

**Draft
Determination**

Applications for Authorisation

Lodged by

**Australia and New Zealand Banking Group,
Australian Settlements Ltd, Bank of Queensland,
Bank of Western Australia Ltd, Bendigo Bank,
Cashcard Australia Ltd, Commonwealth Bank of Australia,
Credit Union Services Corporation (Australia) Ltd,
National Australia Bank, St. George Bank Ltd,
Suncorp Metway Ltd and Westpac Banking Corporation**

**in relation to the collective setting of
EFTPOS interchange fees**

Authorisation numbers

A30224

A30224

Commissioners

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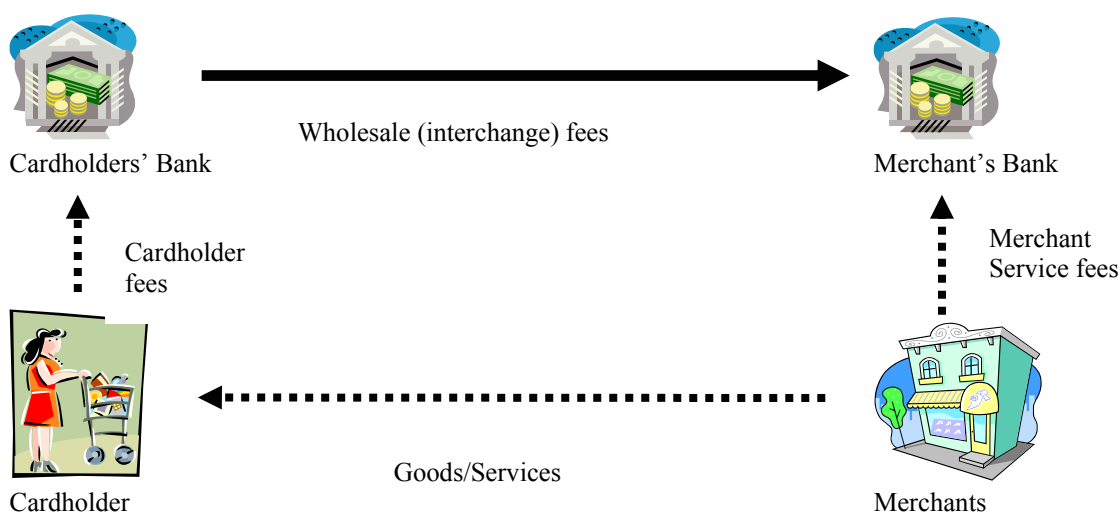
Summary

Introduction

EFTPOS (Electronic Funds Transfer at Point of Sale) provides consumers with an electronic means of payment for goods and services at the point of sale. EFTPOS transactions are facilitated by a debit card issued by the cardholder's financial institution and linked to a transaction account. In general terms, when the cardholder makes a purchase and enters a PIN the relevant data are transmitted over a secure electronic network to the merchant's financial institution. The purchase details are checked against the cardholder's account and an authorisation or decline message is returned to the merchant. Typically this process is completed within a few seconds.

In Australia each month approximately 63.8 million EFTPOS transactions are processed at a value of \$4 billion. This compares with approximately 80.6 million credit card transactions per month at a value of \$9 billion. The significance of both debit and credit cards in Australia's retail payments system has meant that they have both come under increasing scrutiny from network participants and industry regulators who have an interest in ensuring the overall efficiency of Australia's payments system. In this regard the Reserve Bank of Australia (RBA) has recently 'designated' the four party credit card schemes in Australia as payments systems subject to its regulation and has introduced a package of reforms that establish a standard for the setting of interchange fees, a standard for merchant pricing of credit card purchases and a regime for access to the four party credit card schemes.¹

Fees payable in respect of EFTPOS transactions



¹ In September 2002, MasterCard International and Visa International commenced proceedings in the Federal Court to have the reforms overturned. The hearing commenced on 19 May 2003.

Customers who hold and use debit cards and merchants that accept the cards as a means of payment generally pay fees to their financial institutions for the card services they receive. Less well known and transparent are the wholesale or interchange fees currently paid by the cardholder's financial institution (card issuer) to the merchant's financial institution (merchant acquirer) in respect of each debit card transaction. Currently these fees are set by bilateral negotiations between card issuers and merchant acquirers and on an aggregate basis amount to approximately \$150 million per annum.

The applications for authorisation

The applications for authorisation that are currently before the Commission, and to which this draft determination relates, are in relation to a collective agreement among card issuing institutions and merchant acquiring institutions to set the current interchange or wholesale fees for EFTPOS transactions to zero.

Authorisation, if granted by the Commission, would provide immunity from court action under the Act in respect of this conduct. However immunity can only be granted if the Commission is satisfied that the likely public benefits flowing from the conduct outweigh the likely anti-competitive detriments.

The Applicants² have sought authorisation as aspects of a proposed Interchange Fee Agreement (the proposed Agreement), in collectively setting the interchange fee at zero, may constitute a breach of the provisions of the *Trade Practices Act 1974* (the Act) which prohibit the fixing of prices. In addition, the Applicants propose to use 'reasonable endeavours' to amend existing contracts that are inconsistent with the zero interchange fee, this conduct may give rise to an exclusionary provision or primary boycott in breach of the Act.

Applicants' submissions

The Applicants have submitted that the proposed Agreement will result in a net benefit to the public as it is likely to:

- reduce the overall cost of the Australian payments system, by decreasing the cost of EFTPOS for consumers and thereby encouraging the use of EFTPOS;
- introduce greater flexibility over time into the setting of EFTPOS interchange fees, reducing the inertia that has made them unresponsive to changes in market circumstances; and
- make entry as a new issuer or acquirer of EFTPOS transactions easier.

² Australia and New Zealand Banking Group, Australian Settlements Ltd, Bank of Queensland, Bank of Western Australia Ltd, Bendigo Bank, Cashcard Australia Ltd, Commonwealth Bank of Australia, Credit Union Services Corporation (Australia) Ltd, National Australia Bank, St. George Bank Ltd, Suncorp Metway Limited, Westpac Banking Corporation (the Applicants) lodged applications for authorisation A30224 and A30225 on 21 February 2003.

The Applicants consider that it is likely that, as card issuers will no longer pay interchange fees in respect of EFTPOS transactions made by their cardholders, cardholders will enjoy lower EFTPOS transaction fees or enhanced services.

The Applicants also consider that it is likely that merchant service fees will be increased as acquiring institutions under the proposed Agreement will no longer receive interchange fee revenue and will seek to recoup this loss from merchants. In turn, the Applicants consider it is likely that merchants may pass on this cost increase to consumers in the form of a small increase in the overall price of goods and services.

The Applicants claim that the proposed Agreement will not lessen competition, and instead it is likely to facilitate a more competitive outcome by making it easier for the interchange fees to be amended in response to changing market conditions. Further, the Applicants consider that the proposed Agreement is unlikely to increase, and is more likely to reduce, the barriers to direct entry into the debit card system as a card issuer or merchant acquirer by narrowing the scope and cost of the negotiations necessary to facilitate new entry.

The Applicants submit, however, that broad reform to improve the ability of potential entrants to join the EFTPOS network is beyond the scope of the current applications for authorisation and that access issues would be more appropriately addressed in a separate authorisation application currently before the Commission in respect of the technical rules and procedural standards for the clearing and settlement of EFTPOS and ATM transactions³.

Commission consideration

The Commission considers that reform of the EFTPOS network, including interchange fees, is necessary in order to encourage competition and efficiency in the operation of the network. In turn this will contribute to the overall efficiency of Australia's payments system. The Commission notes that reforms to achieve this aim have recently been implemented in relation to credit cards. In particular the reform process for credit cards has been considered and implemented by the RBA as a package that is intended to address access, interchange fees and pricing transparency. The Commission is concerned, however, that the current proposal the subject of these applications proposes only one element of reform – that is to EFTPOS interchange fees.

After considering the information before it, including submissions by the Applicants and interested parties, the Commission is of the view that the proposed arrangement is likely to lessen competition. As a general principle, the Commission considers that an agreement between competitors to substitute a series of interchange fees negotiated on a commercial basis between two parties

³ Australian Payments Clearing Association (APCA) applications for revocation and substitution A30228 and A30229 in relation to Consumer Electronic Clearing System (CECS) rules and regulations.

(a card issuer and merchant acquirer) with a single interchange fee agreed and implemented on a multilateral basis is likely to result in a less competitive outcome. The Commission also considers that there are several factors that are likely to influence the effectiveness of competition between card issuing institutions and merchant acquiring institutions, including the high degree of market concentration; the dominance of a small number of large institutions; the cross representation between card issuers and merchant acquirers; and the high barriers to entry to both card issuing and merchant acquiring.

The Commission notes that it has been submitted that the competitive detriment arising from the proposed Agreement may be offset to some extent by the potential liberalisation of access to the EFTPOS network as part of the APCA review of the CECS arrangements. The Commission is concerned however that the outcome of the APCA review process is highly uncertain. As such it is the Commission's view that it would be inappropriate to attach a lesser weight to the likely anti-competitive detriment resulting from the proposed Agreement on the basis of the APCA review. However, the Commission considers that, in the event that suitable access reform was to be introduced the proposed Agreement is more likely to be in the net public benefit.

While the Commission considers that the proposed Agreement has the potential to result in benefits to the public, in particular as the proposed agreement may contribute to improved payment system efficiency, the Commission is concerned that the weight to be attached to these potential benefits is uncertain. In particular the Commission is concerned that competition between card issuing institutions may not be sufficient to ensure a lasting benefit enjoyed by the public and that current barriers to entry may inhibit the competitive pressures that may otherwise be exercised by potential new entrants (which would thereby increase the extent and likelihood of that benefit being passed through to the general community). The Commission is also concerned that transparent pricing signals that would encourage greater payments system efficiency may not be readily observable by consumers.

The Commission also considers that the proposed Agreement is unlikely to improve the flexibility of interchange fees (as it will continue to maintain standardised fees, albeit at zero) and is concerned that the proposed Agreement may have the effect of increase existing barriers to entry by removing an important bargaining tool and may act to further entrench the high level of card issuer and merchant acquirer concentration, resulting in anti-competitive detriment.

Consequently, the Commission concludes that the public benefits likely to flow from the proposed Agreement are not sufficient to outweigh the detriment likely to flow from the proposed Agreement.

The Commission therefore proposes, subject to any request for a pre-decision conference, to deny authorisation to the applications.

Abbreviations

The Act	<i>Trade Practices Act 1974</i> (Cth)
The Applicants	Australia and New Zealand Banking Group, Australian Settlements Ltd, Bank of Queensland, Bank of Western Australia Ltd, Bendigo Bank, Cashcard Australia Ltd, Commonwealth Bank of Australia, Credit Union Services Corporation (Australia) Ltd, National Australia Bank, St. George Bank Ltd, Suncorp Metway Limited, and Westpac Banking Corporation
The Commission	Australian Competition and Consumer Commission
ABA	Australian Bankers' Association
ACA	Australian Consumers' Association
ACC	Aboriginal Co-ordinating Council
ACIL Tasman	ACIL Tasman Pty Limited
ADI	Approved Deposit-taking Institution
AIP	Australian Institute of Petroleum
APCA	Australian Payments Clearing Association
ARA	Australian Retailers' Association
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ATM	Automatic Teller Machine
Caltex	Caltex Australia Petroleum Pty Ltd
CCLS(WA)	Consumer Credit Legal Service (WA) Inc
CECS	Consumer Electronic Clearing System
CFA	Consumers' Federation of Australia
CLC(V)	Consumer Law Centre of Victoria
Coles Myer	Coles Myer Ltd
EFTPOS	Electronic Funds Transfer at Point of Sale
EAWG	EFTPOS Access Working Group

EIWG	EFTPOS Industry Working Group
ESA	Exchange Settlement Account
Joint Study	<i>Debit and Credit Card Schemes in Australia: A Study of Interchange Fees and Access</i> Reserve Bank of Australia, Australian Competition and Consumer Commission, October 2000
McDonald's	McDonald's Australia Limited
MTAA	Motor Trades Association of Australia
NARGA	National Association of Retail Grocers of Australia
PIN	Personal Identification Number
POAAL	Post Office Agents Association Limited
PSRA	<i>Payment Systems (Regulation) Act 1998</i>
RBA	Reserve Bank of Australia
Woolworths	Woolworths Limited.

Contents

Summary.....	i
Abbreviations	v
Introduction.....	1
Statutory test	1
Background.....	4
The EFTPOS payment system	4
Operation of the EFTPOS network.....	5
<i>Parties to an EFTPOS transaction.....</i>	<i>5</i>
<i>Current operation of the EFTPOS payments system.....</i>	<i>6</i>
Australian Payments Clearing Association application for authorisation - Consumer Electronic Clearing System.....	8
The applications	15
The Interchange Fee Agreement	15
<i>Setting of EFTPOS interchange fees</i>	<i>15</i>
<i>Inconsistency with contractual obligations</i>	<i>15</i>
<i>Review and monitoring.....</i>	<i>16</i>
Submissions.....	17
The Applicants.....	17
Submissions by interested parties.....	20
<i>Consumer organisations.....</i>	<i>20</i>
<i>Merchants.....</i>	<i>21</i>
<i>Industry regulators</i>	<i>23</i>
<i>Reserve Bank of Australia (RBA)</i>	<i>23</i>
<i>Government Ministers</i>	<i>25</i>
<i>Others</i>	<i>26</i>
Commission evaluation.....	29
Scope of the Commission's considerations	29
Future with-and-without test	30
The relevant market.....	32
Effect on competition	35
<i>Card issuing.....</i>	<i>36</i>
<i>Merchant acquiring.....</i>	<i>41</i>
<i>Conclusion on anti-competitive detriment.....</i>	<i>47</i>
Public benefits	48
<i>Making EFTPOS more attractive/Improving the efficiency of the Australian payments system.....</i>	<i>48</i>

<i>Introducing greater flexibility into the setting of EFTPOS interchange fees</i>	53
<i>Making new entry to the EFTPOS network easier by simplifying the negotiation of bilateral interchange agreements</i>	54
<i>Conclusion on public benefit</i>	54
Conclusion Commission evaluation – weighing up of the competitive detriments and public benefits	55
Next steps	57
Draft Determination	61
Applications A30224 and A30225	61
Statutory test	61

Introduction

- 1.1 The Australian Competition and Consumer Commission (the Commission) is the Commonwealth agency responsible for administering the *Trade Practices Act 1974* (the Act). A key objective of the Act is to prevent anti-competitive conduct, thereby encouraging competition and efficiency in business, resulting in a greater choice for consumers in price, quality and service.
- 1.2 The Act, however, recognises that competition may not always result in the most efficient outcome. It therefore allows the Commission to grant immunity from the Act for anti-competitive conduct in certain circumstances.
- 1.3 One way businesses may obtain immunity is to apply for what is known as an ‘authorisation’ from the Commission. Broadly, the Commission may ‘authorise’ businesses to engage in anti-competitive conduct where it is satisfied that the public benefit from the conduct outweighs any public detriment.
- 1.4 The Commission conducts a comprehensive public consultation process before making a decision to grant or deny authorisation.
- 1.5 Upon receiving an application for authorisation, the Commission invites interested parties to lodge submissions outlining whether they support the application or not, and their reasons for this.
- 1.6 The Commission then issues a draft determination in writing proposing to either grant the application (in whole, in part or subject to conditions) or deny the application. In preparing a draft determination, the Commission will take into account any submissions received from interested parties.
- 1.7 Once a draft determination is released, the applicant or any interested party may request that the Commission hold a pre-decision conference. A pre-decision conference provides interested parties with the opportunity to put oral submissions to the Commission in response to a draft determination. The Commission will also invite interested parties to lodge written submissions on the draft.
- 1.8 The Commission then reconsiders the application taking into account the comments made at the conference (if one is requested) and any further submissions received and issues a written final determination. Should the public benefit outweigh the public detriment, the Commission may grant authorisation. If not, authorisation may be denied. However, in some cases it may still be possible to grant authorisation where conditions can be imposed which sufficiently increase the public benefit or reduce the public detriment.

Statutory test

- 1.9 The Commission must consider and assess applications for authorisation according to a ‘test’ set out in the Act. Relevantly, sub-section 90(8) of the Act provides that the Commission shall not make a determination granting

authorisation to a proposed exclusionary provision of a contract, arrangement or understanding, unless it is satisfied in all the circumstances that the proposed provision would result or be likely to result in such a benefit to the public that the proposed contract or arrangement should be allowed to be made.

- 1.10 Under sub-section 90(6) of the Act, the Commission may grant authorisation to a provision of a proposed contract, arrangement or understanding, other than an exclusionary provision, if it is satisfied that:
- the provision of the proposed contract, arrangement or understanding would be likely to result in a benefit to the public; and
 - this benefit would outweigh the detriment to the public constituted by any lessening of competition that would be likely to result if the proposed arrangement was made and the provision concerned was given effect to.
- 1.11 While there is some variation in the language between the test in sub-section 90(6) and the test in sub-section 90(8), the Commission adopts the view taken by the Trade Practices Tribunal (now the Australian Competition Tribunal) that in practical application the tests are essentially the same.⁴

Applications A30224 and A30225

- 1.12 On 21 February 2003 the Australia and New Zealand Banking Group, Australian Settlements Ltd, Bank of Queensland, Bank of Western Australia Ltd, Bendigo Bank, Cashcard Australia Ltd, Commonwealth Bank of Australia, Credit Union Services Corporation (Australia) Ltd, National Australia Bank, St. George Bank Ltd, Suncorp Metway Limited and Westpac Banking Corporation (the Applicants) lodged two applications for authorisation.
- 1.13 The Applicants are seeking authorisation of an ‘Interchange Fee Agreement’ (**Attachment A**). The Interchange Fee Agreement broadly provides for the collective setting of electronic funds transfer at point of sale (EFTPOS) interchange fees and for the review of the level of the interchange fees approximately every three years or at any other time if there is a material change in circumstances with the consent of the parties. The Interchange Fee Agreement is set out in detail in chapter 3 of this draft determination.

Conduct of the Inquiry

- 1.14 The Commission conducts inquiries and assessments of authorisation applications in accordance with the requirements of the Act and with the procedures for authorisations as described in the Commission’s *Guide to Authorisations and Notifications*. A chronology of the main stages of the Commission’s inquiry is provided below in Table 1.1.

⁴ *Re Media Council of Australia (No 2)* (1987) ATPR at 48-418; *Re 7-Eleven Stores Pty Ltd* (1994) ATPR 41-357.

Table 1.1 – Chronology of the Commission’s assessment of the authorisation application

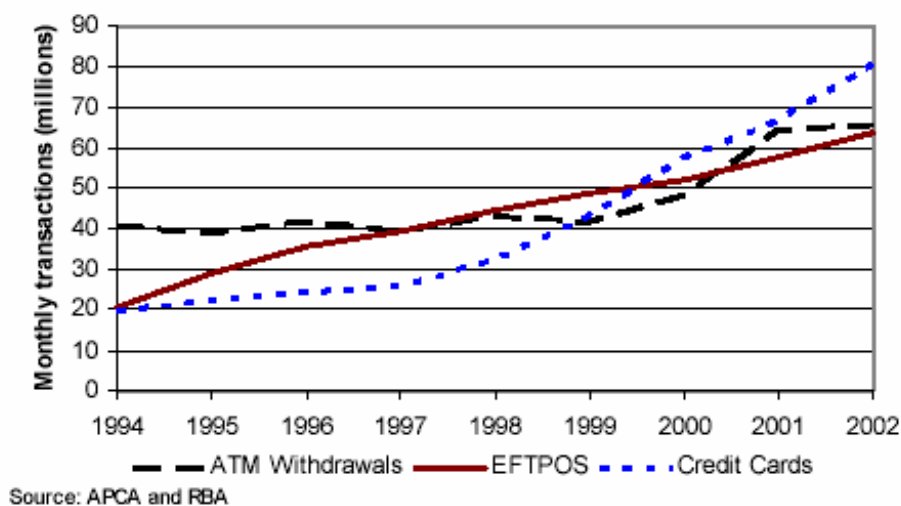
Date	Action
21 February 2003	Applications for authorisation received from the Applicants.
24 February 2003	Commission sent letters to interested parties seeking submissions.
27 February 2003	Commission sent letter to the Applicants requesting additional information.
21 March 2002	Closing date for submissions from interested parties in relation to the applications for authorisation.
26 March 2003	Commission sent letter to the Applicants providing copies of submissions received from interested parties.
28 March 2003	Extended date for interested party submissions in relation to the applications for authorisation.
28 March 2003	Confidential information provided by the Applicants in response to the Commission’s request of 27 February 2003.
4 April 2003	Commission sent letter to the Applicants providing copies of further submissions received from interested parties.
24 April 2003	Comments received from the Applicants in relation to submissions made by interested parties (rejoinder submission).

Background⁵

The EFTPOS payment system

- 2.1 EFTPOS was introduced in Australia in 1984. It provides a means of payment for goods and services at the point of sale. In Australia EFTPOS transactions are PIN-based and are authorised in real-time by the card issuer over a secure electronic network. EFTPOS terminals are used for both debit and credit cards. A large number of merchants also provide a cash-out facility which enable merchants to offer their customers a cash withdrawal facility.
- 2.2 EFTPOS terminals at points of sale were at first connected only to one financial institution, and could only accept the cards issued by that financial institution. Use of EFTPOS in Australia was initially moderate but grew rapidly in the early 1990s with the acceptance by petrol retailers and with several major retailers joining the network. However, during the later part of the 1990s debit card transaction growth tapered off while credit card transaction growth increased. This is illustrated in Figure 2.1. Credit and debit cards were used for payments at almost the same rate in 1994, approximately 20 million transactions per month each, and at about half the level of Automatic Teller Machine (ATM) withdrawals. Subsequently, use of both credit and debit cards grew faster than ATM withdrawals. The number of credit card transactions exceeded both ATM and EFTPOS transactions by 2000.

Figure 2.1: Number of Credit Card, ATM and EFTPOS transactions 1994 – 2002



Source: Applicants submission, February 2003, at page 4.

⁵ The information contained in this section is sourced from the Applicants' submission, interested party submissions in particular those submissions provided by the Reserve Bank of Australia and the Australian Retailers Association and the discussion paper released by the EFTPOS Industry Working Group in July 2002.

- 2.3 At the end of June 2002 there were 415,167 EFTPOS terminals in Australia, processing 63.8 million EFTPOS transactions per month with a monthly value of \$4.0 billion.⁶ For the same period EFTPOS terminals also processed 80.6 million credit card transactions per month with a monthly value of \$9.0 billion dollars.⁷

Operation of the EFTPOS network

Parties to an EFTPOS transaction

- 2.4 In Australia there are four primary parties to an EFTPOS transaction (see Figure 2.2). A basic outline of these parties and their role in the EFTPOS network is provided below.

Card issuer

This is the cardholder's bank. The card issuer provides their customers with a payment instrument (a card) that complies with appropriate standards and which can be used to withdraw funds or make payments for goods and services.

Cardholder

The cardholder is the ultimate customer of the EFTPOS system. The cardholder is also the joint customer of the card issuing bank and the merchant.

Merchant

Merchants provide goods, services and (where applicable) cash to customers and initiate non-cash payment transactions. The merchant receives the value for these transactions from their merchant acquirer via payment to a nominated financial institution account.

There are two categories of merchants in the Australian debit card network, being:

- those merchants who obtain the full range of acquiring services (terminals, switching, provision of funds etc) from their financial institution and pay a merchant service fee; and
- certain large merchants who take on some of the processing of debit card transactions using their own facilities, and may have negotiated arrangements under which they share the interchange fee with their financial institution. These merchants are called 'merchant principals'.

Merchant acquirer

This is the merchant's financial institution. Merchant acquirers support merchants' participation in EFTPOS by obtaining funds from the cardholder's bank and paying these to the merchant. The merchant acquirer charges the merchant a fee for this service and associated infrastructure if provided.

⁶ Australian Payments Clearing Association Limited website,
http://www.apca.com.au/Public/apca01_live.nsf/WebPageDisplay/Payment_Statistics?OpenDocument

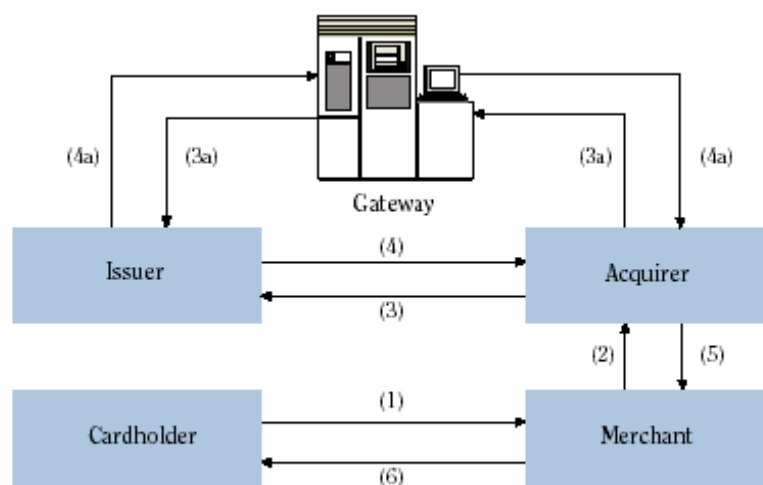
⁷ Ibid.

- 2.5 Gateway providers also exist to provide indirect access to the EFTPOS network. In simple terms a gateway is an entity that will allow third parties to access its bilateral arrangements in return for a fee (known as a gateway fee). It is understood that small institutions, such as credit unions and building societies, predominantly obtain access to the EFTPOS network via a 'gateway'.

Current operation of the EFTPOS payments system

- 2.6 The EFTPOS network is comprised of a series of proprietary bilateral communications links between merchants, the merchant's financial institution (merchant acquirer) and the debit card issuing financial institution (card issuer). The bilateral links are supported by bilateral interbank agreements (establishing the terms, conditions, and fees for the bilateral exchange of EFTPOS transactions), and by bilateral settlement arrangements. Third-party providers also provide switching and processing services in some cases. Figure 2.2 shows the information flows between the various parties in an EFTPOS transaction.
- 2.7 In transactions where the same financial institution provides EFTPOS payment services to both the cardholder (as the card issuer) and the merchant (as the merchant acquirer), the financial institution receives the EFTPOS transaction information through a terminal in the merchant's outlet. The financial institution advises the merchant of authorisation for the transaction (through a signal returned to the EFTPOS terminal), and then debits the cardholder's account and credits the merchant's account.
- 2.8 In transactions where the issuer and acquirer are different organisations the merchant acquirer receives the electronic transaction information through its merchant's outlet and forwards the information to the card issuer. Once the card issuer authorises the transaction the merchant acquirer advises the merchant who accepts the EFTPOS payment in exchange for goods or services provided to the cardholder. The card issuer debits the cardholder's account and the merchant acquirer credits the merchant's account via overnight net settlement of all transactions processed by the merchant.
- 2.9 Some merchants, known as merchant principals, have invested in switching and processing facilities which allows them to send EFTPOS transactions directly to a card issuer (for example, Coles Myer Limited). Merchant principals are able to enter into agreements with card issuers to send transactions directly. Alternatively, merchant principals may still utilise the services of a merchant acquirer to settle EFTPOS transactions with card issuers with which it has not negotiated bilateral agreements but undertake a significant part of the transaction processing itself. Merchant fees (or rebates) may be payable to or by a merchant principal. Merchant fees reflect the different level of network participation by a merchant principal compared with other merchants.

Figure 2.2: Information flow in an EFTPOS transaction



The cardholder presents the card to the merchant and enters a PIN (1), and the relevant data are transmitted to the merchant's financial institution (the merchant acquirer) (2). If it is one of the acquirer's own cards, the account is checked internally and authorisation returned to the merchant (5). If the card is issued by another financial institution, the information is switched to the card issuer either directly via a bilateral link (3) or, if the card issuer does not have this link, via a third institution acting as a gateway (3a). The card issuer then checks the account and returns an authorisation (or a decline) to the merchant acquirer either directly (4) or via the gateway (4a). The merchant acquirer passes the message to the merchant (5) and the transaction is complete (6). Typically the process is completed in a few seconds.

Source – Debit and Credit Card Schemes in Australia – A study of interchange fees and access, Reserve Bank of Australia, Australian Competition and Consumer Commission, October 2000, at pages 20 and 21.

2.10 EFTPOS network fees are currently individually negotiated between contracting parties and include:

- Interchange fees
Interchange fees are wholesale, per-transaction fees which are set bilaterally between each issuer and acquirer and in some cases merchant principals, for example Coles Myer (see paragraph 2.9). In Australia the interchange is paid by the issuer to the acquirer. Interchange fees may be shared by acquirers with major merchants or offset merchant fees paid to acquirers, particularly where the merchant provides EFTPOS infrastructure.
- Merchant service fees
Merchant service fees are charged by merchant acquirers to their merchant customers for transaction acquiring, processing, and related services. Unlike credit card merchant service fees (which are calculated on an ad valorem basis), EFTPOS merchant service fees are charged on a 'knock for

knock' or per transaction basis. They are individually negotiated and may vary significantly depending on transaction volume, whether the merchant switches its own transactions, and other factors.

- Switching fees
Switching fees may also be paid to an entity performing telecommunications routing services for transactions between acquirers and issuers to facilitate real-time electronic transactions. There may be more than one switch involved in a transaction.
- Gateway fees
Gateway fees are generally paid by institutions that issue cards to another institution that provides access to the network of bilateral EFTPOS linkages.
- Cardholder fees
Cardholder fees are charged by card issuing institutions, to consumers, for EFTPOS transactions (these arrangements often include 'fee free' transactions).

Australian Payments Clearing Association application for authorisation - Consumer Electronic Clearing System

- 2.11 Standards relating to the processing and settlement of EFTPOS transactions (and other payments clearing systems) are administered by the Australian Payments Clearing Association Limited (APCA) through the Consumer Electronic Clearing System (CECS) regulations and procedures. An application for authorisation lodged by the APCA in relation to the CECS regulations and procedures was granted conditional authorisation by the Commission on 16 August 2000. A copy of the Commission's decision in relation to the CECS authorisation is available from the Commission's public register or its website at www.accc.gov.au.
- 2.12 The objectives of the CECS arrangement is to co-ordinate and manage standards and procedures to facilitate the conduct and settlement of exchanges of ATM and EFTPOS payment instructions between CECS members⁸ and all aspects of the related clearing cycle. These include procedures to promote the efficiency, security and integrity of such exchanges; and specifications and standards for equipment utilised and cards issued by, and communications links and message formats between the APCA members that participate in ATM or EFTPOS interchange activity.

⁸ CECS members:- Adelaide Bank Limited; Australia and New Zealand Banking Group Limited; Australian Settlements Limited; Bank of Queensland Limited; Bank of Western Australia Limited; Bendigo Bank Limited; Cashcard Australia Limited; Citibank Pty Limited; Coles Myer Limited; Commonwealth Bank of Australia; Credit Union Services Corporation (Australia) Limited; National Australia Bank Limited; St. George Bank Limited; Suncorp-Metway Limited; and Westpac Banking Corporation.

- 2.13 The CECS standards and procedures are mandatory when CECS members engage in the exchange of ATM or EFTPOS transactions with other CECS members. However, any two CECS members may agree to apply divergent standards and procedures, provided they satisfy the CECS Management Committee that the integrity, security or efficiency of the CECS as a whole will not be lessened in any material way as a result. However, no CECS member may require any other member or prospective member to apply standards and procedures in ATM or EFTPOS interchanges other than those in the CECS manual.
- 2.14 The CECS regulations and procedures broadly set out the interchange arrangements upon which the ATM and EFTPOS networks are based and therefore affect access to these networks by card issuers, merchant acquirers and merchant principals.
- 2.15 Although CECS members and prospective members are (generally) required to comply with the CECS standards and procedures in their ATM and EFTPOS interchange arrangements, such compliance does not ensure they will obtain access to the ATM or EFTPOS networks as either a card issuer or a merchant acquirer. In particular the CECS Regulations specify that no CECS member is obliged, solely on account of its membership of CECS, to exchange ATM or EFTPOS payment instructions with any other CECS member. Accordingly, for a party to obtain access to the EFTPOS (and ATM) network it is necessary for them to enter into bilateral interchange agreements or 'gateway' arrangements.
- 2.16 Access to the EFTPOS network on reasonable terms, including price, is important for competition between network participants and potential competitors. Commercial reality means that merchants are likely to wish to offer all customers the option of payment by EFTPOS. This means that the merchant's EFTPOS facilities must accept all card issuers' cards. Consequently, to participate as a merchant acquirer in the EFTPOS network, an organisation must enter into bilateral interchange agreements, or a gateway agreement, with all card issuers. Furthermore, a card issuer is unlikely to gain market acceptance if its cards are not universally accepted by merchants. This requires the card issuer to enter into a series of bilateral arrangements with all merchant acquirers, or a gateway agreement. At present prospective card issuers or merchant acquirers could be denied access to the EFTPOS network because incumbent card issuers or merchant acquirers refuse to enter into interchange agreements with the prospective entrant. Alternatively, entry could be impeded by an inability to negotiate interchange agreements, or gateway arrangements on commercial terms that allow viable entry to the network. In either case, the outcome could be detrimental to competition.
- 2.17 In assessing the 2000 APCA application for authorisation the Commission considered the impact of the CECS arrangements on access to the ATM and EFTPOS networks and noted that, in its view, access should be available on fair and reasonable commercial terms. However the Commission concluded that for an industry association to require its members to contract with other members or with non-members that meet certain criteria would be to exceed what is generally required under the competition provisions of the Act. The

Commission further considered that to require CECS members as a condition of authorisation to enter into ATM or EFTPOS interchange agreements with other members or non-members that are able to satisfy the interchange standards and procedures established by CECS, would not be justified. In particular it was the Commission's view that such a condition would impose upon CECS, through the authorisation process, elements of a comprehensive access regime for the ATM or EFTPOS networks. The Commission concluded that should such an access regime be considered necessary, it would be more appropriate that the regime be established under the provisions of Part IIIA of the Act⁹, or by the Reserve Bank's Payment Systems Board under the *Payment Systems (Regulation) Act*¹⁰ (PSRA).

- 2.18 The immunity conferred by the CECS authorisation will expire on 7 September 2003. On 30 April 2003 the APCA lodged an application for revocation and substitution in relation to its CECS rules and procedures. The Commission notes that as part of this process the APCA has indicated that it is now undertaking a detailed examination of access issues and exploring the practicability of implementing rules governing access to the EFTPOS network. APCA has advised that this process may take up to 12 months to complete and that in any event there may be significant obstacles to the APCA implementing access rules and that it would not want to unduly raise expectations that such rules necessarily are practical.¹¹ A copy of the APCA's application for revocation and substitution is available from the Commission's public register or its website at www.accc.gov.au.

The Joint Study

- 2.19 In October 2000, the RBA and the Commission released a study entitled *Debit and Credit Card Schemes in Australia: A Study of Interchange Fees and Access* (the Joint Study).
- 2.20 The objectives of the Joint Study were to:
- obtain information on interchange fees paid by financial institutions;
 - clarify the basis on which interchange fees are set, looking particularly at the role of costs;

⁹ Part IIIA of the Act establishes a legal regime to facilitate access to the services of certain facilities of national significance. The Commission has a regulatory and administrative role in the arbitration of disputes over access to facilities declared to be essential under the terms of the Act, and in the assessment of undertakings by owners/operators of facilities.

¹⁰ Under the *Payment Systems (Regulation) Act* the Payments System Board has the ultimate say on issues of access to the payments system. It may 'designate' a particular payment system as being subject to its regulation, and then determine rules for participation in that system including rules on access and arbitrate on access disputes.

¹¹ APCA application for revocation and substitution A30228 and A30229, submission dated 29 April 2003.

- assess whether current interchange fees are encouraging efficient provision of debit and credit card services; and
 - obtain information on current restrictions on credit card scheme membership.
- 2.21 The Joint Study broadly concluded that in the Australian credit and debit card networks competition is not working as it should.
- 2.22 In relation to interchange fees the Joint Study recognised that they may provide an appropriate incentive for payment systems to reach an efficient size (when net benefits are maximised). However, interchange fees in one network can affect participation in competing networks because of cross-network effects. Therefore it can be difficult to determine an optimal interchange fee. This means that the effectiveness of an interchange fee as a price signal to guide resource allocation may be reduced. The Joint Study found that price signals may be further distorted as end-users, that is cardholders and merchants, do not have a direct role in the setting of interchange fees. The resulting distortion to price signals and resource allocation may be further compounded by restrictions on entry.

Credit card network

- 2.23 The key findings from the Joint Study in relation to credit card payments systems were that:
- credit card issuing in Australia generates revenue well above the average cost of providing these services. The margin between revenues and average cost, on a percentage basis, is wider for credit card acquiring. Only part of these margins appears to be attributable to the need to earn a competitive return on capital;
 - interchange fees account for around one-third of revenue from credit card issuing. The major contribution to revenue comes from cardholders who make use of the line of credit. Interchange fees are not reviewed regularly by the card schemes on the basis of any formal methodology. Application of a formal cost-based methodology would suggest an interchange fee well below current levels;
 - ‘card not present’ transactions, where merchants are unable to verify signatures, do not usually attract a guarantee of payment for merchants. Even so, such transactions are charged at the higher interchange fee of 1.2 per cent for transactions that do not qualify as electronic. The study can see no logical basis for this practice;
 - cardholders who use credit cards purely as a payment instrument contribute least to the cost of credit card schemes and, in some cases, are effectively paid to use credit cards. A greater contribution from such cardholders would reduce the subsidy they receive from other consumers;
 - the study can see no convincing reason for the ‘no surcharge’ rule preventing merchants passing on their costs for accepting credit cards; and

- current restrictions by card schemes on which institutions can enter the acquiring business are unjustified. Restrictions on access to card issuing may also be overly limiting and need to be reviewed.
- 2.24 In April 2001 the RBA's Payments System Board designated the 'four-party' credit card schemes operated in Australia by Visa, MasterCard and Bankcard. Following extensive consultation, the RBA in August 2002 introduced a package of reforms to the four-party credit card schemes intended to promote greater competition and a more efficient allocation of resources in the Australian payments system. The reform measures involve:
- a standard on interchange fees that involves an objective, transparent and cost based benchmark against which interchange fees in the designated credit card schemes can be assessed;
 - a standard on merchant pricing that removes the restriction imposed by the international credit card schemes on the freedom of merchants to charge according to the means of payment¹²; and
 - an access regime that removes the restrictions on the eligibility of non-financial institutions to apply to participate in the designated credit card schemes, and removes "net issuer" and "balanced development" rules and associated financial penalties that disadvantage participants seeking to specialise in acquiring.

In September 2002, MasterCard International and Visa International commenced proceedings in the Federal Court to have the reforms overturned. The hearing commenced on 19 May 2003.

- 2.25 The Commission considers that these important reforms will lead to a more competitive and efficient credit card network in Australia, in particular as they will enable new entrants to provide alternative services to both cardholders and merchants.

Debit card network

- 2.26 The key findings from the Joint Study in relation to debit card payments systems were that:
- debit card acquiring in Australia generates revenues above the average cost of providing these services but the margin, on a percentage basis, is well below that in credit card acquiring. For debit card issuing, the average cost is recovered as part of the overall cost of providing a transaction account;

¹² It is noted that whilst American Express and Diners Club were not subject to designation by the RBA, they have provided undertakings to the RBA that they would remove their restrictions on merchant pricing.

- debit card interchange arrangements in Australia, in which an interchange fee is paid by card issuers to acquirers, are unique;
- large merchants which have invested in their own acquiring infrastructure have been able to negotiate a sharing of the interchange fee with their financial institutions;
- application of formal interchange methodologies do not provide a convincing case for a debit card interchange fee, in either direction. The Joint Study did not see a continued need for an interchange fee in the debit card network; and
- access to the debit card network through a series of bilateral agreements can put both new issuers and acquirers at a competitive disadvantage, because they may need to use more expensive gateway arrangements.

The EFTPOS Industry Working Group

- 2.27 The EFTPOS Industry Working Group (EIWG) was formed in early 2002 to consider ways by which existing EFTPOS arrangements could be reformed. The members of the EIWG were the Australian and New Zealand Banking Group Limited, Australian Settlements Ltd, Bank of Queensland Limited, Bank of Western Australia Limited, Cashcard Australia Ltd, Coles Myer Limited, Commonwealth Bank of Australia, Credit Union Services Corporation (Australia) Limited, National Australia Bank Limited, St George Bank Limited, and Westpac Banking Corporation.
- 2.28 The RBA convened a series of meetings of industry participants to explore options for EFTPOS reform and assisted in preparing a discussion paper which was released by the EIWG in July 2002. Following the publication of the discussion paper the RBA, at the request of the EIWG, stepped back from its direct role in facilitating reform efforts.
- 2.29 The July 2002 discussion paper released by the EIWG identified a number of criticisms of the current EFTPOS arrangements. These criticisms broadly included:
- fees set through bilateral contracts have been rigid and appear to lack flexibility to change;
 - direct network access is linked to successful negotiation of an interchange arrangement, which includes an interchange fee, with each counterparty card issuer or merchant acquirer;
 - this structure leads to difficulties and inefficiencies in negotiating bilateral interchange arrangements due to market and network structure;
 - there is the potential for shifting of card issuer and consumer incentives away from promotion and use of EFTPOS, particularly relative to credit cards; and
 - there is an apparent lack of consistency between EFTPOS payment interchange fees and those for other retail payment types.

- 2.30 To address these criticisms the paper outlined three broad reform options:
- bilateral interchange agreements;
 - multilateral interchange fees; and
 - no interchange fees.
- 2.31 Following the release of the EIWG discussion paper and a further period of consultation the Commission received two applications for authorisation from a number of banks, building societies and credit unions on 21 February 2003.¹³ This draft determination is in relation to these applications.

¹³ It is noted that the EIWG does not have the same composition of members as that of the Applicants for these authorisations.

The applications

- 3.1 On 21 February 2003 applications A30224 and A30225 were lodged with the Commission seeking authorisation of an Interchange Fee Agreement (the Agreement). A copy of this Agreement is attached to this draft determination (**Attachment A**). The Interchange Fee Agreement broadly provides for the collective setting of EFTPOS interchange fees to zero.
- 3.2 Application A30224 was lodged under sub-section 88(1) to make and give effect to a contract, arrangement or understanding, which contains a provision which is, or may be, an exclusionary provision within the meaning of section 45 of the Act.
- 3.3 Application A30225 was lodged under sub-section 88(1) to make and give effect to a contract, arrangement or understanding, which has the purpose or effect of substantially lessening competition within the meaning of section 45 of the Act.
- 3.4 The Applicants have also requested that, pursuant to s 88 (10) of the Act, in granting authorisation to the proposed Agreement, the Commission also grant authorisation providing immunity to persons who may become parties to the proposed Agreement after it has been made and the giving effect to it authorised.

The Interchange Fee Agreement

Setting of EFTPOS interchange fees

- 3.5 Clause 2.1 of the Agreement provides that the Applicants agree to charge and to receive the following interchange fees for any EFTPOS transaction in Australia in which at least one of the parties is an EFTPOS issuer or EFTPOS acquirer:

Transaction Type	EFTPOS Interchange Fee (cents)
(a) EFTPOS Withdrawal Transaction (including sales, sales/cash-out and cash-out only)	Zero
(b) EFTPOS Declined Transaction	Zero
(c) EFTPOS Reversal Transaction	Zero

Inconsistency with contractual obligations

- 3.6 Clause 2.2 (a) of the Agreement provides that each party to the Agreement agrees that any provision of an existing contract, to which the only parties are any two or more of the parties to this Agreement, and which sets an interchange fee for EFTPOS Transactions in Australia at any level other than set out in

clause 2.1, is hereby amended so that the EFTPOS interchange fee between parties to this Agreement is governed by clause 2.1.

- 3.7 Clause 2.2 (b) of the Agreement provides that if clause 2.1 of this Agreement is inconsistent with a provision of any existing contract, the parties to which include one or more parties to this agreement and one or more parties who are not parties to this Agreement, those parties to this Agreement who are also parties to the existing inconsistent contract will use their reasonable endeavours to amend that contract as soon as practicable to remove the inconsistency.
- 3.8 The Commission notes that while the proposed Agreement does not make specific provision for non-existing (or new) contracts, it is understood from the Applicants' submission that it is envisioned that the zero interchange fee will apply to bilateral arrangements entered into between incumbents and potential new entrants.¹⁴

Review and monitoring

- 3.9 Clause 3.1 of the Agreement provides that the parties agree that they will monitor EFTPOS interchange fees and the impact of the changes on an on-going basis and meet at least annually.
- 3.10 Clause 3.2 provides that the parties to the Agreement will conduct a review of the EFTPOS interchange fees set out in clause 2.1;
- (a) every 3 years (approximately) from the date of commencement (unless a review under (b) has been conducted within the prior 2 years); and
 - (b) at any time, if there is a material change in circumstances and at least 25% of the parties in number request such a review.
- 3.11 Clause 3.3 provides that the Agreement may be amended pursuant to a review under clause 3.2, if no less than 75% of the parties in number agree to the amendment. Where such an amendment is not agreed to unanimously, the amendment will not come into force for at least 120 days.

¹⁴ For example Applicants submission, February 2003, at page 23.

Submissions

The Applicants

- 4.1 The Applicants have provided the Commission with two written submissions in relation to the applications for authorisation, being a lodgement submission (February 2003) and a rejoinder submission provided in response to public submissions by interested parties (April 2003). Commission staff also met with representatives of the Applicants for an oral briefing (29 April 2003). Copies of the non-confidential submissions provided by the Applicants are kept on the Commission's public register. Provided below is a brief summary of the Applicants' submissions in terms of public benefit and effect on competition. The Applicants' submissions are considered in more detail in chapter 5 of this draft determination.
- 4.2 The Applicants advise that the applications result from the review of interchange fees by the RBA and the Commission and the subsequent deliberations of the EWIG. The primary purpose of the proposed arrangement is to make EFTPOS more attractive to cardholders (particularly relative to credit cards) than it is at present and hence to address concerns about efficiency in the payments system. The Applicants submit that the concurrent proposed amendments to credit card interchange fees (outlined at paragraphs 2.23 to 2.25) will assist, but the proposed EFTPOS change will still be beneficial in addressing the problem.

Market definition

- 4.3 The Applicants have submitted that the proposed conduct will have a direct effect in the market for retail banking and that there will be an indirect effect on the market for retail goods and services. In providing these market definitions, the Applicants have noted that in their view there is no useful market definition that would bring these markets under one umbrella and that furthermore there is no useful reason to seek one. It is the Applicants' view that the essence of analysing competitive impacts of potentially anti-competitive conduct is to examine all relevant markets and not to assume that one is paramount or that all the effects of the conduct are in one market.
- 4.4 The Applicants have submitted that, whilst the market for retail banking may be oligopolistic in structure (exhibiting a high degree of market concentration), inter-firm rivalry occurring in a market place governed by principles of appropriate trade practices has led to the achievement of the desirable outcomes of a perfectly competitive market, such as a wide variety of products and strong innovation. It is the Applicants' view that, while the market for retail banking is not perfectly competitive, it is nonetheless 'effectively competitive'.

Public benefits

- 4.5 The Applicants claim that the proposed arrangement will be likely to result in a number of public benefits, including:

- making EFTPOS more attractive to consumers relative to less efficient means of payment, thereby inducing a shift towards the use of EFTPOS and reducing the overall cost of the Australian payments system;
- introducing greater flexibility into the setting of EFTPOS interchange fees; and
- making entry as a new issuer or acquirer of EFTPOS transactions easier by simplifying the negotiation of bilateral interchange agreements.

Making EFTPOS more attractive

- 4.6 The Applicants have submitted that the proposed conduct will result in a reduction of the costs incurred by card issuers in providing debit card services to cardholders. It is the Applicants' view that effective competition between issuers in the retail banking market is likely to lead to those cost reductions being passed on to cardholders through lower banking fees and/or enhanced services.
- 4.7 Acquirers are likely to increase merchant service charges so as to replace the income stream previously provided by interchange fees. The Applicants claim that effective competition in retailing is likely to see merchants recover their higher costs through a general (although inconsequential) rise in the price of goods and services, rather than through surcharges for the use of EFTPOS.
- 4.8 Therefore the proposed conduct will mean that consumers face a lower relative cost of using EFTPOS compared with other means of payment. This is likely to lead to substitution by consumers towards the use of debit cards and away from credit cards in their payments for goods and services. The Applicants claim that, as argued by the RBA, this will give rise to public benefits through improvements in the efficiency of the payments system as a whole.
- 4.9 In response to concerns by interested parties about the pass through of interchange reforms, the Applicants agree that commercially appropriate disclosure (in addition to the current regulatory imposed disclosure regimes) and information campaigns may be useful and appropriate to help smooth the adjustment to new levels of cardholder fees and merchant service charges.
- 4.10 However, in relation to the pass through of savings to cardholders and the price signals consumers are likely to face, the Applicants claim that the change in interchange fees will not always necessarily be passed through in an easily observable manner. The Applicants advise that they anticipate the reduced costs to be passed on in some form – such as lower retail banking fees and/or through enhanced services and/or higher transaction account deposit interest rates. However, given the fee and charge structures of financial institutions it is unlikely that such a change would be in the form of a simple pass through of 'X' cents per transaction.

More flexible interchange fees

- 4.11 The Applicants advise that the current arrangements whereby interchange fees are set as part of the bilateral agreements create a difficulty in renegotiating agreements and creates an inertia that discourages any review and change in the interchange fees despite changes in market circumstances.
- 4.12 The Applicants claim that under the proposed Agreement the level of the interchange fee will be reviewed after three years, or earlier, which will introduce greater flexibility into the fee level.

Assist new entry as an issuer or acquirer

- 4.13 It is the Applicants' view that the proposed Agreement will make entry as a new card issuer or merchant acquirer of EFTPOS transactions easier by simplifying the negotiation of bilateral interchange agreements. In particular, the Applicants have submitted that the proposed conduct would ameliorate the extent of natural barriers to direct entry into the EFTPOS market by making bilateral negotiations between parties easier through the removal of one element of negotiation – interchange fees.
- 4.14 In any event, the Applicants claim that access issues are more appropriately handled by the APCA in the context of a review of the authorisation of the CECS arrangements. The Applicants advise that the APCA has already commenced a detailed examination of access and related issues.

Anti-competitive detriments

- 4.15 The Applicants have submitted that in assessing the anti-competitive detriment arising from the proposed Agreement it is important to distinguish the effect of the proposed conduct from the effect of the existing CECS arrangements. It is the Applicants' view that the proposed conduct will not have any adverse effect on natural barriers to entry facing potential card issuers or merchant acquirers and that there is no reason to expect that the proposed conduct would result in the withdrawal of existing market participants nor any lessening of competition between them.
- 4.16 It is the Applicants' view that, as the proposed Agreement provides that the Applicants will use their reasonable endeavours to negotiate zero interchange fees with new entrants, this will have the effect of eliminating any market power that an existing card issuer or merchant acquirer might otherwise have been able to exercise in respect of negotiations involving the level of the interchange fee.
- 4.17 In addition, it is the Applicants' view that, although potential new merchant acquirers would not, as a result of the proposed Agreement, receive the prospective revenue stream from interchange fees as was available to existing merchant acquirers when they entered the market, new entrants would nonetheless be on the same footing as existing merchant acquirers when negotiating service fees with merchants.

- 4.18 The Applicants have submitted that potential new entrants with efficient costs would suffer no detriment as a result of the conduct. In particular it is the Applicants' view that, although new entrants would necessarily be exposed to the realities of economies of scale and competitors whose costs were already sunk, these factors would have no effect on the setting of interchange fees.
- 4.19 The Applicants also claim that nothing in the proposed conduct will change the bargaining power of financial institutions vis-à-vis retailers. Effective competition in commercial banking will not only limit aggregate increases in merchant service charges to the loss of interchange revenue, but also ensure that there is no unwarranted redistribution of the costs of acquiring between classes of merchants in the process.
- 4.20 The Applicants have stressed that the proposed conduct is part of a package of payments system reforms. Merchants will now be significant direct beneficiaries of debit and credit card reform, taken together, in terms of the net cost incurred in accepting debit and credit cards. Merchants will also see their costs reduced over time as a result of changes to price signals that provide consumers with greater incentives to use lower cost payment methods.

Submissions by interested parties

- 4.21 The Commission sought submissions from a wide range of interested parties in relation to the applications for authorisation and received 34 public submissions. A copy of each submission is held on the Commission's public register. A list of interested parties who lodged public submissions is at **Attachment B**.
- 4.22 A summary of the main issues raised by interested parties, both in support and in opposition to the proposed arrangements, is provided below.¹⁵

Consumer organisations

- 4.23 Submissions were received from the following organisations that represent the interests of consumers – Aboriginal Co-ordinating Council (ACC), Australian Consumers Association (ACA), Consumer Credit Legal Service (WA) Inc (CCLS(WA)), Consumers Federation of Australia (CFA) and Consumer Law Centre of Victoria (CLC(V)).
- 4.24 In general terms the consumer organisations broadly support the proposed Agreement to the extent that the reduction of the EFTPOS interchange fee will enhance transparency and efficiency and deliver clearer pricing signals than those currently received by consumers.

¹⁵ Responses, but no substantive submissions, were also received from the NSW Department of Fair Trading, the ACT Chief Minister, the Commonwealth Treasury, Bankcard Association of Australia, and the Commissioner for Consumer Affairs (SA).

- 4.25 However, there is concern that without some form of compulsion the banks will fail to pass on the expected cost savings to cardholders. The ACA, CCLS(WA), CLC(V) and CFA propose that as a condition of authorisation the applicants undertake to pass on the net savings to EFTPOS customers. They also propose that a prices oversight body be established to monitor merchant pricing and the direct charging of consumers by merchants and report to the Commission and public on the impact of the EFTPOS interchange fee agreement. This ongoing monitoring should feed into a review at the end of the authorisation period to assess whether the costs to EFTPOS customers have fallen and the impact the reforms have had on the use of EFTPOS relative to other payments systems.
- 4.26 The CFA, ACC and CCLS(WA) were also particularly concerned to ensure that savings were passed through to rural and remote consumers who often missed out on the benefits from such reforms given the limitations of the banking services currently provided to them.

Merchants

- 4.27 Submissions were received from the following merchants and organisations representing merchants – Australian Institute of Petroleum (AIP), Australian Retailers' Association (ARA), Caltex Australia Petroleum Pty Ltd, Coles Myer Ltd, McDonald's Australia Limited, Motor Trades Association of Australia (MTAA), National Association of Retail Grocers of Australia (NARGA), Post Office Agents Association Limited (POAAL) and Woolworths Limited.¹⁶
- 4.28 In general, merchants oppose the applications for authorisation as they claim that the proposed Agreement will be detrimental to competition in the EFTPOS market and would result in a negative public benefit. Submissions by merchants focussed on the following issues as being reasons for their opposition:
- the Applicants have not provided any data or evidence to support their arguments or demonstrate the effects of a zero interchange;
 - the proposal does not address the issue of network access. Access is a critical part of delivering increased competition to the EFTPOS market thereby keeping the costs of the system down. A multilateral fee does not make it easier for new acquirers to enter the market;
 - there is no evidence to suggest that the reduction in costs experienced as a result of a zero interchange fee will increase debit card usage as a result of card issuer savings being passed on to cardholders. Given the level of competition between banks and the fact that many EFTPOS cardholders currently have their fees waived by card issuers, it is likely that card issuers will retain a substantial majority of the savings they make from the move to zero interchange;

¹⁶ Responses were also received from Metcash and Queensland Retail Traders & Shopkeepers Association indicating their views were included in other submissions.

- merchant principal investment in the EFTPOS network is significant and the current interchange fee arrangement enables merchant acquirers to reimburse merchant principals for their investments. This in turn ensures that the high standard and security of the EFTPOS network is maintained through future investment. The move to a zero interchange fee is likely to diminish the incentive for both merchant principals and merchant acquirers to invest in the ongoing development of the EFTPOS network;
 - merchant acquirers will seek to recoup their loss in interchange fee revenue by increasing merchant service fees to retailers and service stations. Woolworths advises that merchants will be faced with an increase in their EFTPOS transaction processing costs of around 20 cents per transaction. merchants in turn will pass on the higher costs to consumers, most likely in the form of a general increase in prices. Thus all consumers will subsidise users of EFTPOS. McDonald's submits that a worst case scenario is that businesses may even choose to remove the EFTPOS facility;
 - if all consumers pay for the cost of EFTPOS there is no transparency in pricing and correct pricing signals are not sent. This is the very problem the Joint Study identified as being significant in relation to credit and debit card reform; and
 - there will not be an overall reduction in payments system costs, the result would simply shift costs away from card issuers to both consumers and merchants. This is an inequitable position as issuers derive the major benefit from the widespread adoption and use of EFTPOS. This does not represent effective reform.
- 4.29 NARGA and MTAA also submit that increases in merchant fees would impact disproportionately on small businesses. Under current arrangements, small retailers pay transaction fees and line rental charges, while large retailers such as supermarket chains and oil companies receive fees from merchant acquirers or are able to negotiate merchant fee reductions or other offsets by virtue of their market power. The net result is that a small retailer pays a higher cost per transaction, compared with a large retailer. Competition faced by small retailers means that they are often unable to pass on these costs to consumers and as such are forced to absorb them. Such a disadvantage is likely to be exacerbated under the proposed new arrangements.
- 4.30 The POAAL expresses its concern for the unknown and unexpected consequences that may arise should the financial institutions attempt to recover the revenue from existing fees through other fees and charges, which in turn may be unrelated to the cost of providing such a service.
- 4.31 Caltex claims that the applicants rely almost exclusively on the Joint Study. However, Caltex submits that the Joint Study does not provide any basis upon which the Commission could be satisfied that the public benefits of a price fixing agreement in relation to debit card interchange fees outweigh the public detriment of such an arrangement. Further, Caltex submits that there are a number of defects with the Joint Study that caused incorrect findings.

- 4.32 The AIP submits that if the Commission does authorise the application conditions should be imposed to ensure that future reviews of the EFTPOS arrangements are conducted independently of the banks; that card issuers be required to pass on all cost reductions or disclose enhanced services resulting from the arrangements to cardholders within a defined time period; merchant service charges by merchant acquirers should not change as a result of the arrangements and merchant acquirers should be required to enter into good faith negotiations with merchant principals, who have invested in EFTPOS infrastructure, to ensure that arrangements fairly reflect merchant investments; and access arrangements should be reviewed as part of this application to target maximum access at both issuing and acquiring levels.

Industry regulators

Reserve Bank of Australia (RBA)

- 4.33 The RBA agrees that the proposal will have significant public benefits, particularly as the lowering of transaction fees for debit cardholders will produce a more efficient set of price signals for consumers choosing between EFTPOS and other means of payment. Public benefits will be maximised if the reduction in interchange fees is passed immediately and in full to debit cardholders. The RBA advises that it can see no reason why debit card issuers, in a competitive market environment, should not do so.
- 4.34 The RBA advises that merchant acquirers can be expected to seek to recoup the loss of interchange fee revenue directly from merchants through increases in merchant service fees on EFTPOS transactions. The loss of EFTPOS interchange fee revenue received by merchant acquirers will be approximately \$150 million per year. The RBA submits that the extent to which the amount is recouped from merchants should be set against the reduction in merchant service fees from the reforms to credit card schemes which are expected to reduce credit card interchange fee amounts paid by acquirers by around \$350 million per year.
- 4.35 Merchants will therefore be significant beneficiaries of debit and credit card reform taken together, although the impact will differ across merchants depending on the mix of payment cards they accept. The RBA submits that merchants will also see their costs reduced over time as a result of changes to price signals that provide consumers with greater incentive to use lower cost payment methods. Competition will ensure that the lower costs incurred by merchants will pass through to consumers in the general level of prices.
- 4.36 While the RBA recognises that some large retailers have made significant investments in their own EFTPOS terminals and related infrastructure and have negotiated arrangements to share interchange fee revenue with their merchant acquirer as a means of recovering costs, there is no evidence that it is necessary for merchants to continue to recoup the costs of their initial investments or upgrades. The RBA claims that if EFTPOS fee revenues are eliminated investment decisions by merchants would be determined by normal market

mechanisms and merchants would continue to invest in EFTPOS facilities if there are direct benefits in doing so.

- 4.37 The RBA advises that reform also needs to address the issue of access to the EFTPOS network. The current bilateral arrangements are not beneficial to the Australian payments system and can be a significant barrier to new entrants. The elimination of bilateral interchange fees should facilitate access of new entrants to the EFTPOS network since they will no longer need to negotiate interchange fees as a condition of entry. Although without interchange fee revenues some incumbents may have less financial incentive to establish interchange links with potential new entrants.
- 4.38 The RBA supports the Applicants' suggestion that access issues are more appropriately dealt with in the context of reauthorisation of the CECS rather than the current application. However the RBA advises that it would want to be assured that the APCA will address impediments to access to the EFTPOS network in a timely manner. A new entrant that is approved as a member of the CECS and meets the APCA's technical requirements should be entitled to exchange EFTPOS transactions with any other CECS member in a timely manner and at reasonable cost. The RBA submits that over the longer term the industry might want to consider the case for developing an industry owned switch to facilitate access and encourage competition and efficiency in the operation of the EFTPOS network.

Australian Securities and Investments Commission (ASIC)

- 4.39 The ASIC recognised the potential for the proposal to result in real savings for consumers and to encourage consumers to use lower cost payment mechanisms. The ASIC advised that this potential is, however, dependent upon consumers receiving the benefit of the reforms in terms of significantly reduced EFTPOS banking fees.
- 4.40 The ASIC submitted that as the proposal has no built in mechanism to ensure that fee reductions are passed on to consumers it would be sensible for authorisation to bolster the chances of this happening. For example, by making it clear that any renewal of the authorisation would be dependent upon proof that the reduction of interchange fees to zero had resulted in a significant reduction in the fees consumers' financial institutions charged them for their part in processing EFTPOS transactions.
- 4.41 In addition, the ASIC has submitted that it is essential that there is adequate disclosure about the new system. In particular, it should be a requirement that all merchants who surcharge for EFTPOS transaction disclose the amount of the surcharge prior to the transaction. The ASIC also propose that it should be a requirement that all parties to the EFTPOS agreement provide cardholders with a clear explanation of the rationale of the reforms and the implications for the fees payable by cardholders, including disclosure of whether or not the standard fees for EFTPOS transactions are reduced and by how much.

- 4.42 On a related point, the ASIC raised the issue about whether a cap should be placed on merchant surcharging as there is anecdotal evidence that in rural and remote areas, where there is little competition, merchants had imposed extremely high EFTPOS surcharges that would seem to far exceed the cost to the merchant of providing the service.

Government Ministers

Minister for Tourism and Racing and Minister for Fair Trading – Queensland Government – The Hon. Merri Rose MP

- 4.43 The Minister provided in principle support to the proposal which is likely to lead to cost reductions being passed on to consumers. However, the Minister noted that a review of the fee structure in three years or earlier should determine whether the assumptions upon which the proposal is based have in fact eventuated and therefore a more informed decision could be made on the merits of any future proposals.

Minister for Consumer Affairs – South Australian Government – The Hon. Michael Atkinson MP

- 4.44 The Minister was of the view that the proposed agreement will benefit consumers:
- through a decrease in transaction fees for transaction accounts;
 - by making EFTPOS a cheaper form of payment than credit cards (coupled with credit card reforms);
 - by making fees more transparent and flexible so that they remain at levels sufficient only to recover costs with savings passed on to consumers; and
 - if, as a result of the fee level being multilaterally set, negotiations of agreements with new entrants are less complicated, new entry will be easier and therefore competition will increase with flow on pricing benefits to consumers.
- 4.45 The Minister noted that these benefits would rely, to some extent, on financial institutions not seeking to recoup lost revenue from interchange fees by increasing direct fees to cardholders and merchants. It is therefore important that regulators strictly monitor the carrying out of the agreements to ensure the desired effects identified in the Joint Study are realised.
- 4.46 The Minister also noted that, given the conclusion of the Joint Study, a better option would be eliminating fees altogether. Although the proposed agreement is a compromise that appears to deliver the major benefits of elimination for at least the life of the agreement.

Minister for Regional Development, the Illawarra, and for Small Business – New South Wales Government – The Hon. David Campbell MP

4.47 The Minister submitted that the Applicants had not made a sufficient case in support of a zero interchange fee and expressed concern that the economic interests of stakeholders may be a barrier to them jointly reaching agreement on a position in relation to debit card interchange fees. In particular the Minister submitted that:

- there should be an extension of the timeframe of the debit card/EFTPOS review;
- a review panel should be established by the RBA comprising representation of all stakeholders, including consumers and small businesses, and facilitated by the RBA; and
- the scope of the review should be expanded to include all debit card schemes and related fees.

Others

Australian Bankers' Association (ABA)

4.48 The ABA advises that it supports the application as setting the EFTPOS interchange fee to zero will provide greater incentive for people to purchase goods and services using their debit card relative to credit cards. This will provide greater economic efficiency consistent with the RBA's claims that debit cards are a more efficient form of payment than credit cards.

4.49 The ABA claims that merchants will benefit from the package of debit and credit card reforms and that EFTPOS and credit card reforms should be introduced concurrently to minimise any potential disadvantage. The ABA claims that large retailers have a strong financial incentive to oppose the concurrent introduction of EFTPOS and credit card reforms.

Australian eCommerce Network

4.50 The Australian eCommerce Network opposes the proposed EFTPOS fee reform as it is self interested and ignores many of the most significant aspects of the current EFTPOS system, such as the fact that banks exercise an oligopolistic control over the system. All but the largest retailers and merchants have little option but to rent their EFTPOS terminals from the banks. So if the banks suffer any revenue reduction from the proposals, fees to merchants for their EFTPOS facilities will inevitably rise.

Cosmos E-C Commerce Pty Limited

4.51 Cosmos seeks the assurances of the RBA and Commission that new parties wishing to enter the EFTPOS acquiring market are protected from anti competitive behaviour.

First Data Resources Australia Limited

- 4.52 First Data advised that it supports the proposed arrangements. First Data has provided third party processing services to the retail payments industry, including EFTPOS acquiring services for both merchants and financial institutions for the past 20 years.

Macquarie Corporate Telecommunications Pty Ltd

- 4.53 Macquarie has submitted that there is currently a restriction on the telecommunications services over which EFTPOS services are provided. In the interests of competition in the telecommunications market and to reduce the cost of EFTPOS services, the Commission should include a requirement that carriers other than Telstra Retail are able to bundle EFTPOS solutions.

MasterCard International

- 4.54 MasterCard advises that it regards the EFTPOS system as being competitive with its credit card system in use in Australia.
- 4.55 MasterCard submits that the Applicants have not provided information as to how the zero rate of interchange fee proposed is arrived at. MasterCard believes there should be some methodology employed to ascertain the appropriate interchange fee rather than it being set on what appears to be an ad hoc basis. This is particularly given that interchange fees for credit card systems are now regulated by the RBA and to have a major competitor setting interchange fees in such a manner may lead to a perverse anticompetitive result. MasterCard considers that it is in the public interest that interchange fees for EFTPOS should be determined by reference to a transparent methodology.
- 4.56 Further, MasterCard believes that if there is no methodology used to ascertain the zero rate, how will the proposed review of interchange fees be undertaken and what criteria will the zero rate be compared against.
- 4.57 MasterCard submits that, consistent with the participants in the credit card system, the RBA and the APRA should consider the introduction of a regime providing for prudential regulation and supervision of all EFTPOS participants.
- 4.58 MasterCard also submits that it is more likely that merchants with market power will impose surcharges in respect of EFTPOS and credit card transactions as they are not subject to competitive pressures faced by other merchants. MasterCard regards it as objectionable that merchants with market power are able to extract surcharges from consumers in these circumstances.
- 4.59 MasterCard also outlined its disagreement to references made by the Applicants to the four-party credit card schemes and the RBA regulations. MasterCard's detailed views on the RBA's regulations are found in its submission to the RBA located at www.mastercard.com/au/rba/.

MoneySwitch Ltd

- 4.60 As a potential new provider of merchant acquiring services, MoneySwitch has submitted that the proposed Agreement is likely to result in a significant cost disadvantage for new entrants, in particular as under a zero interchange fee card issuers will have no incentive to lower access costs by adopting appropriate technology and standards. Further it is MoneySwitch's view that the proposed Agreement does not address issues such as commercial, technical, operational, testing, communications and attachment costs, and that these will still have to be negotiated by incumbents and potential new entrants.
- 4.61 However, new entrant merchant acquirers must still negotiate other items (commercial, technical, operational, testing, communications and attachment costs) on a bilateral basis with all card issuers. MoneySwitch submits that as the card issuing organisations (banks) are also largely involved in merchant acquiring activities they have no incentive to assist new merchant acquirers because this will negatively impact on their own merchant acquiring business. This makes it very difficult for a new merchant acquirer to negotiate a fair and balanced agreement in a reasonable time frame.
- 4.62 MoneySwitch submits that gateway providers do not solve the problem because the fees charged by the gateway add a significant cost that major existing merchant acquirers do not have to bear. The cost disadvantage for the new entrant significantly lowers their business viability and reduces competition in the merchant acquiring marketplace.
- 4.63 MoneySwitch submits that it is essential that conditions be imposed to enable and encourage new entrant merchant acquirers, including requirements for existing issuers to:
- negotiate the interconnect agreement in the utmost good faith;
 - allow connection using modern networking technology; and
 - set attachment fees on a verifiable cost recovery basis, without overheads.

SingTel Optus Pty Limited

- 4.64 Optus advises that it is a major supplier of telecommunications services to the banking and finance sector including services used for the provision of EFTPOS. Optus supports the proposed Agreement as Optus considers that it will stimulate the use of EFTPOS as a means of payment and in turn increase the number of EFTPOS payments and their proportion of total payments.

Commission evaluation

- 5.1 The Applicants have sought authorisation for an agreement to reduce EFTPOS interchange fees to zero. Arrangements that have the purpose or likely effect of fixing, controlling or maintaining the price for goods or services are deemed by the Act to substantially lessen competition.
- 5.2 The Applicants have also sought authorisation of a contract, arrangement or understanding that contains an exclusionary provision. Essentially an exclusionary provision, sometimes referred to as a primary boycott, involves an agreement between competitors which has the *purpose* of preventing, restricting or limiting the supply of goods or services to, or the acquisition of goods or services from, particular persons or classes of persons. Such agreements are a *per se* contravention of section 45 of the Act, that is, no assessment as to the effect on competition is required in respect of this type of conduct. In order to obtain the broad adoption of zero interchange fees, the Applicants will use their reasonable endeavours to amend bilateral EFTPOS contracts with non-Applicant parties to include a zero interchange fee. The Applicants have advised that the requirement that they use reasonable endeavours to amend existing contracts that are inconsistent with the zero interchange fee may be viewed as an exclusionary provision and have accordingly sought immunity for this conduct.
- 5.3 The extent of the detriment and public benefit that results from the price fixing and boycott provisions within the proposed Agreement is linked to the relevant market structure, including the level of current and proposed competition among both card issuers and merchant acquirers.
- 5.4 The Applicants, as card issuers, compete with each other (and other card issuers who are not Applicants) in the provision of retail transaction/savings accounts and the associated card facility that enables cardholders to make purchases and withdraw cash via the EFTPOS network. The level of competition between card issuers is considered further at paragraphs 5.38 to 5.58 of this draft determination
- 5.5 As merchant acquirers the Applicants compete with each other to provide financial services to merchants including the commercial relationship that supports merchants' participation in the EFTPOS network. The level of competition between merchant acquirers is considered further at paragraphs 5.59 to 5.88 of this draft determination.

Scope of the Commission's considerations

- 5.6 As a preliminary matter the Commission notes that a number of submissions, particularly by Coles Myer, the ARA, and the AIP raise concerns about the EWIG process. In particular, they express concerns that this process did not provide a genuine opportunity for participants in the EFTPOS network other than the financial institutions to have their interests included in the debate.

Further, concerns were expressed that all the possible options for reform were not properly debated and considered by the EWIG. For example, Coles Myer has submitted that the failure to consider alternative options is significant in that when assessing the net public benefit of a proposed arrangement the test is one of benefit to the community generally not just those who have brought the application before the Commission.

- 5.7 The role of the Commission is to apply the statutory test in section 90 of the Act to determine whether or not authorisation should be granted (or granted subject to conditions) to the application before it (see paragraphs 1.9 to 1.11). It is relevant to note the observation of the Australian Competition Tribunal in *Re: 7- Eleven Stores Pty Ltd, Independent Newsagents Association, Australasian Association of Convenience Stores Inc*, in respect of the Commission's role in authorisation matters:

*"... the Commission's role is not to design for others business arrangements that can be authorised, nor insist on optimum arrangements before granting authorisation, but rather to assess formally whether some proposed conduct that might breach the provisions of the Act yields a net public benefit, and therefore can be authorised."*¹⁷

Future with-and-without test

- 5.8 In order to identify and measure the public benefit and public detriment generated by the proposed conduct, the Commission applies the "future with-and-without test". This requires a comparison of the public benefit and public detriment that the proposed conduct would generate in the future if the authorisation is granted with the position if the authorisation is not granted. The prediction of how the relevant markets will react if authorisation is not granted is referred to as the 'counterfactual'.
- 5.9 In the context of these applications for authorisation, the Commission considers that the most likely counterfactual in the short to medium term is the market without the proposed multilateral agreement that provides for a zero interchange fee – that is the status quo. This is particularly as the Applicants have indicated that a number of features of the Agreement include exclusionary provisions and price fixing between competitors. Accordingly, in the absence of authorisation, the Applicants would be at risk of breaching the Act and would therefore be unlikely to engage in the proposed conduct.
- 5.10 An outline of the current environment in which EFTPOS transactions take place (status quo) is provided in section 2 of this draft determination. Briefly, this environment is characterised by:
- a network of bilateral interchange agreements between issuers and acquirers covering both technical and commercial arrangements;

¹⁷ *Re: 7- Eleven Stores Pty Ltd, Independent Newsagents Association, Australasian Association of Convenience Stores Inc* (1998) ATPR 41-666, at page 41.481.

- common standards relating to the processing and settlement of EFTPOS transactions are administered by the APCA through the rules of the CECS. Observance of these rules or membership of APCA does not however automatically enable participation in the EFTPOS network (bilateral arrangements remain necessary);
 - interchange fee arrangements that generate revenue above costs for acquiring institutions; and
 - high barriers to entry particularly for new entrant acquirers.
- 5.11 Whether the current environment would continue in the same form in the medium to longer term, if authorisation were denied, is questionable. This is particularly because the current interchange fees and access arrangements for debit cards have come under increased scrutiny following the Joint Study of debit and credit card schemes (see paragraphs 2.19 to 2.26). In relation to debit cards the Joint Study found, among other things, that debit card acquiring in Australia generates revenues above the average cost of providing these services, there is no convincing need for an interchange fee in the debit card network, and access to the debit card network through a series of bilateral agreements can put both new issuers and acquirers at a competitive disadvantage, because they may need to use more expensive gateway arrangements.
- 5.12 Following the publication of the Joint Study, the EIWG was convened to develop and implement options for debit card reform. The EIWG identified three options for the basis of discussion on interchange fee reform, one of which – the zero interchange fee – is the subject of the current applications for authorisation. The Commission notes that other parties, such as Coles Myer, have also identified alternate proposals for reform of the EFTPOS system.
- 5.13 Further, in relation to credit cards, it is noted that the RBA has designated the Bankcard, MasterCard and Visa credit card schemes in Australia as payment systems subject to its regulation under the (PSRA). The RBA established a standard for the setting of interchange fees, a standard for merchant pricing of credit card purchases and a regime for access to these credit card schemes.¹⁸ Accordingly, in the longer term if the RBA considers it to be in the public interest it may exercise its regulatory power to designate the EFTPOS network and to set interchange fee standards or impose an access regime in relation to the EFTPOS network.
- 5.14 Therefore, whether one of these, or other, alternate proposals for reform of Australia's debit card arrangements would be pursued should the Commission deny authorisation is difficult to determine although the Commission does

¹⁸ The Commission notes that the interchange fee standard came into force on 1 July 2003. The removal of merchant pricing restrictions imposed by the schemes and their members ('no-surcharge' rules) came into effect on 1 January 2003. In September 2002, MasterCard International and Visa International commenced proceedings in the Federal Court to have the reforms overturned. The hearing commenced on 19 May 2003.

consider that the pressure for EFTPOS reform is likely to continue in the longer term should the Commission deny authorisation.

The relevant market

- 5.15 Consistent with the statutory test (see paragraphs 1.9 to 1.11), the Commission must assess the public benefits and detriments and competitive effects of the arrangement for which authorisation is sought. This assessment is conducted in the context of the relevant market(s) and as such a first step for the Commission is to identify the boundaries of the relevant market(s), to the extent necessary to enable the Commission to undertake the required analysis.
- 5.16 The Applicants have submitted that the relevant markets for the purpose of assessing the proposed Agreement are the market for retail banking and the market for the retail supply of goods and services. It is the Applicants' view that there is no useful market definition that would bring these markets under one umbrella and that there is no useful reason to seek one.
- 5.17 The Commission notes that some interested parties have submitted alternate definitions of the relevant markets affected by the proposed conduct.
- 5.18 Caltex Australia Limited (Caltex) has submitted that there are at least four markets affected by the proposed arrangements, being;
- (a) the card issuer / merchant acquirer market;
 - (b) the merchant principal network / merchant acquirer market;
 - (c) the merchant / merchant acquirer market; and
 - (d) the card issuer / cardholder market.
- 5.19 Caltex submits that the proposed Agreement is likely to have an anticompetitive effect in the card issuer / merchant acquirer market and the merchant principal network / merchant acquirer market.
- 5.20 Woolworths submits that the proposed agreement will limit competition in two markets, being the market between issuers and acquirers and the market between acquirers and merchants.
- 5.21 The report prepared by ACIL Tasman Pty Limited (ACIL Tasman) and provided as part of the submission by Coles Myer has criticised the Applicants' market definition (and the Joint Study) as having failed to explicitly take account of payment instruments other than credit cards with which debit card products compete, in particular cash and cheques. It is ACIL Tasman's view that the Applicants' proposal has failed to consider the likely effect of the conduct on the Australian payments system as a whole, in particular whether the proposal would encourage increased use of cheques resulting in a decrease in the overall efficiency of the payments system.

- 5.22 The Commission considers that it may be difficult to accurately define the relevant market(s) in this matter. For example, debit cards are often supplied as part of a bundle of financial services provided to customers. This bundle may include, among other things, loans and credit cards. In theory, customers pay a fee to their financial institution (issuer) for the use of debit cards. However, in practice a customer who acquires a debit card as part of a package of financial services may be exempted from paying all, or part, of the debit card fee. A notional rise in a supplier's debit card fees will not necessarily induce customers to switch to suppliers of close substitutes because: (a) they may not actually pay the fee; or (b) the fee is just one component of the entire cost of the financial package that is supplied. This means that even if a cardholder does observe an increase in fees, it will not necessarily be apparent that this is the result of a rise in debit card fees.
- 5.23 Similarly, in some instances, the various payment options may be sufficiently close substitutes to be considered within the same market. However, in other instances they may not be. Furthermore, when determining the extent of substitutability, it is also important to recognise that price is not always the main determinant. For example, both debit and credit cards are supplied with a range of additional features, such as loyalty programs, which offer benefits to users over and above the direct benefit associated with an ability to access the payments system. These additional benefits would need to be taken into account when considering substitutability. The value of benefits may also change over time, or in particular instances. For example, a loyalty program may be less valuable when interest is payable on credit card transactions compared with when it is not.
- 5.24 The Commission further notes that, the provision of merchant acquiring services is generally integrated with card issuing services. Although, the reverse is not necessarily the case as many small card issuers are not merchant acquirers.
- 5.25 These characteristics mean that it might be difficult to apply a SSNIP¹⁹ test to delineate the relevant product markets.
- 5.26 The Commission accepts that each of the various payments instruments are substitutes to varying degrees in both supply and demand for consumers and merchants. However, in this instance, the Commission does not consider it necessary to consider the extent of this substitutability by definitively delineating the market boundaries.
- 5.27 The Commission considers that an assessment of public benefits and detriments can be undertaken by looking at the direct effects of the conduct for which authorisation is sought and the flow on effects of this conduct in areas of relevant competition.

¹⁹ The process of market definition can be viewed as establishing the smallest area of product, functional and geographic space within which a hypothetical current and future profit maximising monopolist would impose a Small but Significant Non-transitory Increase in Price (SSNIP).

- 5.28 The proposed arrangement is an agreement made between card issuing institutions and merchant acquiring institutions that the interchange fee in respect of EFTPOS transactions be fixed at zero. This agreement has flow on implications for card issuers in their dealings with their cardholders and for merchant acquirers in their relationship with their merchant/retailer clients. The first relationship also has flow-on consequences for consumers in their choice of payment instruments. Similarly, the second relationship has flow on consequences for retailers in the pricing of goods and services to consumers.
- 5.29 The Commission does not consider it necessary to identify whether these relationships constitute separate markets in their own right or sub-markets within a broader context. The Commission is also of the view that it is appropriate to consider the applications for authorisation within the broader context of the credit card reform process that is currently underway, particularly given the integrated nature of the credit card and debit card payment systems and the proposals for their reform. The Commission notes in this respect that the test set out under sections 90 (6) and 90 (8) of the Act requires that the Commission be satisfied that ‘in all the circumstances’ the conduct for which authorisation has been sought would result in a net public benefit before making a determination granting authorisation.

Market features

- 5.30 In order to assess the impact of the proposed arrangements on competition, the Commission considers that it is beneficial to identify some of the features that affect competition within these loosely identified areas of relevant competition. In this respect the Commission considers the following features, in addition to those set out at paragraph 5.10 of this draft determination, to be pertinent to its consideration:
- the high degree of market concentration and the dominance of a small number of large institutions;
 - the cross representation between merchant acquirers and card issuers;
 - the high barriers to entry to both card issuing and merchant acquiring, including:
 - the costs associated with establishing bilateral technical connections;
 - the complexity of technical arrangements that are required to be satisfied in order to join the network;
 - the lack of transparency in what is required in order for a potential entrant to obtain access; and
 - the lack of certainty that access will ultimately be obtained.
 - the lack of transparency of fee setting arrangements and the static nature of these fees (both wholesale and retail).

Effect on competition

- 5.31 Under the proposed Agreement card issuers and merchant acquirers will no longer negotiate an EFTPOS interchange fee as part of their bilateral agreements (although a range of both technical and commercial aspects will still need to be negotiated and agreed between the parties). In particular the proposed Agreement provides that interchange fees will automatically be set at zero where both parties are applicants to this authorisation and that the applicants will use their reasonable endeavours to amend their remaining bilateral agreements to include a zero interchange fee where one or more of the parties to the agreement are not applicants. The Commission also notes that while the proposed Agreement does not make specific provision for non-existing (or new) contracts, it is understood from the Applicants' submission that it is envisaged that the zero interchange fee will apply to bilateral arrangements entered into between incumbents and potential new entrants.
- 5.32 In general terms, the agreement between competitors to substitute a series of interchange fees negotiated on a commercial basis between two parties (a card issuer and merchant acquirer) with a single interchange fee agreed and implemented on a multilateral basis is likely to result in a less competitive outcome.
- 5.33 In particular the Commission notes the submission by Caltex that a move from a large number of bilateral agreements to a single multilateral pricing arrangement will remove any possibility of price variation (as currently exists) and would therefore result in a less competitive outcome than existing interchange fee arrangements.²⁰
- 5.34 Further, Woolworths has submitted that as the bilateral interchange fee arrangements are based upon separate negotiations it is currently possible for interchange fees set by these arrangements to be modified between the two parties without the need for agreement of all other issuers and acquirers. Under the proposed Agreement for the interchange fee level to be amended following a review, no less than 75% of the parties in number must agree to the amendment. The ARA claims that this is an unwieldy, time consuming and less flexible process for reviewing interchange fees.
- 5.35 However, the Commission also notes that the Joint Study found that interchange fees for debit card transactions had hardly changed since they were introduced in the early 1990s and that newer interchange fee agreements appeared to have been based on earlier agreements, without regard for changes in costs that may have warranted a revision to interchange fees.²¹ In this respect the Commission

²⁰ Caltex Australia Limited, submission dated 28 March 2003, at page 9.

²¹ *Debit and Credit Card Schemes in Australia – a study of interchange fees and access*, Reserve Bank of Australia and the Australian Competition and consumer Commission, October 2000, at page 62.

notes that confidential submissions provided to it indicate that average interchange fees have remained broadly consistent with the fee levels considered by the Joint Study.

- 5.36 Indeed, the Applicants have submitted that one of the problems of the current bilateral interchange fee arrangements is that the difficulty in renegotiating these agreements creates an inertia that discourages review and change in the interchange fees. It is the Applicants' view that the proposed Agreement will improve this situation by providing for system-wide interchange fee negotiation and by providing for a review of the zero interchange fee after three years (or earlier as described by paragraphs 3.9 to 3.11).
- 5.37 It is also noted that under the proposed Agreement there is the ability for the Applicants to review the level of the interchange fee and, where there is agreement by 75% of the parties in number, to change the interchange fee. As the proposed Agreement does not provide any methodology for determining a non-zero interchange fee the Commission is unable to consider the competitive effects of any change in the level of the interchange fee pursuant to clause 3 of the proposed Agreement. However the Commission notes the statement by the Applicants that "No authorisation is sought to grant the Applicants *carte blanche* to set interchange fee rates".²² The Applicants acknowledge that if they wanted to introduce a non-zero interchange fee they would need to seek fresh authorisation at that time and provide methodology to support any move away from zero.

Card issuing

- 5.38 As a result of the proposed Agreement card issuers will no longer pay an interchange fee to merchant acquirers in respect of EFTPOS transactions conducted by their cardholders. There are therefore cost savings from the proposed Agreement directly accruing to card issuers. The Applicants submit that competition between card issuers is likely to result in these cost savings being passed on to cardholders, while several interested parties submit that there is a lack of competitive pressure between card issuers to ensure the pass through of the benefits to cardholders. The issue of whether the pass through of the cost saving is likely to constitute a public benefit is examined in paragraphs 5.96 to 5.105.
- 5.39 The Applicants have submitted that the four major commercial banks compete vigorously in debit card issuing and face numerous small competitors. The Applicants claim that the products offered by these institutions are not uniform and demonstrate broad differentiation which is indicative of healthy competition.
- 5.40 The Applicants have submitted that, in their view, it is not enough to simply assert that card issuing is uncompetitive, as a number of interested parties have

²² Applicants' submission, April 2003, at page 9.

done. In the Applicants' view it should be assumed that, in the absence of extreme concentration, or conditions for tacit collusion, effective competition is the norm. The Applicants have further submitted that effective competition is likely to result in the pass through of the benefits of the proposed Agreement to consumers in some form, for example by way of lower consumer retail banking fees, enhanced services or higher transaction account deposit interest rates. It is the Applicants' view that this pass through should be determined by competitive forces and that consequently it is not the Applicants' intention to reach collective agreement in relation to the pass through of these cost savings.²³

- 5.41 The Commission notes that whilst there are a significant number of card issuing institutions, several interested parties have expressed concern as to the level of competition between these institutions. The Commission considers that the relative lack of competition between card issuers is likely to be influenced by the general reluctance on the part of consumers to transfer their banking relationship or, more simply, to 'swap' banks, particularly once they have set up facilities such as home loans, and the high degree of market concentration – the ARA has previously estimated that 90% of debit card issuing services are provided by the four major institutions.²⁴
- 5.42 The Commission considers that these factors are likely to mean that the competitive incentives of card issuing institutions to pass on the cost savings resulting from the proposed Agreement are unlikely to be maximised by the current market conditions. The Commission considers however that these incentives will also be influenced by the potential for new entry.
- 5.43 The ease of access for prospective card issuers is also an important determinant of the level of competition that exists. To obtain access to the EFTPOS network as a card issuer, an organisation must:
- be an Approved Deposit-taking Institution (ADI) and maintain customers' deposit transaction accounts, which the customers can draw upon in EFTPOS transactions;
 - issue transaction cards (payment instruments) to its customers/cardholders for their use in making EFTPOS transactions;
 - enter into bilateral interchange agreements with each acquirer in the EFTPOS network, or enter into a gateway agreement with an issuer; and
 - establish an Exchange Settlement Account (ESA) to settle its clearing obligations with each acquirer, or draw on the ESA of another institution in the case of indirect access (under a commercial agreement).

²³ Applicants' submission February 2003 and rejoinder submission April 2003 at pages 13 – 23, and pages 2 – 5, 13 – 16 respectively.

²⁴ ARA, Submission to the Reserve Bank of Australia, Response to the EFTPOS Industry Working Group, 13 September 2002, at page 8.

- 5.44 It is the Applicants' view that the statutory requirements of becoming an ADI and establishing an ESA do not constitute a barrier to the entry of a suitably qualified organisation.
- 5.45 Therefore the main barrier to direct access faced by new entrant card issuers appears to be the need to negotiate bilateral agreements covering technical and commercial arrangements with each merchant acquirer in the EFTPOS network. A new entrant may seek indirect access requiring only one bilateral agreement with the gateway provider. However gateway fees can make this an expensive option. The Commission understands that gateway services are predominantly utilised by the smaller card issuing institutions.
- 5.46 The Applicants have submitted that while the likely effects of the proposed Agreement on access are unknown at this stage, it is unlikely that it will increase barriers and is more likely that it will reduce the barriers to direct entry to the EFTPOS system. In particular, it is the Applicants' view that the proposed Agreement is likely to narrow the scope, and therefore the cost, of bilateral negotiations. The Applicants also consider that the proposed Agreement is likely to have a flow on effect and reduce the cost of indirect access (via gateway arrangements) to the EFTPOS system by potentially lowering the level of current gateway fees.
- 5.47 The Applicants note that an artificial barrier to the direct entry as a card issuer (or merchant acquirer) could theoretically be created by incumbent merchant acquirers (or card issuers) raising the cost of negotiations, including by engaging in lengthy negotiations, by proposing unreasonable terms and conditions, by demanding exorbitant contributions towards costs of interconnection facilities, or ultimately by refusing to negotiate at all. The Applicants further acknowledge that as the EFTPOS network is already established there is a lack of commercial incentive for incumbent card issuers and merchant acquirers to expand the network and interconnect a new entrant.
- 5.48 The RBA has submitted that the current bilateral arrangements can be a significant barrier to new entrants. The RBA considers that while the elimination of bilateral interchange fees should facilitate access of new entrants to the EFTPOS network (since they will no longer need to negotiate interchange fees as a condition of entry), at the same time the removal of interchange fee revenues may lower the financial incentive of incumbents to interconnect with new entrants
- 5.49 The Commission considers that while agreement on the interchange fee is one important element in the successful negotiation of a bilateral agreement, other commercial and technical aspects must still be negotiated and remain a significant barrier to new entry.
- 5.50 The Commission acknowledges that even where the incumbent has the best of intentions the current access arrangements are not ideal. Connecting a new entrant imposes costs relating to the negotiations as well as software and hardware changes. The Commission understands that it is also the case that each additional participant can make the task of maintaining network links more

complicated due to the need to accommodate multiple technical connections and requirements. The Commission further understands that these access barriers exist independent of the proposed Agreement.

- 5.51 The Commission considers that the proposal does not of itself address the barriers to entry into the EFTPOS network and is concerned that in the absence of effective access reform it may have the effect of increasing such barriers. In particular it is the Commission's view that the proposal is likely to diminish the commercial incentive of existing merchant acquirers to interconnect with new entrant card issuers by removing a form of financial recompense, although, as noted by the Applicants, other means exist outside interchange fees for new entrants to provide incumbents with such incentives. Nonetheless, the Commission considers that the proposal may result in higher upfront payments being required for access to the network.
- 5.52 The Commission also considers that the fact that the Applicants have sought authorisation for an exclusionary provision (whereby they will use their reasonable endeavours to ensure that all existing contracts, and presumably future contracts with new entrants, apply a zero interchange fee) is likely to have the effect of reducing the scope for new entrants to negotiate alternative access fee proposals. While the Applicants have not provided details as to what is meant by 'reasonable endeavours' the Commission notes that as they have sought authorisation for an exclusionary provision at the extreme it is envisaged that 'reasonable endeavours' could include primary boycott activity such as the collective refusal to interconnect a party because that party has refused to adopt a zero interchange fee.
- 5.53 The Commission notes the Applicants' submission that broad reform to improve the ability of potential new entrants to join the EFTPOS network is beyond the scope of the current applications for authorisation and would require the development and approval of a third-party access regime within a multi-party network agreement. In particular, it is the Applicants' view that formally moving to a multilateral scheme structure would be a quantum change from the existing bilateral arrangements. The Applicants submit that access reform would be best addressed by requesting that, as part of the application for renewal of the current authorisation of the APCA's CECS regulations and procedures, the APCA consider technical and procedural amendments that would improve the process for and timeliness of establishing interconnections for EFTPOS entrants.
- 5.54 The Commission notes that the RBA has supported the Applicants' suggestion that access issues would be more appropriately dealt with in the context of the re-authorisation of the CECS arrangements. However, in supporting this suggestion, the RBA has advised that it would want to be assured that the APCA will address the EFTPOS network access impediments in a timely manner. The RBA considers that the APCA should consider appropriate amendments to the CECS that would provide that if a new entrant is approved as a member of CECS and meets the APCA's technical requirements it should be entitled to exchange EFTPOS transactions with any other CECS member in a timely manner and at reasonable cost. The RBA has suggested that over the

longer term the industry may wish to consider the case for developing an industry owned switch to facilitate access and encourage competition and efficiency in the operation of the EFTPOS network.

- 5.55 However, a number of interested parties (including the ARA, Coles Myer, Woolworths, Caltex, and the AIP) have submitted that access to the EFTPOS network is an integral part of interchange fee reform and should be addressed as part of the current applications for authorisation. Arguments by interested parties in this regard stress that addressing access barriers is a critical factor in keeping the costs of the EFTPOS system down. They argue that the proposal for a zero interchange fee does not address the existing barriers to entry into the EFTPOS network.
- 5.56 The Commission agrees that reform of the current EFTPOS access arrangements is an important part of both the reform of the EFTPOS network and the reform of the Australian payments system more generally. The Commission notes that it has previously expressed its concerns in relation to the current EFTPOS access arrangements in its 1997 draft determination regarding the APCA CECS arrangements and again in the corresponding final determination issued in 2000 (see paragraph 2.17). Consistent with the statutory test, the Commission has assessed the current applications in the context of all the relevant circumstances. The Commission considers that a significant feature of the EFTPOS network is the high barriers to entry. The existence and persistence of these high entry barriers increase the likelihood that the potential anti-competitive detriment that may result from the proposed Agreement will be sustained over the longer term.
- 5.57 As discussed at paragraphs 2.11 to 2.18 the Commission has received applications from the APCA for the revocation of the existing authorisations in respect of the CECS and the substitution with new authorisations. As noted, the APCA has advised that it is now undertaking a detailed examination of access issues and exploring the practicability of implementing rules governing access to the EFTPOS network. The APCA has, however, advised that this process may take up to 12 months to complete, that there may be significant obstacles to it implementing access rules and that it would not want to unduly raise expectations that such rules necessarily are practical.
- 5.58 As outlined above, the Commission considers that the proposed Agreement may have the effect of increasing existing barriers to entry and may act to further entrench the high level of card issuer concentration. The Commission notes that interested parties have submitted that this detriment may be offset to some extent by the potential liberalisation of access to the EFTPOS network as part of the APCA review of the CECS arrangements. The Commission is concerned, however, that the outcome of the APCA review process is highly uncertain. As such it is the Commission's view that it would be inappropriate to attach a lesser weight to the likely anti-competitive detriment resulting from the proposed Agreement on the basis of any outcome of the APCA review of existing access arrangements. However, the Commission considers that, in the event that suitable access reform was to be introduced the proposed Agreement is more likely to be in the net public benefit.

Merchant acquiring

- 5.59 Under the proposed Agreement merchant acquirers will no longer receive interchange fee revenue from card issuers in respect of EFTPOS transactions. The Commission notes that the RBA has estimated that the loss of EFTPOS interchange fee revenue to merchant acquirers will be around \$150 million per annum.²⁵ The Applicants and interested parties have stated that in order to recoup this loss of revenue it is likely that merchant acquirers will increase EFTPOS service fees charged to merchants. A consequence of the increase in merchant service fees is an increase in the cost of goods and services to consumers, either in the form of an EFTPOS surcharge or as higher average prices for all goods and services.
- 5.60 The Applicants have advised that in seeking authorisation for the proposed Agreement it is not their intention to reach collective agreement in relation to the pass through by merchant acquirers of the likely cost increases to merchants. The Applicants have however submitted that the market for merchant acquiring is effectively competitive and that it can therefore be expected that this competition will limit aggregate increases in merchant service fees.
- 5.61 The Applicants acknowledge that the result of the renegotiation of EFTPOS merchant service fees will depend upon the relative bargaining power of the parties but argue that competition will ensure that there is no unwarranted redistribution of costs between classes of merchants. It is the Applicants' view that the proposed Agreement will not affect the relative bargaining positions of merchants and merchant acquirers and that no evidence has been provided to suggest that the Agreement will result in an increase in the market power exercised by merchant acquirers.²⁶
- 5.62 A number of interested parties have however expressed concern as to the likely effect of the proposed Agreement on the existing level of competition between merchant acquirers and the potential for the proposed Agreement to result in an inequitable allocation of the resulting cost increase by merchant acquirers.
- 5.63 For example, Woolworths has submitted that, while average interchange fees are around \$0.20 per transaction, individual merchant acquirers receive a range of interchange fees from around \$0.19 to \$0.25 per transaction. Woolworths notes that under the current bilateral arrangements, merchant acquirers have the capacity to offer different pricing to a particular merchant based upon the potential income to be generated from the transactions of that merchant. It is Woolworths' view that this competitive pricing element would be lost if the proposed Agreement were to be implemented.²⁷ Similarly, Caltex has

²⁵ Reserve Bank submission dated 21 March 2003, at page 3.

²⁶ Applicants' submission February 2003 and rejoinder submission April 2003 at pages 13 – 23, and pages 2 – 7, 13 – 16 respectively.

²⁷ Woolworths submission dated 31 March 2003, at page 15.

submitted that the arrangement will have a detrimental effect on the current level of competition between merchant acquirers. In particular it is Caltex's view that the agreement will result in the equalisation of network access fees offered by merchant acquirers, thereby removing a key element in the pricing discretion able to be exercised by merchant acquirers when dealing with merchant principals.²⁸

- 5.64 The Commission notes that some interested parties, for example the ARA and NARGA, have submitted that the proposed Agreement is likely to lessen the ability of merchants to exercise countervailing power when negotiating merchant service charges with merchant acquirers. NARGA is concerned that the Applicants intend to replace lost revenue from interchange arrangements with a similar or higher level of revenue from new merchant fee arrangements. NARGA has also submitted that the lack of competition between merchant acquirers will result in a disproportionate recoupment of the increased cost resulting from the proposed Agreement. In particular it is NARGA's view that this cost recoupment will favour large merchants and will further exacerbate the competitive disadvantage suffered by small merchants and may result in small businesses being forced to exit their markets. The submission of the MTAA expresses similar concerns.
- 5.65 The Commission notes that the recent *Small Business Banking Issues Paper* compiled by the Financial Services Consumer Policy Centre (FSCPC), concluded that the level of competition in the Australian small business banking market was very poor.²⁹ It was the FSCPC view that this was because a small number of large institutions dominated the small business banking market and failed to compete with each other on either price or service. In particular the FSCPC considered that small business banking customers were not mobile and that their "stickiness" made it hard for smaller players and new entrants to compete for reasonable market share, even though they might have superior products.
- 5.66 The Commission considers that, in order to recover the income lost as a result of the proposed Agreement, merchant acquirers are highly likely to charge merchants a higher EFTPOS merchant service fee. For some merchants, for example merchant principals and some franchisees, this may take the form of a reduction in the level of income or rebates received from merchant acquirers. The Applicants have submitted that this cost increase is relatively insignificant – amounting to only 0.07 per cent of total retail turnover³⁰ and that in any event this cost increase will be offset by the cost savings to merchants following the implementation of the RBA's credit card reforms. The RBA has submitted that reforms to credit card schemes are expected to reduce credit card interchange fees paid by merchant acquirers by around \$350 million per annum.

²⁸ Caltex Australia Limited, submission dated 28 March 2003, at page 11.

²⁹ *Small Business Banking - Options for Reform*, Financial Services Consumer Policy Centre, September 2002, at page 10

³⁰ Applicants submission, February 2003, at page 16.

- 5.67 The Commission notes that confidential information provided to it suggests that, due to the varying mix of payment instruments employed by consumers, certain merchants will be affected by this cost increase to a greater extent than other merchants. In this regard the ARA has estimated that the combined effect of the proposed EFTPOS interchange fee reform and credit card reform will leave retailers a shortfall of \$60 million. According to the ARA retailers will be required to pass this cost imbalance on to consumers in the form of higher prices for goods and services.
- 5.68 The Commission considers that where authorised conduct results in cost increases, an important consideration as to whether this cost increase is to the benefit of the public is whether the value and allocation of the cost increase is governed by competitive pressures.
- 5.69 Furthermore, while it is noted that the Applicants have advised that they do not intend to reach collective agreement as to the recoupment of merchant acquirer cost increases, the Commission considers that it is likely that the timings of this cost recoupment will be broadly consistent across all merchant acquirers, and is concerned that an industry wide price increase, even in circumstances where there is no agreement as to the level of increase, is likely to lessen the bargaining position of a merchant in negotiating a revised merchant service fee.
- 5.70 The Commission notes that the Joint Study observed that the market for debit card acquiring is highly concentrated, with four merchant acquiring institutions accounting for almost 95% of the market.³¹ Confidential information provided to the Commission in respect of this application indicates that there still appears to be a high degree of concentration, although it is noted that five merchant acquiring institutions now provide approximately 95% of these services.
- 5.71 Further the Commission notes that a new merchant acquirer seeking to participate in the EFTPOS network must:
- enter into bilateral interchange agreements (which include standards for the EFTPOS facilities provided to merchants by the acquirer, as well as clearing, settlement and fee arrangements) with all issuers in the network, or enter into an arrangement with a ‘gateway’ acquirer that has bilateral interchange agreements with issuers in the network;
 - have the means of settling its clearing obligations with each issuer, in practice this would require the organisation to either have its own ESA or have access (under a commercial arrangement) to another institution’s ESA.
- 5.72 As with card issuing, the main barrier to entry for new merchant acquirers is the ability to enter into bilateral interchange agreements with existing card issuers.

³¹ *Debit and Credit Card Schemes in Australia – a study of interchange fees and access*, Reserve Bank of Australia and the Australian Competition and consumer Commission, October 2000, at page 20.

- 5.73 Coles Myer has submitted that bilateral negotiations require consideration of a range of matters including price, technical interfaces, implementation costs and resource allocation and commercial incentive. It is Coles Myer's view that while price is an important part of these negotiations, it is Coles Myer's experience that these other aspects frustrate and delay the negotiation process. In Coles Myer's view access to the payments network is essential to encourage improved competition. Further it is Coles Myer's view that the proposed Agreement will reduce the incentive for incumbents to engage in interchange activity with new entrants making access to the network more difficult. Indeed Coles Myer submit that their success in entering into bilateral arrangements, including interchange fee arrangements, has been largely due to the financial incentives it has offered prospective interchange partners.
- 5.74 The AIP has submitted that access to the market for EFTPOS services is an important factor in maximising competitive forces and driving down costs. The AIP strongly disagrees with the separation of access and interchange fee reform and has submitted that the maximisation of competitive pressures is an essential component of EFTPOS reform that impacts directly upon net public benefit.
- 5.75 The ARA has submitted that it considers the issue of network access to be a critical part of delivering increased competition to the EFTPOS market and has disputed the Applicants' submission that the proposed Agreement will remove a significant part of the access issues faced by potential entrants.
- 5.76 A submission was also received from MoneySwitch which advises it intends to offer merchant acquiring services for EFTPOS and thereby compete with existing acquirers by using modern networking and transaction processing technology. MoneySwitch has submitted that the proposed Agreement is likely to result in a significant cost disadvantage for new entrants, in particular as under a zero interchange fee card issuers will have no incentive to lower access costs by adopting appropriate technology and standards. Further it is MoneySwitch's view that the proposed Agreement does not address issues such as commercial, technical, operational, testing, communications and attachment costs, and that these will still have to be negotiated by incumbents and potential new entrants.
- 5.77 MoneySwitch has submitted that, as card issuing institutions are also largely involved in merchant acquiring activities, they have no incentive to assist new merchant acquirers as these new merchant acquirers are likely to have a negative impact on the card issuers' own acquiring business. It is MoneySwitch's view that this makes it very difficult for a new merchant acquirer to negotiate a fair and balanced agreement in a reasonable time frame and that this is particularly difficult in the EFTPOS acquiring market as a new acquirer can not start business until bilateral agreements have been negotiated with all card issuers. MoneySwitch submits that in the circumstances gateway providers do not provide a cost effective alternative to direct entry for parties seeking to provide merchant acquiring services. MoneySwitch has submitted that the Commission should impose conditions to enable and encourage new entrant acquirers and require existing issuers to:

- negotiate the interconnect agreement in the utmost good faith;
 - allow connection using modern networking technology; and
 - set attachment fees on a verifiable cost recovery basis, without overheads.
- 5.78 As is the case with card issuing, the Commission considers that there are currently high barriers to entry to merchant acquiring and is concerned that the proposed Agreement may have the effect of increasing these barriers to entry which may further entrench the high level of merchant acquirer concentration. In particular the Commission understands that merchant principals have previously offered concessional interchange fees to incumbent card issuing institutions as a negotiation incentive. In this context the Commission notes that while the proposed Agreement does not make provision for non-existing (or new) contracts, it is clear from the Applicants' submission that it is envisaged that the proposed Agreement will narrow the scope of negotiations between incumbents and potential new entrants by eliminating the need to negotiate interchange fee structures. It is the Commission's concern that this may also have the effect of deterring an incumbent card issuer from accepting a 'reverse interchange' fee (or payment), thereby removing an important tool that could otherwise be used in the successful negotiation of bilateral agreements.
- 5.79 The Commission also notes that, by removing a potential revenue stream, the proposed Agreement may have the effect of placing new entrants at an increased cost disadvantage vis-à-vis incumbents in relation to the recoupment of (sunk) costs. The Commission notes that in general new entrants can face such disadvantages and as such this is not unique to the EFTPOS network. While the Commission considers that these costs may be recouped by new entrants from alternate revenue streams (for example merchants), it is concerned that in the absence of effective access reform, in particular reform offering greater certainty as to the cost of interconnection, the proposed Agreement may have the effect of deterring new entry in the short term.
- 5.80 As noted previously (see paragraph 5.53 to 5.58), it has been submitted that the detriment arising from the proposed Agreement may be offset to some extent by the potential liberalisation of access to the EFTPOS network as part of the APCA review of the CECS arrangements. The Commission is concerned however that the outcome of the APCA review process is highly uncertain. As such it is the Commission's view that it would be inappropriate to attach a lesser weight to the likely anti-competitive detriment resulting from the proposed Agreement on the basis of the APCA review. The Commission considers that, in the event that suitable access reform was to be introduced the proposed Agreement is more likely to be in the net public benefit.
- 5.81 It is also noted that some interested parties have submitted that the Commission should impose a series of conditions that would seek to liberalise access to the EFTPOS network. The Commission however is concerned that the utility of such conditions, where they would not cover all participants in the EFTPOS network (that is, those who are not applicants to this authorisation), is unclear. Further, while the Commission considers that improving access to the EFTPOS network is highly desirable, it notes the RBA's submission that the industry

may wish to consider developing an industry owned switch to facilitate access and encourage competition and efficiency in the operation of the EFTPOS network. Accordingly the Commission considers that it would be inappropriate to mandate a compulsory access regime in the context of this authorisation process.

- 5.82 The Commission also notes that some interested parties have submitted that the proposed Agreement is likely to have an anti-competitive effect by deterring efficient investment in the EFTPOS network.
- 5.83 The Applicants acknowledge that EFTPOS interchange fees play some part in encouraging investment in acquirer side terminals and other facilities.³² The Applicants have submitted that it is possible that lowering the interchange fee will reduce the immediate returns on those investments and the incentives to undertake the expenditure needed to maintain and improve the present quality and penetration of the network. However, the Applicants consider that the likely response to lower interchange fees is that acquiring institutions will raise merchant service fees to offset the loss of revenue. It is the Applicants' view that this will mean that there will still be a flow of revenue to finance investments in acquiring facilities, but the pattern of returns, and the associated investment, may be changed.
- 5.84 The ARA has argued that the only course of action available to retailers under the proposed EFTPOS interchange fee reform is to:
- reduce expenditure on EFTPOS networks as far as possible; and
 - pass on both their own network costs and the higher acquiring institution costs to consumers. The most likely outcome is an increase in the general prices of goods and services.
- 5.85 Submissions received from Coles Myer, Woolworths and Caltex have further stated that if merchants do not undertake required upgrades of infrastructure the relative level of security of the Australian EFTPOS network is likely to decline.
- 5.86 However the RBA submission has noted that no evidence was presented to the Joint Study, or subsequently, that EFTPOS interchange fee revenue continues to be required by merchants to recoup the costs of their initial investments or subsequent upgrades. The RBA submits that if EFTPOS interchange fee revenues are eliminated, investment decisions by merchants would be determined by normal market mechanisms. The RBA considers that merchants will continue to invest in EFTPOS facilities if they perceive direct benefits in doing so, such as savings in merchant service fees by undertaking some acquiring services themselves, or greater customer satisfaction through improved transaction processing speeds.

³² Applicants' submission, February 2003, at page 17.

- 5.87 The ACA has also submitted that the costs of developing the EFTPOS network have long been recovered. The ACA also notes that infrastructure for accepting EFTPOS transactions is generally the same as that employed for credit cards, reducing the likelihood that merchants will discontinue their investment in EFTPOS infrastructure.
- 5.88 The Commission considers that, if the proposed Agreement were to be given effect to, then it is likely that investment decisions of incumbents would be determined by market conditions. In particular, the Commission considers that if incumbent EFTPOS network participants perceived a need to upgrade the infrastructure of the EFTPOS network, then they would do so if the benefits derived from the network upgrade exceeded the costs. The Commission notes that it has been argued that the cost of such upgrades to a party may not necessarily reflect the network benefits accruing to all users of the network. Hence investment may be below optimal levels. The Commission considers that in such circumstances other beneficiaries of the upgrade would have an incentive to contribute to these upgrade costs. In this respect it is noted that the payment of an interchange fee is one of several methods by which this contribution may be facilitated.

Conclusion on anti-competitive detriment

- 5.89 The Commission considers that an agreement between competitors to substitute a series of interchange fees negotiated on a commercial basis between two parties (a card issuer and merchant acquirer) with a single interchange fee agreed and implemented on a multilateral basis is likely to result in a less competitive outcome.
- 5.90 As outlined above, the Commission considers that there are several factors that are likely to influence the effectiveness of competition among card issuing institutions and merchant acquiring institutions, including the high degree of market concentration; the dominance of a small number of large institutions; the cross representation between card issuers and merchant acquirers; and the high barriers to entry to both card issuing and merchant acquiring.
- 5.91 Based upon the information presented to it the Commission is concerned that the competitive incentives of card issuing institutions to pass on the cost savings resulting from the proposed Agreement are unlikely to be maximised by the current market conditions and while the Commission considers that these incentives will be influenced by the potential for new entry, it is concerned that the proposed Agreement may have the effect of increasing the already high barriers to entry. The Commission notes that the APCA is currently reviewing access arrangements within the context of the CECS authorisation, however, the Commission is concerned that the outcome of this review is highly uncertain. Accordingly the Commission considers that it would be inappropriate to attach a lesser weight to the anti-competitive detriment that may arise from the proposed Agreement on the basis of the APCA review. However, as noted previously, the Commission considers that, in the event that suitable access reform was to be introduced the proposed Agreement is more likely to be in the net public benefit.

5.92 Further in relation to merchant acquiring the Commission considers that the proposed Agreement is likely to result in an increase in barriers to entry and therefore will affect the potential for enhanced competition through new entry and may further entrench the high level of merchant acquirer concentration. As outlined above the Commission does not consider it appropriate to attach a lesser weight to this detriment on the basis of the APCA review of the CECS arrangements. The Commission further considers that, in order to recover the income lost as a result of the proposed Agreement, merchant acquirers are highly likely to charge merchants a higher merchant service fee and further that it is likely that the timings of this cost recoupment will be broadly consistent across all merchant acquirers. The Commission is concerned that an industry wide price increase, even in circumstances where there is no agreement as to the level of increase, is likely to lessen the bargaining position of a merchant in negotiating a revised merchant service fee.

Public benefits

5.93 To grant authorisation the Commission must be satisfied that any anti-competitive detriment is outweighed by the benefit to the public arising from the proposed conduct. As detailed at paragraphs 4.5 to 4.14 the Applicants claim that the proposed Agreement will result in a number of public benefits including.

- making EFTPOS more attractive to consumers relative to less efficient means of payment, particularly credit cards, thereby inducing a shift towards the use of EFTPOS and reducing the overall cost of the Australian payments system;
- introducing greater flexibility into the setting of EFTPOS interchange fees; and
- making new entry to the EFTPOS network easier by simplifying the negotiation of bilateral interchange agreements.

Making EFTPOS more attractive/Improving the efficiency of the Australian payments system

5.94 The Commission accepts that there is a clear benefit to the public through improved payment system efficiency and that the promotion of the increased usage of EFTPOS as a less costly payment alternative relative to other payment instruments is likely to contribute to the attainment of this benefit.

5.95 To achieve this benefit, price signals that reflect efficient costs of the various payment instruments must be readily observable by cardholders. The Commission considers that the following factors are relevant in assessing the extent to which the proposed Agreement will facilitate this:

- pass through of card issuer cost reductions to cardholders; and
- the transparency of pricing signals.

Pass through of card issuer cost reductions to cardholders

- 5.96 Currently when a cardholder uses a debit card to make a purchase from a merchant the card issuing bank will pay an interchange fee (on average between \$0.18 and \$0.25) to the merchant acquiring institution. Accordingly the proposed Agreement, by reducing EFTPOS interchange fees to zero, will result in cost savings for EFTPOS card issuers.
- 5.97 The Applicants claim that effective competition between card issuers is likely to lead to at least part of the cost reduction being passed on to cardholders. The Applicants consider that the form of the pass through should be allowed to be developed by card issuers in an effectively competitive retail banking market and not by collective agreement. The Applicants note that this pass through may take the form of lower retail banking fees and/or enhanced services but that it is unlikely that this pass through will occur in an easily observable manner due to the complexity of retail transaction accounts.
- 5.98 The RBA has submitted that public benefits will be maximised if the reduction in EFTPOS interchange fees is passed immediately and in full to debit cardholders and that it can see no reason why debit card issuers in a competitive market environment should not do so.
- 5.99 A number of interested parties have however expressed concern as to the level of competition between existing card issuers, in particular in relation to the potential for competition between existing card issuers to ensure the pass through to cardholders of the full benefit of the cost reductions that will accrue as a result of the proposed Agreement.
- 5.100 For example, submissions by the CLC(V) and the CFA have expressed strong reservations regarding the capacity of the banking industry and competitive pressures to ensure the pass through of the lasting benefits of the proposed arrangements to consumers.³³ The ACA has submitted that Australian banks have a poor record with respect to passing on cost savings to consumers, particularly in the area of transaction charges in retail banking, where insufficient competition has facilitated soaring fee levels.³⁴ Similarly, Coles Myer has submitted that the Applicants have failed to establish that the benefit of cost savings will be passed on to consumers and further, that historically it is clear that financial institutions have retained the benefits of cost reductions, in particular those that have resulted from branch closures and the increased usage of cheaper alternatives, including EFTPOS and ATMs. It is Coles Myer's view that the evidence points to a lack of competition and cites a report of the Reserve Bank which noted that 'it is difficult to point to obvious areas of

³³ CLC(V) submission dated 24 March 2003, at page 1. CFA submission dated 24 March 2003, at page 1.

³⁴ ACA submission dated 28 March 2003, at page 3.

increased competition in deposit markets over the 1990's'.³⁵ Woolworths has also submitted that the lack of competitive pressure will mean that card issuers are likely to retain a substantial amount of the savings generated by the move to zero interchange fees.

- 5.101 A number of interested parties (for example the ACA, AIP, ASIC, CCLS(WA), and CLC(V)) have submitted that the benefits of increasing the use of EFTPOS as a lower cost payment mechanism depend upon cardholders receiving the benefit of reduced EFTPOS banking fees. As the proposed Agreement does not provide a mechanism to ensure that fee reductions are passed on they argue that the Commission should impose a condition on the Applicants mandating the pass through of cost savings by card issuing banks to cardholders. Some interested parties have also argued that a prices oversight body should be established to ensure, and report on, ongoing compliance with the pass through requirement.
- 5.102 Further, some interested parties including the ARA, Caltex and Woolworths submit that as RBA data suggests that the majority of EFTPOS cardholders do not exceed their fee free transaction threshold, it is highly unlikely that the majority of EFTPOS users will benefit from the pass through of card issuer savings as they do not currently pay transaction fees.
- 5.103 As a preliminary matter it is noted that the concept of a benefit to the public is not limited to a benefit to consumers. In particular the Commission considers that a benefit to a private party which is of value to the community generally may be a public benefit. However the Commission considers that the weight to be attached to this benefit will depend upon the durability of the benefit and the likelihood and extent of that benefit being passed through to the community. In this respect the Commission considers that a competitive market will encourage the pass through of benefits accruing to particular groups, such as cost savings, to the community. Conversely the Commission is concerned that where a firm is not subject to adequate competitive pressures it is more likely that these cost savings will be dissipated over time, thereby reducing the weight that it would otherwise attach to this public benefit.
- 5.104 The Commission's views in relation to competition between card issuers are outlined in the previous section. As discussed, the Commission considers that while there are more card issuing institutions than merchant acquirers, competition among card issuers is constrained and new entrants face high barriers to entry. The Commission is concerned that in this environment competition between card issuing institutions may not be sufficient to ensure a lasting public benefit. It is further concerned that high barriers to entry are likely to inhibit the competitive pressures that may otherwise be exercised by potential new entrants thereby reducing the weight that would otherwise be attached to this public benefit.

³⁵ Ibid at page 21, and *The Australian Financial System in the 1990's*, Reserve Bank of Australia, 2002, at page 196.

- 5.105 In the event that authorisation were to be granted to the proposed Agreement the Commission considers that the Applicants would need to satisfy it that the card issuer savings were being passed through to cardholders on an ongoing basis. In this respect the Commission notes the Applicants' advice that the fee and charge structures of the various transaction account products offered by financial institutions are too complex to necessarily expect a simple pass through of 'x' cents. The Commission is concerned that, in the circumstances, it may be difficult for the Applicants to demonstrate that a condition mandating the pass through of cost savings had been complied with. This would create a high degree of uncertainty as to whether the conduct would continue to result in a net public benefit.

Improving the transparency of pricing signals

- 5.106 The Joint Study concluded that the current pricing signals for Australian retail payment services (ATM, credit cards, EFTPOS) are distorting consumer payment choices. Consumers make decisions about which payment instrument they use on the basis of a range of factors such as convenience, type of payment being made, personal preferences and the relative prices of alternative instruments. For cardholders who do not face a cash constraint a debit card is a close substitute for a credit card. For these cardholders the choice between the two types of card will be influenced by their relative price and other incentives (such as fee free transactions, loyalty points).
- 5.107 The Joint Study found that the credit card network has been encouraged to grow at the expense of the debit card– a less costly alternative (albeit that debit card acquiring generates revenues above average costs). For example, the cost to merchants in accepting a credit card averages \$1.78 for a \$100 transaction, while the merchant fee for debit cards for merchants who do not provide any acquiring infrastructure is around \$0.80. Merchants who operate their own infrastructure receive a share of the interchange revenue paid to their financial institution by issuers and hence receive revenue from accepting debit cards.
- 5.108 As a result of the distorted payment signals facing consumers, the Joint Study concluded that Australia has a higher cost retail payments system than is necessary.
- 5.109 In their submission the Applicants have argued that the proposed conduct will lead to an overall improvement in payment method pricing signals and will promote increased debit card usage by encouraging consumers to shift away from credit cards, leading to an overall decrease in the cost of the Australian retail payments system.
- 5.110 The Commission considers that there are essentially two consumer price signals which are relevant to its considerations – those provided by card issuers and those provided by merchants.
- 5.111 In relation to card issuer generated price signals the Applicants have submitted that whilst debit card issuing occurs in a competitive market, which will ensure

that the cost savings are passed on to consumers in some form, the price signals evidencing this pass through may not be easily observable due to the bundling and cross subsidisation of transaction account products.

- 5.112 Several interested parties have also provided submissions in relation to card issuer generated price signals. For example, the ASIC has submitted that the Applicants should be required to provide cardholders with a clear explanation of the rationale of the reforms and the implications for the fees payable by cardholders, including disclosure of whether or not the standard fees for EFTPOS transactions are reduced and by how much.
- 5.113 Coles Myer and Woolworths have however submitted that cardholders who do not exceed their fee free threshold are unlikely to benefit from card issuer cost savings and therefore the decision of these cardholders to use EFTPOS in preference to credit cards would not be influenced.
- 5.114 Based upon the submissions of the Applicants and interested parties, the Commission is concerned that the complexity of the current pricing structures for retail transaction accounts is likely to result in price signals that are not transparent and therefore difficult to act upon. This would diminish the extent of efficiency gains from switching to lower cost payment instruments. In any event, as discussed the Commission is concerned that current and future competition between card issuers may not be sufficient to ensure a lasting public benefit.
- 5.115 In respect of merchant generated price signals, the Applicants have submitted that effective competition in retailing is likely to result in merchants recovering the increased cost of EFTPOS merchant service fee charges through higher prices for goods and services rather than through surcharges for the use of EFTPOS. In this respect it is noted that the Applicants consider that EFTPOS surcharges may diminish the incentive of cardholders to increase their usage of EFTPOS over other means of payment and that as such the absence of a price signal at point of sale (in other words no EFTPOS surcharge) is an important part of the generation of net benefits through improved efficiency of the payment system.
- 5.116 Interested parties have agreed with the Applicants' general proposition that it is highly unlikely that merchants will recoup this cost increase via an EFTPOS surcharge and that it is considered more likely that merchants will recover this cost increase by raising prices for goods and services generally.
- 5.117 Woolworths has submitted that under such arrangements merchant costs will not be transparent as it will mean that the prices of goods and services will increase for all consumers for all payment methods and the correct price signals will not be sent to consumers. It is Woolworths' view that this will lead to consumers who purchase goods and services by way of cash, for example, effectively subsidising consumers who purchase goods and services by credit or debit card, a situation which was deemed to be undesirable by both the

Financial System Inquiry and the Joint Study.³⁶ Similar concerns were raised by the ARA, Caltex, the AIP and NARGA.

- 5.118 The Commission notes that while the proposed Agreement does not of itself require merchants to incorporate EFTPOS merchant service fees in the general level of prices, it is likely that the proposed Agreement will nonetheless result in an increase in the retail payment instrument pricing distortions that were identified by the Joint Study.
- 5.119 The Commission considers that clear pricing signals have the potential to promote increased use of debit card products. However the Commission is concerned that, for the reasons set out above, market conditions for both card issuers and merchants are likely to result in the suppression of the price signals that may otherwise have been generated by the proposed Agreement. As such the Commission is concerned that the weight to be attached to this public benefit is uncertain.

Introducing greater flexibility into the setting of EFTPOS interchange fees

- 5.120 The Applicants have submitted that the proposed Agreement will introduce greater flexibility into the setting of interchange fees which will facilitate system-wide initiatives, for example network improvements. In particular the Applicants have submitted that such changes could be negotiated far more easily through an appropriately set non-zero interchange fee than if all existing bilateral agreements had to be renegotiated.
- 5.121 Some interested parties, for example Coles Myer, Woolworths, the ARA and Caltex, have questioned how a move from the current arrangements (being bilateral, separately negotiated fees) to a multilateral price fixing agreement would introduce greater flexibility. In particular it has been submitted that the proposed review process (clause 3) is by its very nature more unwieldy, time consuming and less flexible than the current arrangements.
- 5.122 The Commission notes that the Joint Study expressed concern that interchange fees for debit card transactions had hardly changed since they were introduced in the early 1990's and that newer interchange fee agreements appeared to have been based upon earlier agreements, without regard to changes in costs that may have warranted a revision to interchange fees.
- 5.123 The Commission considers that the historical inertia of EFTPOS interchange fees is likely to be the result of the structure of the EFTPOS network and the competitive disincentives that it has created. The Commission is concerned that the proposed Agreement, by establishing an industry price fixing arrangement and providing for the potential exclusion of parties who wish to adopt non-zero interchange fees, is unlikely to address this inertia. The Commission considers that the proposed Agreement essentially seeks to 're-set' EFTPOS interchange

³⁶ Woolworths submission, 31 March 2003, at page 18.

fees (albeit at zero) and is unlikely to improve flexibility and is more likely that the proposed Agreement will result in the continuation of ‘standardised’ interchange fees.

- 5.124 The Commission notes that the Applicants envisage that, should they in the future seek to adopt a non-zero interchange fee, then this fee would in all likelihood be determined by methodology and subject to a public interest assessment through the authorisation process. Therefore, if in the future system wide improvements are to be funded by a collectively agreed non-zero interchange fee, the Commission would need to assess these benefits against the anti-competitive detriments at that time.

Making new entry to the EFTPOS network easier by simplifying the negotiation of bilateral interchange agreements

- 5.125 The Applicants have submitted that the proposed Agreement would ameliorate the extent of natural barriers to direct entry into the EFTPOS market and that bilateral agreements should therefore be easier to negotiate. In particular, it is the Applicants’ view that the proposed Agreement is likely to narrow the scope, and therefore the cost, of bilateral negotiations. The Applicants also consider that the proposed Agreement is likely to have a flow on effect and reduce the cost of indirect access (via gateway arrangements) to the EFTPOS system by potentially lowering the level of current gateway fees.
- 5.126 As discussed at paras 5.45 to 5.58 and 5.71 to 5.81, the Commission considers that while agreement on the interchange fee is one important element in the successful negotiation of a bilateral agreement, other commercial and technical aspects must still be negotiated and remain a significant barrier to new entry.
- 5.127 As outlined above, the Commission considers that the proposed Agreement may have the effect of increasing existing barriers to entry and may act to further entrench the high level of card issuer and merchant acquirer concentration. Accordingly the Commission does not propose to accept this claimed public benefit in the circumstances.

Conclusion on public benefit

- 5.128 The Commission considers that there is a clear benefit to the public through improved payment system efficiency and that the promotion of the increased usage of EFTPOS as a less costly payment alternative relative to other payment instruments is likely to contribute to the attainment of this benefit. The Commission considers that the pass through of card issuer savings to cardholders and improving the transparency of pricing signals are relevant in assessing the extent to which the proposed Agreement facilitates this.
- 5.129 Based upon the information presented to it the Commission is concerned that competition between card issuing institutions may not be sufficient to ensure a lasting benefit enjoyed by the public and that current barriers to entry may inhibit the competitive pressures that may otherwise be exercised by potential new entrants (which would thereby increase the extent and likelihood of that

benefit being passed through to the general community). The Commission is also concerned that market conditions are likely to distort the transmission of more efficient pricing signals that may otherwise have been generated by the proposed Agreement. Based upon the foregoing the Commission is concerned that the weight to be attached to this public benefit is uncertain.

- 5.130 The Applicants have also submitted that the proposed Agreement will introduce greater flexibility into the setting of interchange fees which will facilitate system-wide initiatives, for example network improvements. The Commission however is concerned that the proposed Agreement, by establishing an industry price fixing arrangement and providing for the potential exclusion of parties who wish to adopt non-zero interchange fees, is unlikely to improve flexibility and is considered more likely to result in the continuation of ‘standardised’ interchange fees.
- 5.131 It has also been submitted that the proposed Agreement would ameliorate the extent of natural barriers to direct entry into the EFTPOS market and that bilateral agreements should therefore be easier to negotiate. As has been discussed previously, the Commission considers that while agreement on the interchange fee is one important element in the successful negotiation of a bilateral agreement, other commercial and technical aspects must still be negotiated and remain a significant barrier to new entry. Furthermore, the Commission is concerned that the proposed Agreement may have the effect of increasing existing barriers to entry and may act to further entrench the high level of card issuer and merchant acquirer concentration. Accordingly the Commission does not propose to accept this claimed public benefit.

Conclusion Commission evaluation – weighing up of the competitive detriments and public benefits

- 5.132 In order to grant authorisation the Commission must be satisfied that the proposed Agreement results in a benefit to the public that outweighs any detriment to the public constituted by any lessening of competition arising from the proposed Agreement.
- 5.133 As a general principle, the Commission considers that an agreement between competitors to substitute a series of interchange fees negotiated on a commercial basis between two parties (a card issuer and merchant acquirer) with a single interchange fee agreed and implemented on a multilateral basis is likely to result in a less competitive outcome.
- 5.134 As discussed, the Commission considers that there are several factors that are likely to influence the effectiveness of competition between card issuing institutions and merchant acquiring institutions, including the high degree of market concentration; the dominance of a small number of large institutions; the cross representation between card issuers and merchant acquirers; and the high barriers to entry to both card issuing and merchant acquiring.
- 5.135 Based upon the information presented to it the Commission is concerned that the competitive incentives of card issuing and merchant acquiring institutions

under the proposed Agreement are unlikely to be realised given the current market conditions. While the Commission considers that new entry has the potential to enhance these incentives and result in an improved competitive outcome it is concerned that the proposed Agreement may have the effect of increasing barriers to entry. The Commission notes that the APCA is currently reviewing EFTPOS network access arrangements within the context of the CECS authorisation, however, the Commission is concerned that the outcome of this review is highly uncertain. Accordingly the Commission considers that it would be inappropriate to attach a lesser weight to the anti-competitive detriment that may arise from the proposed Agreement on the basis of the APCA review. However, the Commission considers that, in the event that suitable access reform was to be introduced the proposed Agreement is more likely to result in a net public benefit.

- 5.136 The Commission considers that there is a clear benefit to the public through improved payment system efficiency and that the promotion of an increased usage of EFTPOS as a less costly payment alternative relative to other payment instruments is likely to contribute to the attainment of this benefit. In particular the Commission considers that the pass through of card issuer savings to cardholders and improving the transparency of pricing signals are relevant in assessing the extent to which the proposed Agreement facilitates this. However, the Commission is concerned that competition between card issuing institutions may not be sufficient to ensure a lasting benefit enjoyed by the public and that current barriers to entry may inhibit the competitive pressures that may otherwise be exercised by potential new entrants (which would thereby increase the extent and likelihood of that benefit being passed through to the general community). The Commission is also concerned that market conditions are likely to distort the transmission of more efficient pricing signals that may otherwise have been generated by the proposed Agreement. As such the Commission is concerned that the extent to which the proposed agreement results in improved payment system efficiency is uncertain.
- 5.137 The Commission also considers that the proposed Agreement is unlikely to improve the flexibility of interchange fees (as it will continue to maintain standardised fees) and is concerned that the proposed Agreement may have the effect of increasing existing barriers to entry and may act to further entrench the high level of card issuer and merchant acquirer concentration.
- 5.138 Consistent with the findings of the Joint Study the Commission considers that reform of EFTPOS interchange fees is necessary in order to encourage competition and efficiency in the operation of the EFTPOS network. In turn this will contribute to the efficiency of Australia's payments system in general. The Commission notes however that the Applicants' proposal is intended to address only one element of the network deficiencies identified by the Joint Study – being interchange fees. The Commission notes that the Applicants have advised that access reform is beyond the scope of these applications for authorisation. The Commission nonetheless considers that, in the circumstances, the existence of high entry barriers has heavily influenced its consideration of the balance of benefits and detriments likely to flow from the proposed Agreement.

- 5.139 Having considered the arguments advanced by the Applicants and interested parties, the Commission is concerned that, in the circumstances, the public benefits likely to flow from the proposed Agreement are not sufficient to outweigh the anti-competitive detriment likely to flow from the proposed Agreement.
- 5.140 As noted previously, some interested parties have submitted that the Commission should impose conditions intended to:
- address deficiencies in access to the EFTPOS network by lowering existing barriers to entry;
 - ensure the pass through of card issuer savings; and
 - enhance cardholder price signals.
- 5.141 Section 91(3) of the Act provides that the Commission may grant an authorisation subject to such conditions as are specified in the authorisation. This power will be used by the Commission where it is concerned that there may be some uncertainty about whether, in the circumstances, the public benefit outweighs the competitive detriment.
- 5.142 However, prior to imposing conditions the Commission must be satisfied that the proposed conditions are likely to reduce this uncertainty by either increasing the public benefit or reducing the competitive detriment or both. In the circumstances presented the Commission considers that the imposition of conditions is unlikely to address this uncertainty. In particular it is the Commission's view that adherence to such conditions is likely to be highly subjective in nature and is therefore likely to create significant uncertainty as to whether a condition has been, and continues to be, complied with. Further, the Commission's ability to impose a condition on parties other than those who are subject to the authorisation, for example in relation to access, is questionable. Accordingly, the Commission considers that, in the circumstances, it would be inappropriate to grant conditional authorisation. Further, the Commission notes that a suitable access regime would be likely to address the concerns identified by interested parties at paragraph 5.140.
- 5.143 The Commission therefore proposes, subject to any pre-decision conference requested pursuant to section 90A of the Act, to deny authorisation to the Applicants in respect of applications A30224 and A30225.

Next steps

- 5.144 Following the release of the Commission's draft determination, the Applicants or any interested party dissatisfied with the draft determination may request that the Commission hold a pre-decision conference. The pre-decision conference provides parties with the opportunity to put oral submissions to the Commission in response to the draft determination. The Applicants and interested parties will also be invited to provide written submissions in relation to the draft

determination.

- 5.145 Once this process of consultation has been completed, the Commission will reconsider the applications for authorisation, taking into account the comments made at the conference (if one was requested) and any further submissions that were received, prior to issuing a written final determination.
- 5.146 As noted, the introduction of suitable access reform may change the balance of public benefit and anti-competitive detriment such that the Commission could authorise the proposed Agreement. The Commission is aware that the parties to this application alone are not in a position to introduce effective access reform. However, as the Applicants have submitted, such reform could potentially be addressed through amendments to the APCA CECS arrangements which are currently the subject of two applications for revocation and substitution (A30228 and A30229).

APCA applications for re-authorisation - CECS

- 5.147 The Commission has now commenced its process of public consultation in relation to the APCA applications for revocation and substitution of authorisations granted in relation to the CECS arrangements.
- 5.148 The Commission notes that a number of submissions have now been received from interested parties³⁷ in relation to the APCA applications and that some of these submissions have argued that the CECS authorisations are related to the EFTPOS interchange fee proposal and have provided comments in relation to the APCA's current consideration of access to the EFTPOS network within the context of the CECS arrangements.
- 5.149 It is noted that some interested parties have criticised the process of the APCA EFTPOS Access Working Group (EAWG). For example, Woolworths has expressed concern that the APCA has narrowed the considerations of EAWG to exclude consideration of the current network structure and has also expressed concern that the membership of EAWG is not representative of the EFTPOS network stakeholders. The ARA expressed similar concerns in relation to stakeholder representation within EAWG and has suggested that the EAWG be reconstituted to allow for broader stakeholder representation.
- 5.150 Westpac has noted that the initial focus of the EAWG, of which it is a member, has been to identify and address specific issues raised by stakeholders rather

³⁷ Including Coles Myer, the Australian Retailers' Association, Woolworths, the Motor Trades Association of Australia, the Honourable Merri Rose MP, the Honourable Jon Stanhope MLA, the Honourable John Kobelke MLA, Mr Peter Mair, Australia and New Zealand Banking Group, Council of Small Business Organisations of Australia, Queensland Retail Shop Traders & Shop Keepers Association, Optus, ACT Department of Justice and Community Safety, Bendigo Bank, St George Bank, the Commonwealth Bank, Westpac, MoneySwitch and the RBA. Copies of these submissions are available from the Commission's public register and an extension has been granted in relation to the period for providing submissions to the Commission.

than to specify an access regime. The submission provided by Bendigo Bank has noted that developing a solution to access is a significant and complex undertaking, and has expressed concern that, should this process be rushed, the solution may not be the most appropriate.

5.151 The RBA has noted that the current bilateral arrangements upon which the ATM and EFTPOS networks are based can, in practice, act as a significant barrier to new entrants and impose inefficiencies on current participants. It is the RBA's view that the APCA and its members need to develop a framework within the CECS rules to provide fair and open access to new and existing network participants based upon appropriate technical, financial and operational conditions. The RBA acknowledges the complexities of the current EFTPOS network but considers that there are a number of potential options and steps that could be taken to address access issues. In this regard the RBA has submitted that the basic principles for developing a framework for fair and open access to new and existing participants could be as follows:

- the CECS rules would provide the commercial basis for network access rights to all CECS members, including a positive obligation on the part of CECS members to engage in interchange activities with all other members;
- the CECS rules would incorporate all relevant commercial terms for interchange relationships, eliminating the need for bilateral interchange agreements on such matters;
- the CECS rules would provide rights to direct physical interchange links between CECS members, subject to appropriate efficiency-based criteria;
- APCA would establish a standard and transparent process for the establishment of new physical interchange links between CECS members, as well as for other operational steps required in establishing both direct, as well as indirect, interchange relationships;
- the technical requirements and procedures involved in establishing and operating direct physical interchange links would be further standardised through the CECS rules;
- the CECS rules would establish a fair and transparent access fee, or methodology for allocating costs, for the establishment of direct physical interchange links between CECS members;
- APCA would establish and enforce deadlines for CECS members to meet their obligations under these access conditions; and
- CECS membership categories would be reviewed to ensure they are sufficiently broad to allow all potential participants in the EFTPOS network to be afforded appropriate access rights.

5.152 The RBA is of the view that the APCA and its members should commit to developing access conditions consistent with these principles and to agree on a clear timetable for this process. Further, the RBA noted that whilst implementation of these conditions is likely to take some time, it nonetheless considers that the industry is now well placed to commit to developing a general framework for EFTPOS network access in the next few months, and to

developing proposed changes to the CECS rules to implement this framework by early 2004.

- 5.153 The Commission notes that the RBA may, if it considers it to be in the public interest, exercise its regulatory power under the PSRA to designate the EFTPOS network and to set interchange fee standards or impose an access regime in relation to the EFTPOS network.
- 5.154 The Commission considers that a commitment to suitable access reform that establishes an appropriate timeframe (or in the absence of such commitment, action by the RBA) could go some way to addressing the uncertainty associated with this proposal. Whilst the Commission notes that the APCA review of access arrangements is not within the scope of these applications for authorisation, it nonetheless considers that this process may provide a suitable forum for the Applicants and interested parties to further their considerations and address access reform in a way that may satisfy the Commission's concerns in respect of the proposal before it in these applications.
- 5.155 In particular the Commission invites submissions addressing the EFTPOS access reform principles that have been identified by the RBA, and the prospects of a commitment to these principles in accordance with its proposed timetable.

Draft Determination

Applications A30224 and A30225

- 6.1 On 21 February 2003 Australia and New Zealand Banking Group, Australian Settlements Ltd, Bank of Queensland, Bank of Western Australia Ltd, Bendigo Bank, Cashcard Australia Ltd, Commonwealth Bank of Australia, Credit Union Services Corporation (Australia) Ltd, National Australia Bank, St. George Bank Ltd, Suncorp Metway Limited, Westpac Banking Corporation (the Applicants) lodged applications for authorisation A30224 and A30225.
- 6.2 The applications relate to an Interchange Fee Agreement (**Attachment A**) that broadly provides for the introduction of a collective electronic funds transfer at point of sale ('EFTPOS') interchange fee of zero and for the review of the zero interchange fee approximately every three years or at any other time if there is a material change in circumstances with the consent of the parties.
- 6.3 In lodging the applications authorisation has been sought:
- to make and give effect to a contract, arrangement, or understanding a provision of which would be or might be an exclusionary provision within the meaning of section 45 of the *Trade Practices Act 1974* (A30224); and
 - to make and give effect to a contract, arrangement, or understanding a provision of which would have the purpose or would have or might have the effect of substantially lessening competition within the meaning of section 45 of the *Trade Practices Act 1974* (A30225).
- 6.4 The Applicants have identified three aspects of the Interchange Fee Agreement for which authorisation has been sought, being provisions concerning:
- the setting of EFTPOS interchange fees;
 - the response to inconsistency with contractual obligations; and
 - the process for review and monitoring of the interchange fee arrangements.
- 6.5 The applications were also expressed as applying to any other person who subsequently becomes a party to the proposed Agreement pursuant to section 88(10) of the Act.

Statutory test

- 6.6 For the reasons outlined in chapter 5 of this draft determination, the Commission is not satisfied that the conduct for which authorisation is sought under subsection 88 (1) of the Act in respect of provisions which would be or might be exclusionary provisions would be likely to result in such a benefit to the public that it should be allowed to be made and given effect to (A30224).
- 6.7 For the reasons outlined in chapter 5 of this draft determination, the Commission is not satisfied that the conduct for which authorisation is sought under subsection 88 (1) of the Act in respect of provisions which would have

the purpose or would have or might have the effect of substantially lessening competition within the meaning of section 45 Act would be likely to result in a benefit to the public and that this benefit would outweigh the detriment to the public constituted by any lessening of competition that would be likely to result from the contract, arrangement or understanding (A30225).

The Commission therefore proposes, subject to any pre-decision conference requested pursuant to section 90A of the Act, to deny authorisation to the Applicants in relation to applications A30224 and A30225.