

**FINAL SUBMISSION: MULTILATERAL
SETTING OF EFTPOS INTERCHANGE FEES**

19 SEPTEMBER 2003



CALTEX

1. Introduction

- 1.1 As stated in Caltex's submission to the Predetermination Conference of 1 September 2003, Caltex agrees with the Commission's draft determination to deny authorisation of the proposed collective setting of EFTPOS interchange fees.
- 1.2 The purpose of this final submission is to comment on issues raised at the Predetermination Conference by the applicants, which in Caltex's view require further comment.

2. The Applicants' Submission - interchange fees

- 2.1 The applicants note in their submission to the Predetermination Conference that *'the applications represent a voluntary reform... and have been developed in consultation with the Reserve Bank of Australia and the ACCC'*. Caltex assumes that this is a reference to the Reserve Bank of Australia/ACCC October 2000 Joint Study on Debit and Credit Card Schemes in Australia.
- 2.2 Caltex submitted in section 7 of its original submission that the joint study does not provide any basis upon which the ACCC could be satisfied that the public benefit of the price fixing arrangement in relation to debit card interchange fees outweighs the public detriment of such an arrangement, and also set out a number of defects of the Joint Study as a basis for authorisation.
- 2.3 Under all of those circumstances, the applicants' submission that their applications have been developed in consultation with the ACCC is misleading.

3. The Applicants' Submission - Access Reform

- 3.1 Caltex agrees with the applicants' submission that the issue surrounding access reform is not relevant to the current applications.
- 3.2 As Caltex has previously submitted, the applicants chose not to deal with the access issue in their application, and their application must be considered in the context of the very high existing barriers to entry which the current bilateral network architecture constitutes.

4. The Applicants' Submission - Effect on Competition

- 4.1 In paragraph 4, the applicants list three important elements of the status quo:
- (a) *'a large number of bilateral agreements'*. Caltex agrees that this is an important element of the status quo, but submits that it is the existing network architecture involving a large number of bilateral links which creates the barrier to entry; the bilateral agreements flow from the nature of the network;
 - (b) *'interchange fees between issuers and acquirers can be difficult to alter because doing so would involve re-negotiations with a large number of counterparties'*. It is not at all clear why this would be the case. The applicants provide no factual basis for this assertion. In the absence of some other arrangement between issuers and acquirers (the existence of which would raise its own set of trade practices issues) there is no such constraint on parties to bilateral arrangements to renegotiate those arrangements bilaterally. In comparison, the proposed interchange price fixing arrangements will require 75% of all parties to agree to any change.

- (c) *'considerable competition at present between issuers for cardholders, and between acquirers for merchants'*. Caltex agrees there is considerable competition between acquirers for merchants.
- 4.2 The applicants disagree with the Commission's proposition that *'a substitution of a fee set by multilateral agreement for fees set by a series of bilateral agreements is likely to result in a less competitive outcome'*. The applicants overlook the fact that price fixing is deemed by the *Trade Practices Act* to substantially lessen competition, so that the Commission's conclusion is right in law as well as in fact.
- 4.3 The applicants claim that this proposition *'substitutes a conclusion for a competition analysis of the relevant markets'*. However, it was the applicants who chose not to identify any relevant market in their applications, or to provide any competition analysis in support of their applications.
- 4.4 The applicants then assert that the Commission's conclusion *'ignores the fact that changing the interchange fee will precipitate a major market shake up requiring the renegotiation of agreements with merchants and unsticking arrangements which have been static for years'*. Arrangements between acquirers and merchants have not been static for years. They are in general subject to a tender process described in section 4 of Caltex's original submission. Arrangements are typically for a maximum period of three years, but are often for shorter periods.
- 4.5 The applicants go on to argue that the proposal *'will not make the current situation, whether that is regarded as competitive or not, any worse'*, on the basis that if the status quo results in fairly uniform and static interchange fees then the proposed agreement simply alters the level of the interchange to zero. This analysis focuses on arrangements between issuers and acquirers, ignoring entirely the state of competition in the market where acquirers compete for merchants. The applicants have recognised that there is considerable competition in this market. In paragraph 4.6 of its original submission, Caltex described the role that the network access fee played as a differentiating factor in the competitive offers from acquirers, and submitted that moving to a multilateral interchange fee setting would remove this key competitive element. While the applicants may or may not be correct that the effect on competition in the issuer/acquirer market may be insignificant, it is clear that in the merchant/acquirer market, the proposed arrangement will have a significant anti-competitive effect.
- 4.6 The applicants disagree with the ACCC's view that the proposed agreement *'may have the effect of increasing (entry) barriers'* on the basis that the ability to negotiate an interchange fee will not be significant, having regard to the other arrangements that need to be negotiated between an issuer and an acquirer. However the applicants completely ignore the effect the zero interchange price fixing arrangement would have on incentives for investment by a new entrant acquirer, in removing one of the sources of revenue which currently can underpin the investment decision. In a zero interchange regime, the potential new entrant acquirer would need to be able to recover its investment entirely from merchants instead, as is currently the case, from issuers as well as merchants, and as a consequence, start up costs will be more difficult to recover. In addition, incumbents have had the opportunity to fund their infrastructure from both fee streams, placing new entrants at a further competitive disadvantage.
5. **The Applicants' Submission - Public Benefits**
- 5.1 The applicants maintain that the ACCC erred in failing to find benefits from the proposed agreement compared with the status quo, on the basis that a reduction of interchange fees to zero *'will result in pass through of at least some of those savings'*

thereby creating a public benefit (own emphasis). It is noteworthy that the applicants no longer argue that all the savings will be *'passed on in some form in lower retail banking fees paid by cardholders and/or through enhanced services'* as it maintained in its original application.

- 5.2 The applicants now concede that there will not be a complete pass through of their savings, but still claim a public benefit. However, the applicants completely ignore that, as conceded in the application, *'it is likely that acquirers will seek to recover the cost of providing merchant acquiring services from other revenue sources'* in the form of *'changes in merchant service charges to reflect these increased costs'*, that *'merchants will have the option of no longer accepting the cards or passing the cost on to customers in some form'*, and that *'past experience suggests that increasing the average price level may be preferred to surcharging in most markets'*. In the light of the applicants' concession that only some of the savings are likely to be passed through to cardholders, and that it is likely that all increased costs will be passed on to customers through an increase in retail prices, it is clear that there will be no net savings to consumers which could be counted as a public benefit; instead there will be a net public detriment.
- 5.3 The second public benefit claimed by the applicants is that the proposed agreement will reduce *'the level of pricing distortion between the different retail payment instruments'*. The applicants have not provided any evidence to the Commission to support the proposition that the current EFTPOS interchange fees amount to a *'pricing distortion'*, either in the applications, the Rejoinder Submission or in the submission made at the Predetermination Conference.
- 5.4 The submission to the Reserve Bank of Australia by the Australian Institute of Petroleum dated 24 December 2002 refers to the work carried out by industry experts TransAction Resources to calculate the cost of acquiring and processing an EFTPOS transaction. TransAction Resources calculated the cost at 21 cents per transaction, based on industry averages across small and large acquirers and merchants. As the current fee payable by issuers to acquirers is in that order of magnitude, the proposed reduction of EFTPOS interchange fees to zero would be creating a pricing distortion that does not currently exist. As Caltex said in its original submission, solving a non-existent problem (ie. removing a pricing distortion that does not exist) is not a public benefit.
- 5.5 Finally the applicants claim that a mechanism for changing EFTPOS interchange fees is a public benefit, when what is proposed is a change from the current arrangement where parties have the ability to renegotiate fees on a bilateral basis, to one where a 75% majority of all participants is required to do so. Caltex submits that this is a public detriment, not a public benefit from the proposal.