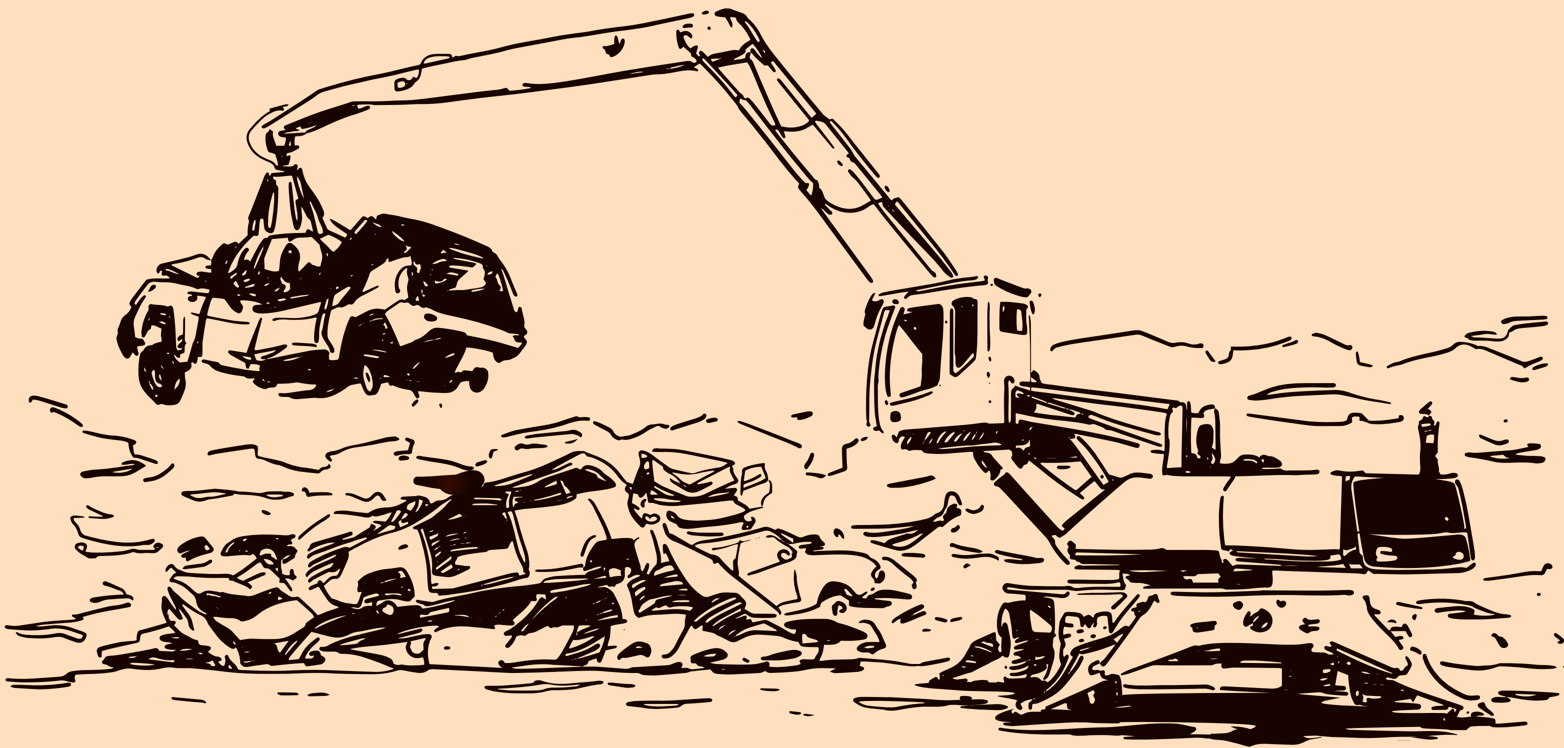
JUNKYARD DOGS: THE LAW AND ECONOMICS OF "JUNK" FEES



BY HOWARD BEALES & TODD ZYWICKI[1]

1 Howard Beales is Emeritus Professor of Strategic Management and Public Policy, George Washington School of Business and was a member of the Taskforce on Federal Consumer Financial Law. Todd Zywicki is George Mason University Foundation Professor of Law, Antonin Scalia School of Law, and was chairman of the Taskforce on Federal Consumer Financial Law.

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By Howard Beales & Todd Zywicki

The notion of "junk" fees is a fine piece of rhetoric, but useless as an analytical tool. Many fees identified as junk impose costs on consumers who generate those costs – rather than forcing others to subsidize their behavior. For example, credit card late fees deter late payments and their associated costs while only world travelers pay foreign currency transaction fees. There is no reason for ordinary consumers to subsidize either group. Because information is costly, consumers rationally focus on the elements of price that are most important in their own circumstances. Requirements to disclose everything everywhere will only interfere with this process. Both the structure of pricing, and the level of prices, should be determined by competition in the marketplace. As we observe, the result is detailed fee structures for some products and services, and bundled pricing for others. Attempts to regulate pricing structures by requiring itemized prices increased the costs of real estate settlements. Regulating components of credit card pricing structures led to increases in other fees and reductions in credit availability. Competition over pricing structures is far more likely to satisfy consumer preferences than an inevitably overbroad set of regulatory requirements.

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As part of its agenda of advancing "competition," the Biden Administration has launched a regulatory assault on "junk" fees. Last January, the Consumer Financial Protection Bureau ("CFPB") published a request for information regarding fees for financial services.[2] It also issued a circular on unexpected overdraft fees, a compliance bulletin on returned deposit item fees, an advisory opinion on debt collection pay to pay fees, in addition to an enforcement action against Region Bank for "surprise" overdraft fees,[3] and most recently, issued a proposed rule reducing late fees for credit cards.[4] In July, the Federal Trade Commission (FTC) cited "junk" fees as part of the rationale for its proposed Motor Vehicle Dealers Trade Regulation Rule,[5] and in November, it published an Advance Notice of Proposed Rulemaking to address junk fees for all firms subject to its jurisdiction.[6] The Department of Transportation has proposed a rule requiring upfront disclosure of airline fees, including baggage and charges for changing a ticket. And the FCC has proposed a "broadband nutrition label" requiring various disclosures about broadband pricing.[7]

Of course, sellers frequently offer additional goods or services for an additional price. The Administration recognizes that a pizza seller can charge for additional ingredients, and a hotel can charge extra for a room with a better view. So which fees are "junk?" The Administration's definition focuses on the "purpose" of the fee, defining as junk fees that are "designed to either confuse or deceive consumers or to take advantage of lock-in or other forms of situational market power."[8] One could certainly argue, however, that charges for extra pizza ingredients take advantage of "situational market power" – no one is going to shop elsewhere for onions to add to their pizza. Similarly, the hotel fortunate enough to have a view would seem to have "situational market power" – there is no other way to acquire the view. The FTC's definition is similarly vague, identifying as "junk" fees "for goods or services that have little or no added value to the consumer" and fees disclosed at a later stage of the purchasing process "whether or not the fees are described as corresponding to goods or services that have independent value to the consumer."[9] The former would seem to lead to arguments about whether the extra pizza ingredient had "little or no added value," and the later would seem to reach the hotel's offer to upgrade the view at check-in.

The economics literature addresses two different kinds of fees, both of which the Biden Administration seems to regard as junk. Some pricing structures are based on partitioned fees, where an overall price is divided into separate prices for separate components (e.g. a separate price for shipping and handling). Others are based on what is known as "drip" pricing, in which one price is featured initially but costs of other components are revealed later in the buying process (e.g. a rental car base price with charges for optional insurance revealed at the time of the contract). Pricing structures may combine these features, as when shipping and handling charges are only revealed at checkout. However, we are not aware of anyone in the law and economics literature who regards all fees of either type as problematic. Instead, careful analysis recognizes that while certain price structures may pose problems for consumers in some circumstances, both structures are efficient in some cases. Separate prices for additional pizza ingredients is surely an efficient use of partitioned pricing, and separate prices for printers and ink or toner cartridges is likely an efficient use of drip pricing. In other situations, however, disclosing fees only on the back-end of a transaction or unnecessarily unbundling prices into multiple parts might provide no consumer benefit and instead might be designed to confuse consumers into paying a higher price, to raise search costs to finding the best deal, or to extract consumer surplus from consumers who have already made an investment of time or energy into shopping.

Rather than reflecting a *lack* of competition, we argue that observed pricing structures are the *outcome* of competition. Just as we rely on competition to determine the right price for goods and services, we should rely on competition to establish the structure of prices. Absent clear evidence of a market failure, regulatory fiats to change these structures are likely to reduce consumer welfare.

I. PRICING STRATEGIES ARE MARKET DETERMINED

A key choice for any seller concerns its pricing strategy, the subject of numerous courses in marketing and economics. Sellers can choose simple unit pricing, a multi-part tariff, offering different versions at different prices, bundling products in different ways, and a host of variations of each

2 https://www.regulations.gov/document/CFPB-2022-0003-0001.

3 See https://www.consumerfinance.gov/rules-policy/junk-fees/.

4 https://www.consumerfinance.gov/rules-policy/notice-opportunities-comment/credit-card-penalty-fees-regulation-z/.

5 https://www.regulations.gov/document/FTC-2022-0046-0001.

6 https://www.regulations.gov/document/FTC-2022-0069-0001.

7 Brian Deese, Neale Mahoney & Tim Wu, The President's Initiative on Junk Fees and Related Pricing Practices, October 26, 2022, https://www.whitehouse.gov/briefing-room/blog/2022/10/26/the-presidents-initiative-on-junk-fees-and-related-pricing-practices/. ("White House Initiative").

8 White House Initiative.

9 FTC ANPRM.

strategy. One factor driving these choices is that different consumers assign different values to the various elements of a product or service. A single price may cost sales to some consumers who attach less value to the product; a more complex pricing structure may enable a firm to sell both to consumers with high and low valuations of the product.

Most relevant to junk fees is that sellers must balance consumers' desire to pick-and-choose what they pay for against the simplicity of an all-inclusive price. "Pick and choose" pricing can result in a bewildering list of seemingly small "ticky-tack" fees. One-size fits-all-pricing requires some consumers to pay for services they don't actually use. And, of course, sellers must recover their costs.

In many industries, pricing is all in – a single upfront price entitles us to the full range of what may be a complicated bundle of services. Typical pricing plans for cable TV, cell phone service, or internet service providers are examples. Consumers choose the package they want up front and pay a price up front.

In other industries, sellers offer an upfront price for the basic service, with a variety of additional, optional fees for other services. Air transportation is one example. We pay one price for a seat on the plane, and additional fees if we want to check baggage or purchase food or beverages. Some markets have a combination of some firms providing all-in and others unbundled pricing, such as the airline industry where many airlines charge fees for flight changes and baggage while Southwest offers free bags and schedule changes all for one price, a phenomenon most likely explained by the differential elasticity of demand of Southwest flyers versus the business flyers who are willing to pay more for more amenities and convenience on other airlines.[10] Similarly, we can purchase an all-in vacation package, or we can choose a separate hotel and build our own package.

Unbundled pricing is particularly attractive when only some consumers choose certain services because unbundling allows those who want additional services to obtain it without shifting the costs to others who do not. The all-in vacation is likely a particularly bad deal for someone who does not drink, because the upfront price must cover the often-significant alcohol consumption of those who do.

Similarly, separate behavior-based fees are often designed to impose costs on consumers who generate them – rather than forcing others to subsidize their behavior. Credit card late fees deter late payments and their associated costs (including the elevated risk of subsequent delinquency and default) while only world travelers pay foreign currency transaction fees. A single upfront price would require the rest of us to subsidize both delinquents and globe trotters, hardly an equitable outcome. Government use of gasoline excise taxes that impose the costs of road maintenance on those who use roads the most is similar, as are user fees for a variety of regulatory "services."

The effects of separate fees on consumer behavior may also reduce the cost on providing a product or service, leading to lower prices for all consumers. Cancellation fees, for example, reduce consumer abuse of cancellation policies, and late checkout fees reduce overstays that can increase costs.[11]

Absent regulatory intervention, different pricing plans are the result of competitive markets. Before airline deregulation, for example, airline prices were all in, including baggage handling, food, and often a first run movie. When competition was finally allowed, current pricing plans developed because they offered benefits, particularly to those who just wanted low-cost transportation without the need to subsidize baggage handling for those who needed it. Competition can also lead to upfront pricing, if that is what consumers prefer. For example, early cell phone pricing schemes were complex, with separate prices for incoming calls, outgoing calls, text messages, and various other features. Competitive pressure to attract consumers who found such plans confusing, along with changes in technology, led to the much simpler pricing plans that prevail today.[12]

The term "junk fees" defies easy definition. But it is imperative to distinguish "junk fees" that are designed to extract rents and consumer surplus from consumers from efficient, behavior-based fees. Welfare-reducing "junk" fees are most likely to emerge only under a relatively narrow set of market conditions — particularly those markets with few repeat customers where consumers are less likely to learn of the hidden fees, where consumers are effectively locked-in and unable to avoid paying the fee when it is imposed, or where such fees may be atypical and thus consumers are not alert to them.

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10 See Geoffrey Manne & Todd J. Zywicki, *Uncertainty, Evolution, and Economic Theory*, 10 J. L., Econ. & Pol'y 555 (2014).

11 Ancarani, F., Gerstner, E., Posselt, T., & Radic, D. (2009). Could higher fees lead to lower prices? *Journal of Product & Brand Management, 18*, 297–305. doi:10.1108/10610420910972828.

12 E. Miravete & I. Palacios-Huerta, Consumer Inertia, Choice Dependence, and Learning from Experience in a Repeated Decision Problem, 96 Review of Economics and Statistics 524-537 (2014).

One example is the growing practice of merchants imposing credit card "surcharge" fees on consumer retail transactions.[13] Under this scheme, merchants can post a lower price up-front while a consumer invests time and energy in shopping then can charge a consumer a higher price during the check-out process. At that point a consumer planning to pay by card has the option of abandoning the transaction and starting over at a new merchant or simply paying the higher price.[14] This practice would be expected to be most common in locations such as tourist areas where most consumers are not repeat customer and so are unable to learn until it is too late.

This ability to extract economic wealth from consumers in these situations likely explains merchants' preferences for imposing credit card surcharges rather than offering cash discounts which are mathematically identical in effect, but do not provide these same opportunities for wealth extraction.[15] The key question is whether consumers know about the charge before they have incurred costs assuming that they can use a credit card. Many gas stations, for example, post the cash price and add an additional amount per gallon if the consumer uses a credit card. But consumers know both prices at the time they decide how to pay, and before they have pumped any gas.

Consider, for example, the "resort fee" charged by some hotels, widely alleged to be a pricing technique to raise consumer's search costs and thereby increase the amount the hotel can charge.[16] If that were the case, we might expect that such fees are nearly universal. In fact, however, only 7 percent of U.S. hotels charge resort fees, and they are mostly used by resort hotels in resort markets, such as Orlando or Las Vegas.[17] Booking sites provide lists of both the amount of the fees and the hotels that do not charge them – including many well-known hotel brands.[18] Search costs are only increased if the products offered by competing hotels are all the same, and the whole point of resort fees is that they are not. An experimental study found that consumers in fact pay more attention to attributes that have a separate price than when prices are bundled.[19] A separate price for the amenities arguably makes it easier to consumers to determine whether they are worth the cost. And it surely isn't surprising that amenities are more important for resort properties in resort destinations.

On the other hand, mandatory resort fees could be problematic. They are most prominent in resort areas where consumers are unlikely to be repeat customers. While the room fee is clearly disclosed and assessed at the time of booking, resort fees may not be disclosed until they are assessed at the property, by which time it is too late for the consumer to avoid paying them (especially if the room is prepaid, which is often the case). A separate fee disclosed up front does not have this drawback, even if it is stated separately from the room rate rather than added it.

II. THE COSTS OF INFORMATION

Effective competition, of course, depends on adequate information in the hands of consumers. Information, however, is costly. Consumers must spend time and cognitive effort to determine how the various components of a pricing structure will affect the ultimate cost of the purchase to them. That cost depends not only on the pricing structure, but also on how a particular consumer will use the product. The cost of ink cartridges, for example, is a significant component of the cost of a printer, but the relative importance of ink costs and the initial purchase price depends on how much a consumer is likely to print over the useful life of the printer. Indeed, charging more for ink and less for the printer allows the seller to charge more to the heavy users who print a great deal, while still selling to household users who need a printer but do not use it often. Similarly, the significance of overdraft fees on a deposit account depends on how often the consumer makes purchases exceeding the available funds.

Because information is costly, it will not pay for consumers to acquire full information. Instead, they will acquire more information only until the benefits of additional information just equal the incremental cost. Because usage patterns differ, some consumers will rationally pay more attention to certain components of the price than will others. For the light printer user, the payoff to additional information about the price of ink is less than it is for the heavy user. The consumer who maintains a significant balance or closely monitors the balance is similarly less likely to

13 See Todd J. Zywicki, Geoffrey A. Manne, and Kristian Stout, *Behavioral Economics Goes to Court: The Fundamental Flaws in the Behavioral Law & Economics Arguments Against No-Surcharge Laws*, 82 Missouri L. Rev. 769 (2017).

14 See id.; see also Helene Bourguignon, Renato Gomes, & Jean Tirole, *Card Surcharges and Cash Discounts: Simple Economics and Regulatory Lessons*, 10 Competition Pol'y Int'l 12 (2014).

15 Zywicki, et al., *Behavioral Economics, supra* note.

16 See e.g. Mary Sullivan, Economic Analysis of Hotel Resort Fees, Bureau of Economics, Federal Trade Commission, January 2017.

17 John O'Neill and Donna Quadri-Felitti, "Resort Fees and Service Fees in the U.S. Hotel Industry: Context and Concepts Related to Partitioned Pricing," ICHRIE Research Reports: Vol. 2: Iss. 1, Article 1, 2017. Available at https://via.library.depaul.edu/ichrie_rr/vol2/iss1/1.

18 See e.g. https://www.lasvegasjaunt.com/resort-fees/. Hotels with no fees in January 2023 include several Marriott and Wyndham properties, and hotels generally promoted as "economy" brands such as Embassy Suites or Travelodge.

19 Bertini, M., & Wathieu, L. (2008), Attention arousal through price partitioning. Marketing Science, 27(2), 236–246.

seek out, or pay attention to, information about overdraft fees. Consumers who regularly pay their credit cards in full will seek information about rewards, not finance charges; those who regularly carry a balance will be far more interested in the interest rate.

Markets can achieve competitive outcomes even though some consumers are not informed, because sellers will compete for those who do seek out information. As long as the informed minority is large enough to be worth competing for, the result is the same outcome that would prevail with full information for all consumers.[20]

Disclosure may help to address part of the search problem, but it cannot eliminate the problem of costly information. At best, a disclosure might list the components of the pricing structure, but it cannot identify which component is, or should be, most important to an individual consumer. Consumers must still choose which components of the price are most significant to them. A disclosure giving equal emphasis (e.g. the same size font) to each component of price may make things worse, if it falsely suggests that all components are equally significant. In any event, particularly in the internet era information is readily available. The harder question for consumers is which information they should pay attention to, a task that disclosures are ill-suited to address. Opening a new deposit account requires a stack of paperwork, often topped with a voluntary summary disclosure that does not itself comply with the regulatory requirements.[21] No wonder many consumers may miss important terms such as fees for overdrafts or insufficient funds. Nonetheless, competitive incentives are strong and competition is possible, as the recent moves by major banks to reduce or eliminate overdraft fees demonstrate.

Even worse, disclosures may misdirect attention, if they imply that consumers should pay attention to information that has no real significance for them. For example, an FTC study found that disclosure of the yield spread premium in a mortgage transaction reduced the fraction of consumers who could identify the lowest price mortgage, because they mistakenly focused on an item of information that did not affect the cost.[22]

For disclosure to have an impact, consumers must be exposed to the information, pay attention to it, understand it correctly, accept it, and remember it.[23] Because information is more likely to be used when it is provided in timely fashion, an important consideration is where and when to disclose.[24] Ideally, the information should be available at the time and in the place where the interested consumer is most likely to need the information. Thus, for example, the price of an optional feature should be available when the consumer decides whether to purchase that option. Earlier disclosure is simply a distraction. If many consumers are likely to make purchase decisions based on advertising alone, disclosure in advertising may be necessary and appropriate. Often, however, information is more useful if it is provided somewhere other than in advertising. This is particularly true for more complex products or services. Although the rulemaking petition that led to the FTC's ANPRM on fees argues for disclosure of all price components in advertising, few consumers are likely to remember the details of a pricing structure based on their inevitably brief exposure to an advertisement, perhaps days or even months before they actually make a purchase decision. Instead, advertising serves to motivate search, and disclosure policies should be designed not to replace search but rather to make sure that adequate information is available before purchase.[25]

Sellers have strong incentives to tailor the information they provide to attract the consumers' interest. Of course, each seller will cast its offering in the best possible light, but other sellers with different advantages also have incentives to point out the differences. Because different consumers use credit cards differently, for example, card issuers have an incentive to develop marketing materials that seek to attract the right consumer to the right card. Rewards are likely of more interest to consumers who pay their balances regularly, who may have little concern about the interest rate. That will be of far more interest to consumers looking to roll over an existing balance, who may have little concern about other card features. Consumers are quite able to make appropriate choices: In an experiment by a large bank that offered a choice between a card with an annual fee and a lower interest rate or a higher rate with no fee, on average consumers made the cost-minimizing choice. Of course, some consumers made mistakes, but they corrected those mistakes, especially when the errors were large.[26]

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20 Alan Schwartz & Louis L. Wilde, "Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis," 127 U. PA. L. REV. 630-682 (1979).

21 Novantas Research, Understanding Consumer Choice: A Review of Consumer Overdraft Behaviors (2015), at 18.

22 James M. Lacko & Janis K. Pappalardo, *The Effect of Mortgage Broker Compensation Disclosures on Consumers and Competition: A Controlled Experiment*, BUREAU OF ECONOMICS STAFF REPORT (2004), available at https://www.ftc.gov/reports/effect-mortgage-broker-compensation-disclosures-consumers-competition-controlled-experiment.

23 For a fuller discussion of the information processing literature, see THOMAS A DURKIN AND GREGORY ELLIEHAUSEN, TRUTH IN LENDING: THEORY, HISTORY, AND A WAY FORWARD (Oxford University Press, 2011). An alternative formulation of the sequence of using information is that consumers must find it, read it, understand it, use it, use it appropriately. See OMRI BEN-SHAHAR AND CARL E. SCHNEIDER, MORE THAN YOU EVER WANTED TO KNOW: THE FAILURE OF MANDATED DISCLOSURE, 34 (2014).

24 See William L. Wilkie, Affirmative Disclosure at the FTC: Communication Decisions, 6 Journal of Public Policy & Marketing 33 (1987).

25 See Michael B. Mazis, Richard Staelin, Howard Beales, & Steven Salop, A Framework for Evaluating Consumer Information Regulation, 45 Journal of Marketing 11-21 (1981).

26 Sumit Agarwal et al., *Do Consumers Choose the Right Credit Contracts,* 4 REVIEW OF CORPORATE FINANCE STUDIES 239-257 (2015).

The marketing of many financial services also makes clear sellers' willingness to provide information, even absent regulatory requirements. Many providers offer features such as low-balance alerts that are designed to help consumers avoid fees. Others offer apps to monitor credit card transactions for common errors such as a transaction mistakenly submitted twice or a wildly disproportionate tip.

III. THE COSTS OF REGULATING PRICING STRUCTURE

Of course, sellers cannot be allowed to misrepresent their prices, or to charge consumers for services they did not agree to purchase. But an overly detailed or comprehensive list of potentially relevant prices and options, particularly at early stages of the search process such as in advertising, is more likely to obscure information than to enhance it. Consumers must still decide which information is worth paying attention to. Seller's incentives to provide the information that consumers value most facilitates that process.

We consider two examples of attempts to regulate pricing structure and their consequences. The regulatory structure for real estate settlements requires itemization of prices in great detail, even when the consumer has no choice about whether to pay that amount. The result has been more fees, not fewer, and higher cost for real estate settlements. In contrast, regulatory requirements for credit and debit cards have attempted to regulate particular components of the price. The result has been increases in unregulated fees, and unintended adverse consequences for consumers least able to afford them.

IV. RESPA: THE FAILURE OF ITEMIZED PRICING

One frequently cited source of many junk fees is a real estate closing. The settlement paperwork lists numerous fees, for vaguely described services of uncertain value. Ironically, these junk fees appear to be the result of Congressional dissatisfaction with the pricing structure of settlement services. The result was the Real Estate Settlement Procedures Act of 1974, substantially amended in 1975. Concerned about the high cost of real estate settlements and payments between the various service providers, Congress adopted a disclosure approach, under which each individual fee must be itemized, hoping to promote "transparency" and encourage price competition as better informed consumers shopped for the lowest cost service providers.[27]

It didn't work. Although the evidence is limited, one study examined closing documents for a sample of loans originated between 1994 and 2007. It found that the cost of closing as a percentage of the loan amount rose substantially compared to the 1972 baseline Congress considered when it enacted RESPA, over 400 percent for all loans and almost 200 percent for purchase money loans. Moreover, the number of fee types doubled, in part because of the unbundling of origination and title-related fees.[28]

The reason for failure is the high costs of information. Lenders require borrowers to use certain service providers for some services. Because these costs are simply passed through to borrowers, lenders have little incentive to bargain for the lowest possible price. For other services, borrowers may choose to shop on their own, but many find it easier to rely on referrals from the lender or a real estate agent. Consumers in the midst of purchasing or refinancing a home have numerous demands on their attention, such as interest rates, the need to provide various financial documentation, and how to manage the down payment. Shopping for settlement services is likely far down the list of decisions requiring attention.

When neither borrowers nor lenders have strong incentives to find the lowest price, inefficient service providers can persist, protected from effective competition. Instead of competing on the cost of services, settlement service providers compete for the lenders' attention, hoping to win a place in the list of providers to whom they refer borrowers. The one limitation on this competition is Section 8 of RESPA, which prohibits "kickbacks," which have been defined to include a service provider's payment to the lender for referrals.[29] Unfortunately, that provision also makes it difficult for an originator or a lender to "bundle" settlement services into a single price, because any payments between service providers and the bundler can be challenged as kickbacks.

A far better approach would be to allow the bundled provision of settlement services at a fixed price. Providers might be lenders, originators, brokers, or new entrants into the market, who would arrange suppliers for the needed services and offer them all to consumers at a fixed price. In 2002, HUD proposed an amendment to the RESPA rules that would have allowed just such a package, which they estimated would

27 Elizabeth Renuart & Jen Douglas, The Limits of RESPA: An Empirical analysis of the Effects of Mortgage Cost Disclosures, 21 Housing Policy Debate 481-528 (2011).

28 Renuart & Douglas.

29 12 C.F.R. § § 1024.14(b) and (f).

save each borrower approximately $1,000.[30] Faced with substantial opposition from the business beneficiaries of the uncompetitive market for settlement services, the proposal was eventually withdrawn. Nevertheless, it seems clear that a competitive market for settlement services would produce a far better outcome for consumers than the forced unbundling that we have today. The Taskforce on Federal Consumer Financial Law also recommended that the CFPB remove the regulatory barriers that prevent bunding.[31]

Sadly, the FTC's Motor Vehicle Dealers NPRM seems to follow the RESPA path. Under the proposal, the dealer's first response to any question about a specific vehicle must state an "offering price," which is the cash price of the vehicle with no dealer add-ons. If the consumer declines to purchase at this price, on a signed, dated form, the dealer can then offer an itemized list detailing all add-ons and their prices (or price ranges). The Commission simply assumes, without offering basis, that this convoluted bargaining process will somehow save consumers three hours per transaction.[32] As with RESPA, it seems far more likely to complicate and extend the already complex process of shopping for a car and its financing.

V. CREDIT CARDS: THE FAILURE OF PRICE STRUCTURE REGULATION

Another frequently cited product allegedly subject to junk fees, and a particular focus of the CFPB's Request for Information, is credit cards. Card issuers charge interest on outstanding balances, but they also charge annual fees, late fees, overlimit fees, and foreign transaction fees, to name only a few. Federal efforts to regulate these fees began in 2008 when the Federal Reserve Board adopted rules prohibiting some price structures as unfair or deceptive, which were effective in 2010. These rules restricted double cycle billing, regulated the allocation of payments, and restricted certain repricing practices when a cardholder's apparent credit risk change. In 2009, Congress passed the CARD Act., which, in addition to codifying some of the Fed's rules, limited fees for violations of the terms of the account (e.g. late fees, returned payment fees, overlimit fees) to amounts that are "reasonable and proportional" to the violation.[33] Card issuers can either set fees based on an elaborate, annual evaluation of their costs on a fee by fee basis, or they can take advantage of safe harbors established in the original rule allowing fees no more than a specified dollar amount, currently $30, adjusted for inflation.[34] Unsurprisingly to any student of industrial organization and the regulatory process, it appears that most issuers charge essentially the maximum safe harbor amount.[35]

Faced with restrictions on one component of a complex pricing structure, firms have an obvious incentive to adjust their prices on other components of the package.[36] A Pew Trust study found that although regulated fees declined, on average annual fees and interest rates increased, along with cash advance fees and penalty interest rates.[37] A CFPB assessment similarly found a 230 basis point increase in the average APR on purchases and an increase in unregulated cash advance fees.[38] To whatever extent high late fees were subsidizing other credit card users, we now have other users subsidizing those who do not pay their bills on time.

The Fed's rules and the CARD Act also had substantial adverse effects on credit availability, reductions concentrated on subprime borrowers, with little impact on prime borrowers.[39] Penetration of credit cards fell significantly, particularly among lower income consumers.[40]

30 James Gattuso & Ronald Utt, The Case for RESPA Reform, The Heritage Foundation Report, June 19, 2003, available at https://www.heritage.org/government-regulation/report/the-case-respa-reform.

31 Taskforce on Federal Consumer Financial Law Report, Volume 2, Section 3.5 (2021).

32 FTC Motor Vehicle Dealer NPRM.

33 15 USC 1665d.

34 See 12 CFR 1026.52(b).

35 See Remarks of CFPB Director Rohit Chopra on Credit Card Late Fees ANPR Press Call, June 22, 2022, available at https://www.consumerfinance.gov/about-us/newsroom/prepared-remarks-of-director-chopra-on-credit-card-late-fees-anpr-press-call/.

36 For a summary of the CARD Act's effects on credit availability and other credit card contract terms, see Thomas A. Durkin, Gregory Elliehausen, & Todd J. Zywicki, *An Assessment of Behavioral Law and Economics Contentions and What We Know Empirically About Credit Card Use by Consumers*, 22 Sup. Ct. Econ. Rev. 1 (2014); see also Consumer Financial Protection Bureau, Taskforce on Federal Consumer Financial Law Report, Vol. 1, pp. 596-604 (2021).

37 See Nick Bourke & Ardie Hollfield, Two Steps Forward: After the Credit Card Act, Credit Cards Are Safer and More Transparent—But Challenges Remain, Report of the Pew Health Group, Pew Trusts (July 2010).

38 Consumer Financial Protection Bureau, CARD Act Report: A Review of the Impact of the CARD Act on the Consumer Credit Market (Oct 2013).

39 Yiwei Dou, Julapa Jagtiani, Joshua Ronen, & Raman Quinn Maingi, *The Credit Card Act and Consumer Debt Structure*, Fed. Res. Bank of Phila. Research Dept. Working Paper, WP 20-32 (Aug. 2020).

40 The share of households in the lowest income quintile with a credit card fell 11 percentage points between 2008 and 2010, compared to a 1-point drop for the highest quintile. See Glenn B. Canner & Gregory Elliehausen, *Consumer Experiences with Credit Cards*, Fed. Res. Bulletin 10, Table 2 (2013).

Subprime borrowers were less likely to receive credit offers, and the offers they received were for lower credit limits at higher interest rates than before.[41] Credit availability effects are likely more due to the Act's restrictions on repricing, which made the prior practice of offering low initial rates and later raising rates for those who turned out to be worse risks than expected far more difficult.

Some studies find little effect of the CARD Act,[42] but these studies fail to account for the impact of the very similar Federal Reserve regulations. When the CARD Act passed, issuers had made substantial changes to comply with the substantially similar rules.[43] Studies that ignore these early compliance steps will understate the impact of the restrictions.

The CFPB's NPRM on Late Fees seeks to revisit the original implementing rules for the CARD Act. The rule would reduce the safe harbor for late fees from $30 to $8, based on an analysis of the costs imposed by late payments that deliberately excludes collection costs after a debt is charged off and that includes no recognition of fixed costs. Moreover, the proposal would end the automatic adjustment of the safe harbor amount based on inflation. In essence, the Bureau only considers variable costs to establish late fees, presumably as a proxy for marginal costs. In general, of course, prices above marginal cost generate consumer welfare losses because consumers purchase less of the product or service. In the context of late fees, however, fewer purchases means that more consumers pay their bills on time. It is difficult to see significant welfare losses because too many consumers pay on time. Late fees do in fact lead more consumers to pay on time, which implies that consumers are in fact aware that the fees exist and do have a deterrent effect.[44] Because late fees are also correlated with a cardholder's risk,[45] reducing late fees with increase overall losses to cardholders resulting in higher costs for all borrowers. In short, late fees are designed to impose the cost of late payments and higher risk on those consumers that pay late and to deter further late payments, rather than enabling late-payers to externalize those costs onto other borrowers, particularly subprime borrowers. As a result, late fees appear to be the antithesis of so-called "junk fees."

Moreover, card issuers also face substantial fixed costs, which they must recover in markups over marginal cost for some components of their product portfolio. There is no reason all markups should be the same. A higher markup on late fees than on other components of the product is particularly appropriate given the increased incentives to pay on time.

The CARD Act requires that rules consider the deterrent effect of late fees, but the Bureau's proposal essentially dismisses deterrence, arguing that some deterrent remains. That is, of course, true; the late fee is not zero and there are other consequences of late payments. But it seems obvious that the deterrent effect of a $30 fee is greater than that of an $8 charge. Moreover, the Bureau exaggerates the impact of other costs by converting one-time costs in a 30-day billing cycle to an annual percentage rate. That rate is irrelevant unless the consumer is planning to continue late payments for a year. That, however, is exactly what late fees are intended to deter.

The Fed's original rule provided that costs of collection for purposes of establishing late fees could not include as costs "losses and associated costs (including the cost of holding reserves against potential losses and the cost of funding delinquent costs)."[46] The Bureau now proposes to "clarify" that no costs incurred after chargeoff can be included in the analysis, based on the sophistry that "any cost in collecting amounts owed to a card issuer that are incurred post-charge-off is related to mitigating a loss as opposed to the cost of a violation of the account terms."[47] Any attempt to collect amounts due, however, no matter when it occurs, is an effort to mitigate losses. There is simply no meaningful economic distinction. The Fed's original distinction, between collection costs and the losses themselves (i.e. the amounts uncollected) is a sensible one, but it is lost in the proposed revision.

Not surprisingly, the Bureau notes that card portfolios with more subprime borrowers are more dependent on late fee revenue, because subprime borrowers are less likely to pay on time. The inability to recover costs from those borrowers who are in fact late will increase the costs to those who pay on time. Moreover, like the restrictions on repricing discussed above, it will likely lead to restrictions on credit availability to all subprime borrowers, since an issuer cannot identify ex ante those who will pay on time.

41 See Song Han, Benjamin J. Keys, & Geng Li, *Unsecured Credit Supply, Credit Cycles, and Regulation*, 31 Review of Fin. Studies 1185 (2018).

42 See e.g. Sumit Agarwal, et al., Regulating Consumer Financial Products: Evidence from Credit Cards, 130 Q. J. Econ. 111 (2015).

43 For example, Dou et al. find significant market effects of reductions in credit availability to non-prime consumers at each stage of the progression from the initial proposal of the Federal Reserve regulations, the passage of the CARD Act, and enactment of the final implementing regulations.

44 See Daniel Grodzicki, Alexei Alexandrov, Ozlem Bedre-Defolie, & Sergei Koulayev, Consumer Demand for Credit Card Services, J. of Fin. Services Res. (2022), https://doi.org/10.1007/s10693-022-00381-4; see also S. Agarwal, J. C. Driscoll, X. Gabaix & D. Laibson, Learning in the Credit Card Market, NBER Working paper 13822 (February 2008), finding that paying a fee in the current month reduces the likelihood of paying a fee next month by 40 percent.

45 See Nadia Massoud, Anthony Saunders, & Barry Scholnick, *The Cost of Being Late? The Case of Credit Card Penalty Fees*, 7 J. of Fin. Stability 49 (2011).

46 Official Interpretation of 12 CFR 1026.52(b)(1)(i).

47 Late Fees NPRM at 30.

Congress also regulated the intricacies of pricing structures in the Dodd Frank Act, passed in 2010. A provision known as the Durbin Amendment established price controls on the prices debit card issuers can charge for interchange fees, which must be "reasonable and proportional" to the costs of a particular transaction, not including the costs of issuing a card, operating bank branches, account acquisition, or general customer support. Interchange fees are paid by merchants rather than consumers, but they are a key component of the pricing of debit cards. When the Federal Reserve's implementing regulations became effective in 2011, interchange fees fell from an average of $0.51 per transaction to $0.24, where they have largely remained.[48]

As with a balloon, squeezing one component of a pricing structure is likely to lead fees to increase elsewhere. Before price controls, interchange revue transformed the economics of checking accounts. Fewer than 10 percent of bank accounts offered free checking before 2001; by 2009, 76 percent of bank accounts were free checking accounts.[49] Free checking typically required a minimum account balance. In 1999, the required minimum averaged $562, an amount that had fallen to $109 by 2008. Price controls led the required minimum to explode to $723 in 2012.[50] Monthly maintenance fees for accounts that were not free roughly doubled.[51] By one estimate, fee increases offset 90 percent of the interchange revenue loss.[52] These costs were disproportionately borne by lower income consumers, who are much less likely to maintain balances that qualify for free checking. According to one estimate, 70 percent of those in the lowest income quintile experienced higher fees, compared to 5 percent of those in the highest quintile.[53]

VI. CONCLUSION

The notion of junk fees is a fine piece of rhetoric, but useless as an analytical tool. Both the structure of pricing, and the level of prices, should be determined by competition in the marketplace. As we observe, the result is detailed fee structures for some products and services, and bundled pricing for others. But marketplace competition over pricing structures is far more likely to satisfy consumer preferences than an inevitably overbroad set of regulatory requirements.

As the experience with RESPA and the credit card market makes clear, regulatory intervention creates a considerable risk of adverse effects for consumers. Each fee is different, serving different economic functions, and raising industry and fee-specific questions about what information consumers need at what point in the purchasing process. Undoubtedly, there are "fees" where regulatory intervention seems appropriate. The FTC's example of fees for automotive add-ons for worthless "products" such as nitrogen filled products is a good example. The problem, however, is not the fees, but the fraudulent claim that the product does something. Disclosing the fee earlier in the purchase process would not address that problem at all. Worse, it may distract consumers from bargaining over the price of the car and its financing.

48 See Todd J. Zywicki, Geoffrey A. Manne, & Julian Morris, *Unreasonable and Disproportionate: How the Durbin Amendment harms Poorer Americans and Small Businesses*, International Center for Law and Economics (Apr. 25, 2017).

49 See Todd J. Zywicki, Geoffrey A. Manne, & Julian Morris, *Price Controls on Payment Card Interchange Fees: The U.S. Experience* 5, ICLE Financial Regulatory Research Program White Paper 2014-2 (2014), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2446080.

50 Vladimir Mukharlyamov & Natasha Sarin, *Price Regulation in Two-Sided Markets: Empirical Evidence from Debit Cards* (Dec. 2019).

51 Zywicki et al., Price Controls.

52 See Benjamin S. Kay, Mark D. Manuszak, & Cindy M. Vojtech, *Competition and Complementarities in Retail Banking: Evidence form Debit Card Interchange Regulation*, 34 J. Fin. Intermediation 91, 92 (2018).

53 Mukharlyamov & Sarin, *supra* note 50.

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