and Motorola, Inc. et al.

Affidavit, Deposition and Trial Testimony in Masco Corporation of Indiana v. Price Pfister, Inc.

Deposition in Loomis Armored, Inc. v. City of Chicago.

Joint Declaration, Joint Reply Declaration, and Joint Supplemental Declaration in the Matter of Mahurkar Double Lumen Hemodialysis Catheter Patent Litigation.

Deposition in American Fidelity Fire Insurance v. General Railway Signal Corp.

Deposition in General Farebox, et al. v. Landa Corp., et al.

Affidavit in Lincoln Savings & Loan Association v. Federal Home Loan Bank Board and M. Danny Wall.

OTHER

FAA-certified private pilot

PADI-certified open water diver

January 2013

Materials Relied Upon

Case Filings

In Re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation, No. 05-MDL-1720 (JG)(JO) Definitive Class Settlement Agreement
Deposition of Etienne Goosse, October 22, 2008 (MasterCard 30(b)(6) witness on UK rules)
Declaration of Dhun Karai, head of Group Financial Services for Woolworths, September 22, 2009
Expert Report of Joseph Stiglitz, Ph.D., June 25, 2009
Report of Alan S. Frankel, Ph.D., July 9, 2009
Report of Professor Kenneth G. Elzinga, December 14, 2009
Expert Report of Dr. Benjamin Klein, December 14, 2009
Report of Barbara E. Kahn, Dean of the University of Miami, School of Business Administration, December 14, 2009
Expert Report of Robert H. Topel, December 14, 2009
Report of William Wecker, December 14, 2009
Rebuttal Report of Alan S. Frankel, Ph.D., June 22, 2010
Reply Report of Joseph Stiglitz, Ph.D., June 22, 2010

Other Legal Documents

Competitive Impact Statement in United States of America, et al. v. American Express Company, American Express Travel Related Services Company, Inc., MasterCard International Incorporated, and Visa Inc., Civil Action No. CV-10-4496, October 4, 2010
Judgment of the General Court (Seventh Chamber), Case T-111/08, May 24, 2012, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62008TJ0111:EN:HTML>
Final Judgment as to Defendants MasterCard International Incorporated and Visa Inc., Civil Action No. CV-10-4496, July 20, 2011
Complaint, in United States of America, et al. v. American Express Company, et al., CV10-4496, October 4, 2010
Response of Plaintiff United States to Public Comments on the Proposed Final Judgment, , in United States of America, et al. v. American Express Company, et al., CV10-4496, June 14, 2011
Closing Argument of MasterCard International Inc., in The Commissioner of Competition [Canada], Applicant, And Visa Canada Corporation And MasterCard International Incorporated, Respondents, And The Toronto-Dominion Bank And Canadian Bankers Association, Intervenors, http://www.ct-tc.gc.ca/CMFiles/CT-2010-010_Closing%20Argument%20of%20Mastercard%20International%20Inc. 300_45_6-29-2012_5632.pdf
Closing Argument of Visa Canada Corporation, in The Commissioner of Competition [Canada], Applicant, And Visa Canada Corporation And MasterCard International Incorporated, Respondents, And The Toronto-Dominion Bank And Canadian Bankers Association, Intervenors
Prepared Testimony of Visa USA, Inc., before the Committee on Banking, Finance and Urban Affairs, Subcommittee on Consumer Affairs and Coinage, United States House of Representatives, "Hearing on Credit Card Surcharges," March 27, 1984

Statement of Hugh H. Smith, Senior Vice President, American Express Co., Before the Subcommittee on Consumer Affairs and Coinage of the Committee on Banking, Finance and Urban Affairs, March 27, 1984

Testimony of Charles Russell, President, Visa U.S.A., Inc., Before the Committee on Banking, Housing and Urban Affairs, Subcommittee on Consumer Affairs, United States Senate, "The Cash Discount Act," February 7, 1984

Prepared Testimony of Hugh M. Smith, Senior Vice President, Government Affairs, on behalf of the American Express Co., before the United States House of Representatives, Committee on Banking, Finance and Urban Affairs, Subcommittee on Consumer Affairs and Coinage, The Cash Discount Act, February 5, 1981

Testimony of Hugh M. Smith, President, Visa U.S.A., Inc., Before the Committee on Banking, Housing and Urban Affairs, Subcommittee on Consumer Affairs, United States Senate, "The Cash Discount Act," February 7, 1984

Public Law 111-203 – July 21, 2010, Sec. 1075

Articles, Books, Papers

Wilko Bolt, Nicole Jonker and Corry van Renselaar, Incentives at the Counter: An Empirical Analysis of Surcharging Card Payments and Payment Behaviour in the Netherlands, *Journal of Banking & Finance* (2009)

Dennis W. Carlton and Alan S. Frankel, "The Antitrust Economics of Credit Card Networks," *63 Antitrust Law Journal* 643 (1995)

Dennis W. Carlton and Alan S. Frankel, "Antitrust and Payment Technologies," *77 Federal Reserve Bank of St. Louis Review* 41 (1995)

Julie Hirschfeld Davis and Lisa Lerer. "Romney Vowing Dodd-Frank Repeal Hits JPMorgan Risky Trades." *Bloomberg News*. May 14, 2012. Web. <http://www.businessweek.com/news/2012-05-14/jpmorgans-inconvenient-truth-hits-romneys-dodd-frank-repeal-vow>

David S. Evans and Richard Schmalensee, *Paying With Plastic* (2nd ed. 2005)

Alan S. Frankel, "Monopoly and Competition in the Supply and Exchange of Money," *66 Antitrust Law Journal* 313 (1998)

Alan S. Frankel, "Interchange Fees in Various Countries: Commentary on Weiner and Wright," in *Interchange Fees in Credit and Debit Card Industries: What Role for Public Authorities?*, Federal Reserve Bank of Kansas City (2005)

Steve Liesman, "Treasury Hits Back at Critics of Dodd-Frank Rules." *CNBC*. January 12, 2012. Web. <http://www.cnn.com/id/45971366>

Scott Schuh, Oz Shy and Joanna Stavins, "Who Gains and Who Loses from Credit Card Payments? Theory and Calibrations," *Federal Reserve Bank of Boston, Public Policy Discussion Paper No. 10-03* (August 2010)

Scott Schuh, Oz Shy, Joanna Stavins, and Robert Triest, "An Economic Analysis of the 2010 Proposed Settlement between the Department of Justice and Credit Card Networks," *Federal Reserve Bank of Boston, Public Policy Discussion Paper No. 11-4* (2011), <http://www.bostonfed.org/economic/ppdp/2011/ppdp1104.pdf>

Exhibit 2

Remarks of Bill Sheedy, (then) Executive Vice President, Interchange Strategy, Visa U.S.A., in
“Interchange Fees in Credit and Debit Card Industries: What Role for Public Authorities?,” Federal Reserve Bank of Kansas City (2005)

Richard Thaler, “Toward A Positive Theory Of Consumer Choice,” 1 Journal of Economic Behavior and Organization 39, 45 (1980)

C. Christian von Weizsäcker, “Economics of Credit Cards - Expert Report on behalf of MasterCard International Incorporated and Europay International SA” dated 23 January 2002

Sears, Roebuck and Co. 1902 Catalog

“Forces Shaping the Payments Environment: A Summary of the Chicago Fed’s 2005 Payments Conference,” The Federal Reserve Bank of Chicago, Chicago Fed Letter No. 219a, October 2005

“Hospital Purchasing Alliances: Utilization, Services and Performance,” Health Care Management Review, July-September 2008, pp. 203-215

“Commerce Commission and MasterCard Agree to Settle Credit Card Interchange Fee Proceedings,” press release, August 24, 2009, <http://www.comcom.govt.nz/media-releases/detail/2009/commercecommissionandmastercardagr>

“MasterCard: Delay processing-fees rule.” Reuters. March 1, 2011. Web.
<http://www.reuters.com/article/2011/03/01/us-finance-summit-mastercard-debit-idUSTRE72058B20110301>

The Nilson Report No. 1011, February 2013

“Chase/Visa Network Partnership,” Nilson Report #1013, March 2013

Bates Numbered Documents

VUSAMDL1-00748463

Visa White Paper, VUSAMDL1-09042437

Visa “Merchant Presentation Messages,” VUSAMDL00153736

MCI_MDL02_10577117

RBA documents

Reserve Bank of Australia and Australian Competition and Consumer Commission, *Debit And Credit Card Schemes In Australia: A Study Of Interchange Fees And Access*, October 2000

Reserve Bank of Australia, Reform of Card Schemes in Australia I: A Consultation Document, December 2001

Reserve Bank of Australia, Reform of Card Schemes in Australia IV: Final Reforms and Regulation Impact Statement, August 2002

“Merchant Surcharging in Australia,” East & Partners, February 2007

American Express Australia Limited, “Review of Payment System Reforms: A Submission to the Reserve Bank of Australia,” August 2007

“Payments System Regulation: Response by MasterCard Worldwide to the Issues for the 2007/08 Review,” (Submission to the Reserve Bank of Australia), August 31, 2007

“Review of Reform of Australia’s Payments System: Regulation of Credit Card Payments and the role of Diners Club,” September 6, 2007, Report to Diners Club (commercial-in-confidence version) by the Allen Consulting Group

Exhibit 2

The Allen Consulting Group, "Review of Reform of Australia's Payments System: Regulation of Credit Card Payments and the role of Diners Club," September 6 2007, <http://www.rba.gov.au/payments-system/reforms/review-cardreforms/pdf/dc-06092007.pdf>

Reserve Bank of Australia, Proceedings of Payments System Review Conference, 29 November 2007

Reserve Bank of Australia, Reform of Australia's Payments System, Conclusions of the 2007/08 Review, September 2008

East & Partners, Australian Merchant Payments: Market Analysis Report, February 2010

Reserve Bank of Australia, Review of Card Surcharging: A Consultation Document, June 2011

Reserve Bank of Australia, A Variation to the Surcharging Standards: A Consultation Document, December 2011

Reserve Bank of Australia, "A Variation to the Surcharging Standards: Final Reforms and Regulation Impact Statement," June 2012

<http://www.rba.gov.au/statistics/tables/xls/c03hist.xls?accessed=2013-03-17-14-09-41>.

<http://www.rba.gov.au/payments-system/resources/statistics/index.html>

Reserve Bank of Australia, Merchant Fees for Credit and Charge Cards,

<http://www.rba.gov.au/statistics/tables/xls/c03hist.xls?accessed=2013-03-17-14-09-41>

MasterCard and Visa Public Documents

MasterCard Systemwide Interchange Report_GCMS Cleared Purchase Vol_US Issued Acquired 2009.xls

Visa International Operating Regulations, 15 October 2012,

<http://usa.visa.com/download/merchants/visa-international-operating-regulations-main.pdf>

http://usa.visa.com/personal/using_visacard/fees/index.html.

Visa Inc. Quarterly Operational Performance Data,

<http://investor.visa.com/phoenix.zhtml?c=215693&p=quarterlyearnings>

MasterCard Inc. Quarterly Financial Results,

<http://investorrelations.mastercardintl.com/phoenix.zhtml?c=148835&p=irol-calendarpast>