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THE ONLINE MAGAZINE FOR GLOBAL COMPETITION POLICY
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Congress and the Courts

Tackle Credit Card Fees at Service Stations

David M. Rodi [*]

With the recent increase in motor fuel prices in the United States, the credit card processing fees paid by service station owners have come under increased scrutiny from both the U.S. Congress and the courts. Most credit card fees are calculated as a percentage of the transaction value. Because US$4-per-gallon gasoline leads to a higher total transaction amount for each fill-up, retailers complain that the resulting increase in credit card fees is eating into or completely consuming their retail margin on each gallon of fuel. National and local media have highlighted this issue, usually presenting the plight of the service station owners as yet another ill-effect of high fuel prices.

Congress has taken notice, too. In March, Representative John Conyers (D-MI) introduced the Credit Card Fair Fee Act of 2008,[1] which would grant merchants an exemption from the antitrust laws in order to allow them to band together and jointly negotiate with credit card companies over fees. The bill, which was passed out of the House Judiciary Committee in July, also would create a new administrative panel of

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[1] H.R. 5546, 110th Cong. (2008).

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"Electronic Payment System Judges" to determine the rates for credit card processing in the event that merchants cannot reach voluntary agreement with the card companies.

Meanwhile, the federal courts have been wrestling with antitrust challenges to the credit card processing requirements that the major oil companies impose on their dealers and wholesalers. In two recent cases, both the U.S. Court of Appeals for the Seventh Circuit and the U.S. Court of Appeals for the Ninth Circuit have rejected allegations that the oil companies' credit card requirements constitute illegal tying under the Sherman Act. Whether these recent decisions will give greater impetus to the Credit Card Fair Fee bill remains to be seen.

I. RETAILER COMPLAINTS ABOUT CREDIT CARD FEES

According to estimates by the National Association of Convenience Stores ("NACS"), between 60 percent and 70 percent of motor fuel purchases in the United States are made by credit or debit card.[2] In 2006, credit card fees paid by the convenience store industry (including service stations) totaled US$6.6 billion. NACS calculates that credit card fees are the second-largest operating expense for convenience store owners, behind only labor costs.

Credit card fees include two primary components: an interchange fee and a merchant discount fee. When a merchant accepts one of the major credit cards for payment, the merchant presents the transaction slip (or its electronic equivalent) to the merchant's bank, which is called the "acquiring bank." In turn, the acquiring bank presents the transaction to the "issuing bank" (which issued the card to the customer) via

[2] *See* The Association for Convenience and Petroleum Retailing, Fact Sheet, Credit Card Fees a Growing Challenge for Convenience Stores (Feb. 1, 2008), *available at* http://www.nacsonline.com.

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one of the credit card companies (e.g., Visa, MasterCard, etc). The issuing bank then pays the transaction amount to the acquiring bank, less an "interchange" fee that is paid to the relevant credit card company. The interchange fee averages about 2 percent of the transaction value, although rates vary by industry and by the size of the merchant.

When the acquiring bank receives the funds from the issuing bank, the acquiring bank credits the merchant's account for the amount of the transaction, less the interchange fee and, often, less an additional 1 percent "merchant discount fee" that the acquiring bank charges for its services. Thus, in total, the merchant pays about 3 percent of the transaction value in processing fees on each credit card transaction. Debit card transactions involve similar fees, which are typically lower.[3]

For service station owners, the problem stems from the fact that the nominal amount of gasoline purchase transactions has increased substantially over the past year, while the retailer's per-gallon margin has not. Typically, the average retail markup on a gallon of gasoline is US$0.10 to US$0.15 over the wholesale cost. Out of that markup, the retailer must cover the cost of station operations, labor, and credit card fees before realizing any profit from fuel sales.[4] As the retail price of gasoline has reached US$4 per gallon or more, the 3 percent credit card processing fee associated with the sale of each gallon has increased to US$0.12 per gallon or more, thereby eroding the retailer's profit margin on such sales.

[3] For a concise overview of the credit card payment system and the associated fees, *see* Kendall v. Visa U.S.A., Inc., 518 F.3d 1042 (9th Cir. 2008).

[4] Of course, most service station owners also offer convenience store items and other ancillary services, which often are more profitable than the sale of gasoline itself.

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In response to retailer complaints about the escalating fees, in 2007, MasterCard announced that it would limit its interchange fee to the first US$50 of each motor fuel purchase. In a similar move, Visa announced in June 2008 that it will reduce its interchange rates for fuel transactions and implement other processing and rate changes. These responses from the credit card industry, however, have not been sufficient to stave off the threat of federal legislation.

II. CONGRESS REACTS: THE CREDIT CARD FAIR FEE BILL

Reacting to publicity about the impact of credit card processing fees on service station owners, Congressman Conyers introduced the Credit Card Fair Fee bill in March. Rep. Conyers explained that the bill "would help level the playing field for merchants and retailers" by giving them a seat at the negotiating table when interchange fees are determined.

The bill would grant limited antitrust immunity to any group of merchants that wanted to jointly negotiate with the owners of a credit card network like Visa or MasterCard in order to establish "the rates and terms for access" to that network. Although largely inspired by the perceived plight of gasoline retailers, the bill is not limited to merchants in any particular industry.

The bill also would create a panel of three Electronic Payment System ("EPS") Judges who would be empowered to set the rates and terms applicable to any credit card syndicate that did not reach voluntary agreements with some of its merchants. The EPS Judges would be appointed jointly by the U.S. Department of Justice's ("DOJ's")

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Antitrust Division and the U.S. Federal Trade Commission. For each credit card network, the EPS Judges would be directed to determine the rates and terms which most closely approximate those in "a hypothetical perfectly competitive marketplace." Elsewhere, however, the bill appears to limit the EPS Judges' discretion in setting terms, requiring them to choose "without modification" between the final proposal presented by either the credit card consortium or the merchant group during the parties' failed negotiations.[5]

The rates and terms determined by the EPS Judges would be effective for two- or three-year periods, and they would apply to all merchants who did not reach a voluntary agreement with the particular credit card consortium at issue. The bill would require the panel to establish a single, across-the-board rate for each consortium, with none of the current variation based on the merchant's industry or volume of transactions.

Not surprisingly, the Antitrust Division has expressed "serious concerns" about the bill, characterizing it as "essentially price-control legislation." The Division's opposition is largely based on the DOJ's traditional resistance to the creation of industry-specific exemptions from the antitrust laws. The Division has noted that the anticipated joint negotiations by groups of merchants "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." In fact, the Division has warned that "this bill may actually harm consumers, not benefit them," citing the experience of Australia, where the annual

[5] The Senate version of the bill makes clearer that the intent is to limit the EPS Judges to choosing between the parties' final negotiating positions in a procedure akin to so-called baseball arbitration. *See* S. 3086, 110th Cong. § 2(d)(2)(C).

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credit card fees paid by *consumers* increased after the interchange fees paid by merchants were capped.[6]

Despite the Antitrust Division's strong opposition, the bill was reported out of the House Judiciary Committee on July 16, 2008, with bipartisan support from ten Democrats and nine Republicans. The bill's ultimate fate no doubt will be impacted by whether the price of gasoline remains high, and whether service station owners continue to receive sympathetic press coverage of what they describe as a credit card price squeeze.

III. COURTS UPHOLD THE STATUS QUO: THE *SHERIDAN* AND *RICK-MIK* DECISIONS

While some members of Congress have been working to provide service station owners and other merchants an antitrust exemption for their negotiations with credit card companies, at least two federal circuit courts have rejected antitrust challenges to the major oil companies' credit card policies.

In order to create a uniform customer experience at all of their branded stations, most major oil companies have policies that require dealers and wholesalers to accept a standard suite of major credit cards. Typically, the parties' contracts require the retailer to process credit card transactions in accordance with a set of standard procedures adopted by the oil company. Often, the oil company will arrange to have all of its retailers' transactions processed by one or more preferred acquiring banks with which the company

[6] Letter from Keith B. Nelson, Principal Deputy Assistant Attorney General, U.S. Department of Justice, to Hon. Lamar Smith, Ranking Member, U.S. House Committee on the Judiciary 1-2 (Jun. 23, 2008), *available at* http://www.usdoj.gov/ola/views-letters/110-2/06-23-08-hr5546-credit-card-fair-fee-act.pdf.

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has negotiated special rates. One advantage of such a system is that the acquiring bank typically will route payment for credit card transactions through the oil company, which offsets the funds against what the retailer owes for product deliveries and rent. This both improves the retailer's cash flow and speeds up payment to oil company.

Retailers, however, sometimes complain that the oil company policies lock them into using a single card processing provider and deny them the opportunity to negotiate directly with banks for lower rates. Two recent cases were filed, one by a Marathon dealer in Indiana and one by a Shell dealer in California, alleging that the oil company policies constituted illegal tying under the Sherman Act because the refiners had improperly limited dealers' freedom to choose their own credit card processor. In each case, the dealer's theory was that the oil company had illegally tied together two separate products by requiring dealers to use a particular processing provider as a condition of obtaining a branded service station dealership.

Unfortunately for the dealers, the district courts in both cases dismissed their complaints as a matter of law, and the appellate courts affirmed. In *Sheridan v. Marathon*,[7] Judge Richard Posner pointed out that, as a prerequisite to asserting a tying claim, the plaintiff must allege that the defendant holds monopoly power in the relevant market. Examining the dealer's complaint, Judge Posner concluded that Sheridan had not alleged that Marathon, the nation's fifth-largest refiner, has monopoly power in the market for gasoline or the market for service station franchises. Of course, Marathon holds a "monopoly" over Marathon-branded dealerships. But, as Judge Posner noted,

[7] Sheridan v. Marathon, 530 F.3d 590 (7th Cir. 2008).

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"'Marathon' is not a market; it is a trademark; and a trademark does not confer a monopoly" in the classic antitrust sense. Therefore, the Seventh Circuit concluded that Sheridan's allegations failed to state a claim for tying under the Sherman Act because there was no allegation that Marathon exercised market power.

Three weeks later, in *Rick-Mik Enterprises v. Equilon*,[8] the Ninth Circuit reached a similar conclusion in a virtually identical case challenging Shell's credit card policy. (Equilon is an affiliate of Shell.) Echoing Judge Posner's reasoning in *Sheridan*, the Ninth Circuit held that Rick-Mik had failed to state a cognizable claim for tying because the "complaint does not allege that [Shell] has market power in the relevant market, which is the market for the tying product—gasoline franchises." The Ninth Circuit went on to note that franchises and dealerships "almost by definition, necessarily consist of 'bundled' and related products or services—not separate products." Tying claims, by contrast, must involve a seller's attempt to link two distinct products that a buyer could reasonably be expected to purchase separately. Therefore, because Shell's "franchises are not a separate and distinct product from the credit card processing services that are part of the franchise," the Court concluded that Rick-Mik's tying theory was fatally flawed.

IV. CONCLUSION

With two such definitive appellate decisions coming within a few weeks of each other, it seems unlikely that service station owners will be able to use antitrust litigation as a tool to change oil companies' credit card processing policies anytime in the near future. On the other hand, station owners have had some success at using the media to

[8] Rick-Mik Enterprises v. Equilon, 2008 WL 2697793 (9th Cir. Jul. 11, 2008).

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obtain voluntary rate relief from MasterCard and Visa. The next big test will be whether the station owners and other merchants can parlay favorable media coverage into the passage of the Credit Card Fair Fee bill, despite strong opposition from the credit card companies and the substantive concerns raised by the Antitrust Division.

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