U.S. Department of Justice

Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

June 23, 2008

The Honorable Lamar Smith
Ranking Member
Committee on the Judiciary
United States House of Representatives
Washington, D.C. 20515

Dear Congressman Smith:

This responds to your letter, dated June 2, 2008, requesting the Department of Justice's views on H.R. 5546, the "Credit Card Fair Fee Act of 2008". We appreciate the opportunity to provide the Department's views.

Section 2(c) of this bill creates a broad immunity under the antitrust laws for merchants and issuers jointly to negotiate interchange fees and terms of access to a credit and/or debit card network above a certain size. For all merchants and issuers that are unable to reach agreement, section 3 of the bill establishes a panel of Electronic Payment System Judges that will establish access rates and terms. The Payment System Judges are to be appointed and supported by the Antitrust Division and the Federal Trade Commission Bureau of Competition, an arrangement that the Department believes conflicts with the Appointments Clause, as discussed further below.

The antitrust laws are the chief legal protector of the free-market principles on which the American economy is based. Companies free from competitive pressures have incentives to raise prices, reduce output, and limit investments in expansion and innovation to the detriment of the American consumer. Accordingly, the Department has historically opposed efforts to create sector-specific exemptions from the antitrust laws. The Department believes that antitrust exemptions can be justified only in very rare instances, when the fundamental free-market values underlying the antitrust laws are compellingly outweighed by a clearly paramount and clearly incompatible public policy objective. Moreover, any such legislation establishing an antitrust exemption should be narrowly drawn and carefully tailored to avoid unintended consequences. Consequently, the Department has serious concerns about this legislation for a variety of reasons.

First, this bill may actually harm to consumers, not benefit them. The credit and debit card markets are complex, so-called "two-sided" markets in that each network needs to attract both cardholders and merchants. Pricing on one side of the market impacts the pricing on the other side. For example, newspapers charge less to readers in order to increase sales and circulation, thereby making their paper more attractive to advertisers. Revenues from advertisers support the lower prices to readers. Similarly, credit card networks forced by regulation to collect less from merchants may well respond by charging more to cardholders in card fees, or reducing card rewards programs and other features that are attractive to consumers. Indeed, a recent GAO Report, *Credit and Debit Cards*, GAO-08-558 (May 2008), suggests this may be what happened in Australia when Visa and MasterCard's interchange rates where capped. The

GAO reported that "consumers have experienced a decline in the value of credit card reward points for most cards and an increase in annual and other consumer credit card fees." GAO Report at 35. Although there remains the important question of whether consumers paid sufficiently less for credit card purchases to compensate for these effects, the GAO Report does raise questions regarding whether legislation regulating rates on one side of the network would benefit competition and consumers.

Second, the bill seeks to counter perceived market power on the part of large credit card networks by establishing market power on the part of merchants negotiating with those networks. It would do this by exempting from the antitrust laws joint negotiations of merchants with any network electronic payment system that has been used for at least 20% of the combined dollar value of U.S. credit, signature-based debit, and PIN-based debit card payments. From a policy perspective, the Department does not support legislatively establishing a buy-side monopoly (or monopsony) to counteract any existing market power. Such a result may well increase, not decrease any existing harm to competition and consumers. Indeed, the joint negotiations among merchants exempted by the bill appear to be the type of naked collusion that the antitrust laws condemn as per se unlawful because such conduct lacks plausible benefits to competition. Moreover, the ability of merchants (and issuers) to discuss, jointly negotiate, and agree upon fees and terms with one network could lead to an implicit understanding on what fees and terms to accept from other networks, including networks not encompassed by this legislation. Such a spillover effect would diminish, not enhance, competition between payment card networks, which is the best and most productive way to ensure that consumers are protected and benefitted.

Third, suppressing competition pursuant to what is essentially price-control legislation is likely to be inefficient and costly, thereby harming consumers. Section 3 of this bill creates a panel of Electronic Payment System Judges that would resolve disputes if issuers and merchants were unable to voluntarily reach a jointly-negotiated agreement. The Department does not support the creation of a regulatory panel to set rates and terms of access. Generally, regulation should be confined to the fewest areas possible, and even then should be narrowly tailored to address a clearly demonstrated market failure. Notwithstanding the best of intentions and goals, the regulator will be imperfect in its attempt to replicate the terms that would be reached in a competitive market. Moreover, a panel of regulators cannot replicate the flexibility that is found in the free market. This bill imposes inflexibility into the terms and fees by requiring all terms to apply across all merchants and issuers that do not reach an agreement and by setting the same fee and terms for a period of two or three years.

Fourth, the Department believes that the method of appointment of Payment System Judges in section 3 conflicts with the Appointments Clause. By giving Payment System Judges authority to issue binding decisions setting rates and terms of access to credit card networks, as well as authority to assess civil penalties for failure to comply with collateral orders, the bill appears to vest a portion of the sovereign authority in the Payment System Judges, making them "Officers of the United States" for purposes of the Appointments Clause. *See* Memorandum

Opinion for the General Counsels of the Executive Branch, *Officers of the United States Within the Meaning of the Appointments Clause* at 1, 12-13 (Apr. 16, 2007), available at http://www.usdoj.gov/olc/2007/appointmentsclausev10.pdf ("delegated sovereign authority . . . is power lawfully conferred by the Government to bind third parties," and includes power to "issue regulations and authoritative legal opinions" and "impose penalties"). The Payment System Judges would likely be inferior, rather than principal officers, because the bill gives the Antitrust Division and Federal Trade Commission Bureau of Competition authority to sanction or remove Payment System Judges; accordingly, Congress may only vest authority to appoint these officers "in the President alone, in the Courts of Law, or in the Heads of Departments." U.S. Const. art. II, § 2, cl. 2; *see Edmond v. United States*, 520 U.S. 651, 662-63 (1997) (stating, as a general rule, that "'inferior officers' are officers whose work is directed and supervised at some level by others who were appointed by Presidential nomination with the advice and consent of the Senate"). The Antitrust Division and Federal Trade Commission Bureau of Competition do not fall within any of these categories and therefore may not statutorily be granted authority to appoint the Payment System Judges.

In addition to these constitutional concerns, the process outlined in sections 3 and 4 of this bill imposes significant burdens on the Antitrust Division and the Federal Trade Commission Bureau of Competition. This bill requires the Antitrust Division to consult with Payment System judges and issue or approve regulations relating to proceedings. The Antitrust Division is a law enforcement agency. It has not performed these functions in the past, does not have the resources to do so currently, and such a requirement likely would detract from the Division's law enforcement mission. The administrative support the agencies are expected to provide the Electronic Payment System judges—by, for example, representing the tribunal of judges before the Circuit Court—is likely to impose substantial burdens, as litigation is almost certain to arise from any decisions of the tribunal and is likely to be extensive and complicated.

For the foregoing reasons, the Department has serious concerns about this bill and the burdens the bill imposes on the Antitrust Division and the Federal Trade Commission Bureau of Competition.

Please do not hesitate to call upon us if we may be of additional assistance. The Office of Management and Budget has advised us that from the perspective of the Administration's program, there is no objection to submission of this letter.

Sincerely,

Keith B. Nelson
Principal Deputy Assistant Attorney General

cc: The Honorable John Conyers, Jr.
Chairman