



## BIS: Consultation on the early implementation of a ban on above cost payment surcharges

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### Consultation response from the ESRC Centre for Competition Policy

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## **General comments on the consultation**

Before addressing the questions raised in the consultation document, we want to explain why we believe that the consultation provides the wrong approach to resolving the issues raised in the Office of Fair Trading (OFT) report: "Payment surcharges Response to the Which? super-complaint" (OFT1349resp., July 2012). The key concern raised in the OFT report was that in some sectors, some transaction charges are not made clear to customers until the end of a transaction.

As the OFT report carefully explains, firms hide their surcharges because of a behavioural assumption about consumers. Consumers for a variety of reasons may fail to allow for such later surcharges and by the time they get hit by them, they have already invested so much in the purchasing decision that they are reluctant to bail out. Once the consumer has failed to anticipate the surcharge, this may be rational if it is costly to go through the purchasing procedure with another supplier, or if the consumer forms an expectation that any alternative supplier is likely to use the same approach to pricing.

Reading the consultation document, one gets the sense that BIS is conflating two different but related problems:

1. The hidden nature of some surcharges, which is the focus of both the analysis and the proposed remedy of the OFT report: "Payment surcharges Response to the Which? super-complaint" (OFT1349resp., July 2012)
2. The level of these surcharges, which is addressed in the EU Consumer Rights Directive (2011/83/EU), due to come into force in 2014.

The focus of the BIS consultation document is on the early implementation of the EU Directive as a remedy for both problems. We will argue that the focus is misplaced. Not only is the first problem much simpler to solve than the second, it also has the possibility to solve the second problem without further intervention. The same is not true of a remedy which directly addresses the second problem. Such a remedy, for example bringing forward the implementation of Article 19 of the EU Directive which requires that "Member States shall prohibit traders from charging consumers, in respect of the use of a given means of payment, fees that exceed the cost borne by the trader for the use of such means", is hard - if not impossible - to enforce and not capable of solving the first problem.

## **Dealing with the hidden nature of surcharges**

If the problem is the hidden nature of part of the price, the OFT proposal to force firms to reveal this as early as possible in the shopping experience is direct and to the point. It has the important merit of being easy for consumers to enforce. Not only is the absence of the required information readily observed, it is also readily demonstrated to a third party, be it an ombudsman, Trading Standards or even the courts. Enforcement would be cheap and fast.

Importantly, it may not be necessary for firms to display the actual size of the surcharge, beyond its existence. One would expect the majority of consumers to respond negatively to a firm saying to them "yes, we will apply a surcharge, but, no, we will not tell you how much". Essentially without adding the level of the surcharge, the firm is sending a very bad signal about itself, a signal warning the consumer to beware. To avoid this inference, firms would have a strong incentive to provide the information about the level of surcharges at the outset. Once the level of the surcharge is out in the open, then competition begins and where there is competition, we would expect to see surcharges being competed down to levels at or below costs. The fact that competition can force below cost

charges is evident in the UK bank industry's failure to stamp out "free banking". It may hence be worthwhile first to implement the simple rule that the existence of any surcharge or other fee must be acknowledged when first displaying a price, while retaining the ability later to add a requirement that the actual surcharge or fee must be displayed should competition not of itself ensure that this happens.

## **It is not just surcharges; it is the hidden nature of the full price**

It is important to add that the regulation about early disclosure should not be restricted to surcharges, but should be in force for any fee which may be added later and where there is a cost of "starting again".<sup>1</sup> The Government's proposal does not deal with the issue of firms simply renaming the surcharges, for example, as "administration fees". These fees would enable the firms to ultimately "surcharge" and the firms can be – and some airlines, for example, indeed are – as elusive as they like about whether these will or will not be imposed and how much they will be until the very end of the transaction. There would be nothing stopping the firms from levying these other charges at the end of the transaction as long as they have not promised the consumers at the beginning of the transaction that such charges do not exist or they have not created the impression that they do not exist. Consumer Protection from Unfair Trading Regulations 2008 (CPRs) are unlikely to help since the Regulations prohibit "misleading" or "aggressive" practices and if the firm has not promised otherwise, levying a charge is not "misleading".<sup>2</sup> One can think of the practice possibly being "unfair" (and fall under the general prohibition of unfair practices) but "unfairness" in the Regulations (and the EU Unfair Commercial Practices Directive) is defined by making reference to "professional diligence" which is a factor of "honest market practice and/or the general principle of good faith in the trader's field of activity". This means that if all the other traders in the same industry also adopt the same practice, it would be difficult to argue that one's practice is against "professional diligence". Thus, the Government's proposal at [32] of the Consultation Document that:

*"other surcharges will continue to be subject to rules in other consumer protection legislation including CPRs. They must therefore be presented clearly and fairly to consumers"*

simply does not deal with the problem. The legal application of CPRs to surcharges might at least arguably not render the result that the Government is assuming it would.

Moreover, what is in a name? The support for the proposed remedy rests on a belief that the surcharges are related to some specific costs. However, if these surcharges did not reflect costs of accepting certain payment methods, which is **why** the Government wishes to take action, why does the Government believe that the surcharges ever had anything to do with the costs of accepting certain payment methods? The Government has evidence that accepting, for example, a payment by debit card costs around £0.50 for merchants. If a merchant is/was charging £5 per person in a transaction to use a debit card fee, why does the Government think that these surcharges were about the payment method at all? Just because the firms call it a fee for paying in a certain manner

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<sup>1</sup> One sensible exception would be postage and packing. Most people are likely to have a fairly good idea about the cost of shipping so that an abuse of such additions to the total price of the product is likely to be detected and if not punished through a lost sale now, likely to be in terms of future sales.

<sup>2</sup> The strategy of hiding the surcharge is only effective if most people's default is that the headline price is also the final price. In terms of reducing uncertainty as well as shopping costs, there is clearly a good economic argument for wanting consumers to maintain this default belief and being able to do so safely. But this also means that from this default position, any surprise fee is meant to deceive the consumer for whom we want it to be reasonable to expect that silence means "no surcharge". However, that may not be enough to make the strategy misleading.

does not actually mean that they are genuinely about the costs of accepting that method of payment. Consequently, these “surcharges” should simply be viewed as one way of the firm increasing the total price of the product/service as the consumer travels along the timeline of the transaction and reaches a point where it is too costly (due to search costs, time, etc) to start all over again with another firm (and there is always the risk that the other firm will do the same, too).

Finally, we are concerned that with the proposed remedy, the Government’s efforts might be in vain. Whereas consumers can easily observe and prove that a firm had breached a commitment to put information about surcharges or other fees up front [as in the OFT decision on travel], establishing whether a particular fee is ‘excessive’ or not cost-reflective is not generally possible for the consumer, as the elements in question 6 below should make this clear. In the Impact Assessment accompanying the Consultation, it is stated that consumers will be able to report businesses that are not complying with the legislation (p.20). This assumes that consumers can know that the fee does not reflect the costs of using a certain payment method, which is an assumption unlikely to reflect reality. Importantly, it is not even clear that enforcers such as Trading Standards would have the necessary information or at least could obtain and process it at a reasonable cost. What is unclear in the consultation document is whether there is a proposal to reverse the burden of proof so that whenever challenged, a firm will have to justify its charges.

Page 10 of the Impact Assessment BIS states that:

“It is important to stress that the proposed action on payment surcharges forms part of a package of measures that are being coordinated with action being taken by the Office of Fair Trading (OFT) to ensure that all transaction charges in the passenger transport sector, where surcharges are causing detriment, are made clear to customers at the beginning, not the end, of a transaction. The OFT will consider extending this initiative to other sectors as may be necessary. The purpose of these measures is to ensure that customers can compare prices fairly.”

We would agree that this is indeed the core problem and that the OFT solution of requiring that information is provided at the first point of contact is the right one. The proposal about the level of surcharges is simply unworkable. It should, however, be noted again that this is not just a problem about “surcharges” but one about revealing all elements of the final price upfront.

Despite our misgivings about whether bringing forward the implementation of the EU Directive is an appropriate remedy, below we have answered as many of your specific questions as possible

## Answers to the specific questions

*Question 1: Do you agree that we should implement the ban on above cost surcharges before the EU transposition deadline?*

Comments:

Yes. The argument in favour of waiting would rest on UK firms losing a competitive edge with respect to other EU firms.

This does raise the question as to who is actually covered by the rule. For example, what if a UK domiciled person purchases from a Dutch web site? Would they be banned from applying an above-cost surcharge on UK domiciled customers but not on others domiciled elsewhere in the EU?

*Question 2: Do you agree that the exemption for low value, off-premises transactions should not be applied to the payment surcharges provision?*

Comments:

Yes the exemption should not be applied in this case – why would such an exception be necessary? High surcharges would be particularly inappropriate if the transaction is low value. One would expect certain types of expensive payment methods, such as credit cards, simply to be excluded by the vendor.

*Question 3: Do you agree that these sectors should be outside the scope of the payment surcharging provision? Please give reasons and provide evidence if possible.*

Comments:

It is not clear from the consultation document what the arguments would be for exempting specific sectors, nor that the arguments would be the same across the proposed sectors. This would require more analysis.

*Question 4 (i): To what extent are payment surcharges applied to bookings for package travel? Please provide evidence of the extent and level of surcharging if possible.*

Comments:

No relevant information.

*Question 4 (ii): Do you agree that the scope of the payment surcharges regulation should cover package travel sales? If you disagree, please explain your reasoning.*

Comments:

Yes.

*Question 5: Do you agree that micro-enterprises should be exempt from any ban on excessive payment surcharges until June 2014? Please provide evidence if possible.*

Comments:

With what possible argument? Why should micro-enterprises be allowed to extract money from customers when we deem it inappropriate that other firms should? Is this simply an attempt to provide such enterprises with extra income? Why should such enterprises be supported by their current customers? If the government wants to skew the playing field, it should do so in a more targeted way.

*Question 6 Please state whether in your opinion each of the following potential costs to businesses of accepting payments should, in the case of card payments, be included within the definition of costs borne to the trader. Please give reasons for your answers:*

a) The merchant service charge  
Maybe.

b) IT, risk management, fraud and operational costs  
No

c) Fees to intermediaries  
No

d) Costs to businesses of carrying out intermediary functions internally  
No

e) Any other potential costs – Please identify  
No

Comments:

This would seem to be the wrong way to look at things. First of all you need to identify the baseline level of costs of completing a transaction. No payment method is without costs, even a cash transaction involves the vendor accepting the cash, running the risk of fraud, and holding the cash, running the risk of a hold-up. Identifying the feasible payment form with the lowest costs would enable you to identify a baseline cost which should be included in the price of the product. If we did not do that, we would need to explain why firms are not generally allowed to quote prices before vat and simply add these taxes at the till. All other allowable surcharges would have to be in excess of these baseline costs.

Operationally this is simply not workable. Who is supposed to enforce this? If you allow the merchant to include all sorts of more or less obscure costs, a customer would have no way of demonstrating that they are being charged too much basically leaving them with the current option of either liking the deal or lumping it. Equally without a very simple rule, a regulator or enforcer would also be wasting too many resources monitoring this.

Moreover, there are competition issues not picked up in the consultation document. There are real dangers in the proposals made by the Government. The payment card market is relatively concentrated, especially as regards credit cards and hence this is not necessarily a competitive market for payment methods we are talking about. By allowing the users of the services of the firms in this market to pass on all the charges of the card issuer, the proposed remedy may be removing important competitive pressure on the payment service providers to lower their costs.

*Question 7: Please give evidence of the use of payment surcharges for means of payment other than credit, debit, prepaid or charge cards.*

Comments:

No evidence.

*Question 8: Do you agree that ‘costs borne to the trader’ should be an average cost of processing transactions of that type rather than of each individual transaction?*

Comments:

That depends on how narrowly you define “type”. If the fees are to be cost reflective, they should reflect cost where feasible.

*Question 9: Do you have any comments on the draft impact assessment (Annex 3)? In particular we would welcome additional evidence on likely costs and benefits. Any financial data may be provided separately and will be treated in confidence*

Comments:

The assumptions made in the assessment look somewhat strange given the nature of the problem, but may reflect an attempt to provide a “worst case scenario”. Take option 2 (the preferred option): apparently there will be no effect on businesses and no significant savings for consumers, which surely begs the question: why are you doing this? It would appear that the more informed decisions which consumers are supposed to make will have no downwards pressure on prices – that is an interesting conclusion to reach. The assumption about what will happen to prices is odd and sits poorly with the reason for introducing greater transparency. More active consumers are generally expected to lead to more competition and hence to lower prices. You could argue that you are simply making very conservative assumptions, but they still look strange.

The argument that it is a benefit that consumers are less misled by payment surcharges that are separate from the headline price is odd. Mostly as consumers we do not know how a specific price arose and generally we do not care. We simply pay the price. The misleading which takes place lies surely in the timing of the revelation of that price.

*Question 10: Do you agree that it would be inappropriate having regard to principles of proportionality to impose criminal penalties on traders who breach the payment surcharges provision?*

Comments:

It depends on whether we believe that these breaches might occur as an innocent mistake. If it could be a mistake or arise from a misunderstanding, then it would be inappropriate. It may equally be inappropriate if this makes enforcement more difficult because courts would be unwilling to impose such harsh penalties or if they demanded stronger proofs. However, regard must be had to the difficulty of dealing with repeat, wilful, offenders.

*Question 11: Do you agree with our proposal to grant Part 8 powers to certain enforcers and to complement these powers with a duty to enforce under the specific injunction regime and consumer private remedies?*

Comments:

While there is no harm in this, it would also appear difficult for consumers to pursue cases for damages privately.