



**Confidential communication**

12 August 2019

To The Commissioners  
c/o Jonathan Roberts  
Transport Division  
Essential Services Commission  
Level 37, 2 Lonsdale Street  
Melbourne VIC 3000  
**By email:** transport@esc.vic.gov.au

Dear Commissioners

**A2B's submission responding to the Essential Services Commission's Draft Decision**

A2B Australia Limited (**A2B**) appreciates the opportunity to provide a submission responding to the Essential Services Commission's (the **Commission**) Draft Decision dated 30 May 2019 (**Draft Decision**) in relation to its "Taxi Non-Cash Payment Surcharge Review" (**Review**).

It is apparent both in the Draft Decision and our recent correspondence with the Commission's project team (copies attached) that the Commission's conclusion and recommendation to lower the maximum non-cash payment service fee (Service Fee) from 5% (including GST) to 4.5% (including GST) effective from 1 January 2020 is premature, misinformed and contains many material errors and factual inaccuracies.

In order to satisfy its statutory objectives and overarching obligations in the Commercial Passenger Vehicle Industry Act 2017 (Vic) (**CPVI Act**) the Commission must rectify these material errors and factual inaccuracies before it is capable of making a final decision.

Most critically, the Commission has not ensured that persons facilitating the making of non-cash payment transactions are able to recover the reasonable cost of accepting and processing such transactions.<sup>1</sup>

[greater than 5%]\*

On 1 March 2019 A2B provided a submission to the Commission showing that given the regulatory and competitive landscape in Victoria a Service Fee of [redacted] % was required for A2B to recover the reasonable cost of accepting and processing such transactions.

To arrive at the conclusion in its Draft Decision, the Commission has had reference to various regulations applied by the RBA in the context of the broader payments system, including its regulation of the maximum interchange fees that issuers in four-party card schemes can charge acquirers and its merchant surcharge rules. The ESC applied these regulatory concepts to determine A2B's reasonable costs of in-Taxi payment processing, despite the fact that A2B is not an issuer in a four-party card scheme and differs from those merchants that are the subject of the RBA's merchant surcharge rules. A2B believes that the application of RBA regulations that apply to other parties within the broader payments system is inappropriate as it mischaracterises

<sup>1</sup> CPVI Act, section 122

\* the actual amount is confidential to A2B.

the role of A2B in the in-Taxi payment processing industry and the nature of the Service Fee that A2B charges for the services it provides.

As indicated in our email on 25 July 2019, likening A2B to an issuer in a four-party card scheme and treating the Service Fee in the same manner as a surcharge is inappropriate. To allow for consistency and improved clarity in our dialogue with the Commission we have asked an expert economist to review the bottom-up costing prepared by the Commission and reviewed A2B's reasonable costs. I have attached to this submission the confidential detailed expert economist's report prepared by Charles River Associates (**Expert Report**). Using a methodology similar to that applied by the Commission and correcting for errors in the Commission's analysis, CRA estimates A2B's reasonable costs to lie between [REDACTED] and [REDACTED] for the six months ended 31 December 2018. This estimate is significantly higher than the ESC's estimate of only [REDACTED].

Consequently, and contrary to the Commission's Draft Decision, a 4.5% (including GST) maximum service fee will not allow A2B to recover its reasonable costs of processing non-cash payments. The Expert Report shows that in addition to the inappropriate application of regulatory concepts that are applied by the RBA in other contexts, the Commission has made material errors in its own bottom-up cost assessment for A2B's reasonable costs of accepting and processing non-cash payments.

### **1. A2B's reasonable costs for providing non-cash payment processing services exceed 5 per cent**

The Commission concluded in its Draft Decision that the least profitable Taxi payment processor would require a surcharge of around 4.3% (including GST) to recover its reasonable costs of accepting and processing non-cash payments. It reasoned that a maximum service fee of 4.5 per cent (including GST) would allow all Taxi payment processors to recover such costs.<sup>2</sup>

A2B submits that its reasonable costs exceed 4.5%, and in fact, are also above the current maximum service fee of 5%.

According to the Expert Report which is based on a review of the Commission's bottom-up cost assessment for A2B, the Commission amongst other things, has erroneously:

- Excluded fees paid to Taxi networks that operate in Melbourne due to a mistaken impression that A2B has double counted these costs;
- Excluded all direct and shared costs that the Commission either directly attributes or allocates to A2B's activities as an issuer of Cabcharge Card products, only allowing A2B to recover a notional interchange fee equal to the weighted average rate set by the RBA for issuers of Visa and MasterCard credit cards and American Express companion cards;
- Calculated the proportion of A2B's issuing costs that can reasonably be recovered through this notional interchange fee as a proportion of the service fee income generated by A2B rather than a proportion of the GST inclusive value of the non-cash Taxi fares that A2B processes;
- Attributed or allocated certain costs to A2B's activities as an issuer, or its operations in States other than Victoria, without understanding or seeking clarification of the nature of these costs with A2B;
- Chosen to ignore the expert determination of A2B's WACC; and

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<sup>2</sup> Draft Decision, page 33.

- Not allowed for the full recovery of its own estimate of A2B's reasonable costs in its calculation of the 'Taxi Non-Cash Payment Surcharge' due to the incorrect treatment of GST.

The Commission has also not taken into account the consequences of its decision for A2B or the Taxi industry more broadly. If A2B cannot recover the cost of issuing Cabcharge payment products through the Service Fee and consequently is forced to reduce the provision of services in Victoria this would have a negative effect on the demand for Cabcharge payments products, the use of FAREWAYplus payment terminals and demand for Taxi services more generally, with a portion of demand switching to the use of rideshare services. This would lower the volume of non-cash transactions processed by A2B and other non-cash payment processors and increase the minimum Service Fee required for each to cover its reasonable costs.

## 2. *Weight should not be given to certain submissions*

### a) **Submissions without evidence of the cost of processing non-cash payment services in the Taxi industry**

The Commission is tasked with ensuring that persons facilitating the making of non-cash payment transactions are able to recover the reasonable cost of accepting and processing such transactions.<sup>3</sup>

However, none of the submissions published on the Commission's website recommending that the Commission lower the maximum service fee are accompanied by any evidence of actual costs of providing non-cash payment processing services in the Taxi industry or evidence to demonstrate that the current maximum service fee of 5% is more than the reasonable cost of accepting and processing non-cash payment transactions.

A2B considers that only Taxi payment processors and other non-cash payment processors will have the necessary information that would allow the Commission to understand the actual and reasonable costs of accepting and processing non-cash payments.

Actual cost information provided by payment processors have the most probative value and greatest potential to assist the Commission with its statutory task.

As the vast majority of the persons making submissions to the Commission are not payment processors, these persons could not reasonably be in a position to have access to information concerning, or to appreciate, the cost of processing non-cash payments in the Taxi industry. It is therefore unsurprising that there is a distinct absence of substantiating evidence in these submissions.

The Commission stated that they assessed the reasonableness of the costs submitted by all Taxi payment processors.<sup>4</sup> In actuality, the Commission received very few submissions and responses from Taxi payment processors<sup>5</sup> admitting that the Commission's bottom up cost assessment upon which it based its Draft Decision was weak.<sup>6</sup>

The Commission not only collected very little information and evidence from those persons who are in a position to provide the most probative value and greatest potential to assist the Commission but the Commission chose to discount that evidence when it did not support their erroneous conclusion<sup>7</sup>. It placed a very heavy reliance on those persons that did not, nor are capable of providing any evidence regarding the reasonable costs of accepting and

<sup>3</sup> CPV Act, section 122

<sup>4</sup> Draft Decision, page 7

<sup>5</sup> Draft Decision, pages 8, 33 and 58

<sup>6</sup> Draft Decision page 33

<sup>7</sup> Draft Decision, Page 33

processing in-Taxi non-cash payments. Therefore, the Commission has given weight to submissions that favour the opaque cost and business model of rideshare against those operating under the Taxi business model with regulated fares.

To base its decision on little or no evidence is inadequate, unsatisfactory and falls well short of the Commission satisfying its statutory objectives.

#### **b) Submissions that misunderstand the difference between a surcharge and a service fee**

From the summary of the submissions received by the Commission, it is clear that there is a fundamental misunderstanding by many in the public of the difference between a surcharge and a service fee charged by Taxi payment processors.<sup>8</sup>

The submissions referred to by the Commission compare the service fee charged by Taxi payment processors with surcharges by non-Taxi payment processing businesses such as banks and supermarkets, stating "many other businesses have no surcharge"<sup>9</sup> and "the 5 per cent maximum surcharge is far beyond the incidental surcharge of most other industries".<sup>10</sup>

This is largely due to the Commission's mischaracterisation of the service fee as a surcharge in its "Taxi non-cash payment surcharge review 2019 Consultation paper" dated 11 December 2018 to which persons were responding. On the one hand Taxis face regulated prices that include payment costs and on the other, processors cannot benefit from the underlying Taxi fare.

Due to the fundamental difference between a surcharge and a service fee (further explained in section 4 below), the Commission should not give weight to these submissions.

#### **c) The ESC has accorded undue weight to Visa's submission**

In the section of the Draft Decision titled "*Five per cent is higher than what other merchants charge*", the Commission outlines Visa's recommendation that the service fee be removed and failing that there should be a reduction in the maximum service fee.<sup>11</sup> We would highlight that A2B is not a merchant in this environment but a processor.

The Commission also cited Visa's contention that the 5% maximum service fee is significantly above the cost of acceptance as reflected in the RBA's data on average merchant fees for debit, credit and charge cards in September 2018.

However, in the same section, the Commission neglects to mention Mastercard's primary contention that Taxi non-cash payment surcharge is intended to cover more than just the costs associated with accepting card payments.<sup>12</sup> Mastercard consequently reasoned that the "surcharge" should, in actuality, be a service fee which has been A2B's position throughout the Review.

There is no apparent basis for the Commission preferring to feature Visa's position saliently while not stating Mastercard's position as a counter view especially as both are equally significant participants in payment systems. This gives the impression that the Commission has given considerably more weight to Visa's submission without reasons for doing so.

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<sup>8</sup> Draft Decision, page 89

<sup>9</sup> Draft Decision, page 90

<sup>10</sup> Draft Decision, page 90

<sup>11</sup> Draft Decision, page 16

<sup>12</sup> The Commission only mentions Mastercard's position peripherally in Appendix J of the Draft Decision. Mastercard, submission received 14 February 2019, pp.2-3.

The Commission chose to use an extract from MasterCard's submission in the section titled "Most stakeholders said the current five per cent surcharge is too high" and followed this extract with the words "While we agree that the current maximum surcharge is too high..."<sup>13</sup>

The Commission's representations made about MasterCard's submission gives the misleading impression that MasterCard agrees the current maximum surcharge is too high, which MasterCard does not explicitly state in its submission. It also ignored MasterCard's primary contention and conclusion that if "surcharging is to continue, the maximum permissible surcharge should be based on the allowable costs identified by the RBA and reflected in the estimates calculated by the ACCC" while also acknowledging that the service fee is not a surcharge and the entire amount levied on a card payment used in a Taxi should not be characterised as a surcharge as it not the only fee levied on the Passenger. The more accurate term is a "fee for the provision of services by Taxi payment processing businesses".<sup>14</sup>

### **3. The ESC would be acting contrary to its statutory objectives by regulating the Taxi industry out of existence instead of supporting the viability of an essential service**

As the Commission is aware, non-cash payment transactions are prescribed services, the maximum service fee is a prescribed price and the non-cash payment transaction industry is a regulated industry for the purposes of the ESC Act.<sup>15</sup>

The Commission's first and foremost objective is to promote the long-term interests of Victorian consumers. In seeking to achieve this objective, the Commission must have regard to the price, quality and reliability of essential services.<sup>16</sup> A further factor the Commission must have regard to is the financial viability of essential services.<sup>17</sup>

The Commission's incorrect assertion that the 4.5% maximum surcharge is promoting efficiency, ensuring that Taxi payment processors are able to recover the reasonable costs and promotes the long term interests of Victorian consumers<sup>18</sup> is directly contrary to each of these statutory objectives and results in severely and irreparably compromising the viability of the Taxi industry and the long-term interests of Victorian consumers.

The Commission concludes, "Our bottom-up cost assessment shows that Taxi payment processors require a service fee of between 2.7 and 4.3% to recover the reasonable costs of processing non-cash payments ... A maximum service fee of 4.5% would not threaten the financial viability of the taxi payment industry."<sup>19</sup>

This statement is not true and should be rectified in light of the findings in the Expert Report. A maximum service fee of 4.5% would threaten the financial viability of the Taxi payment industry.

Further, it would mean, as a matter of certainty, that the Commission is not promoting efficiency in the industry (as conceived by the Commission) and therefore not promoting the long-term interests of Victorian consumers. The Commission stated in its consultation paper that for the purpose of its Review, it considers one of the components of efficiency to involve "the right incentives for investment and innovation by service providers".<sup>20</sup>

The Commission reasoned that to promote efficiency, the maximum surcharge should not be set too low as Taxi payment processors would then not be able to recover their costs, including

<sup>13</sup> Draft Decision, Page 17

<sup>14</sup> MasterCard, submission received 14 February 2019, pp.2-3.

<sup>15</sup> CPV Act, sections 121 and 123; ESC Act, section 32

<sup>16</sup> Essential Services Commission Act 2001 (Vic) (**ESC Act**), s. 8

<sup>17</sup> ESC Act, section 8A

<sup>18</sup> Draft Decision, page 3

<sup>19</sup> Draft Decision, page 98

<sup>20</sup> Consultation Paper, page 8 and Draft Decision, page 58

a reasonable return on their investment. This could lead to under-investment in payment processing services which could see Passengers wanting to make non-cash payments for Taxi travel finding they are unable to do so (meaning there is excess or unmet demand or these services).<sup>21</sup> A2B agrees with the Commission's reasoning in relation to this aspect.

Following the Commission's reasoning and based on the data provided to the Commission, the maximum service fee should not be decreased.

A reduction in the maximum service fee also operates to favour ridesharing services at the expense of the essential service. This is because if in-Taxi payment processors such as A2B are not able to recover their reasonable costs (which will be a certainty if the maximum service fee is reduced from 5 %), the logical result will precipitate a loss of competitiveness of Taxis to rideshare providers as customers switch away from Taxis. If the Service Fee cap is reduced the attractiveness to participate in the Taxi industry will consequently reduce and as a result Drivers will have less choice and be forced to accept higher cost options. This in turn creates an environment where a Passenger's payment choice in Taxi may not include non-cash payments further increasing the attractiveness of the opaque ride share model.

The Commission asserts that as the Draft Decision will allow Taxi payment processors to recover their costs, it is unlikely that service standards will suffer.<sup>22</sup> When in actuality, payment processors in the Taxi industry will not be able to supply the essential service and customers will not be able to access these services as a result of the Commission's determination and contrary to the Commission's overarching objective to promote the long-term interests of Victorian consumers.

The Commission's role is to review and respond to the prevailing industry conditions and ensure Victorians have access to reasonably-priced essential services. Its role does not extend to preferring one business model over another. As the Commission makes clear at the outset of its Draft Decision, rideshare and hire car surcharges are regulated by the Reserve Bank of Australia (RBA) under the national payment systems framework.<sup>23</sup> Ridesharing and hire cars are not essential services for the purposes of its legislative functions. If the Commission proceeds with its Draft Decision to reduce the maximum service fee, it will have advantaged a service that is not an essential service and has an opaque business and payments model.

#### **4. The RBA's surcharging standard is inappropriate**

The Draft Decision adopts the RBA surcharging standard, an approach which is fundamentally inappropriate for in-Taxi payment processors.

The RBA's Standard, in effect, prevents retailers from making a return by charging the customer a surcharge beyond what is necessary to process the non-cash payment.<sup>24</sup> Under the RBA's Standard, the allowable surcharge on card payments cannot exceed the reasonable costs of acceptance of that card.

Surcharges are typically only one component of a charge by a business where the underlying service or product is not payment processing. Businesses that impose surcharges are able to set the price of, and gain a return on, their underlying service or product.

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<sup>21</sup> Draft Decision, page 58

<sup>22</sup> Draft Decision, page 61.

<sup>23</sup> Draft Decision, page 1; RBA 2016, Standard No. 3 of 2016: Scheme Rules Relating to Merchant Pricing for Credit, Debit and Prepaid Card Transactions, May

<sup>24</sup> Merchants may surcharge for non-cash payments if they choose, provided the surcharge is not excessive (Competition and Consumer Act 2010 (Cth), section 55B(1)). A surcharge is considered excessive if it exceeds the 'cost of acceptance'.

In contrast, as with other Taxi payment processors, the underlying fare belongs to a Taxi Driver. A2B does not provide the underlying service to which the service fee is applied. As a result, the current 5% service fee is the only source of revenue available to A2B to recover its costs of payment processing. The only service A2B provides in such a transaction is the payment processing. The “surcharge” paid to Taxi payment processors is more accurately described as a fee for the provision of services by those Taxi payment processors.

As the Commission would be aware, Taxi payment processors cannot in any way control the pricing of the underlying service, being the Taxi fare itself. In fact, it is the Commission who controls this price, one which it has not increased since 2014, limiting the amounts both the Taxi Driver and Taxi payment processor are able to recover.

Therefore, applying the RBA's surcharging standard is inappropriate and wholly mischaracterises the business models of in-Taxi payment processors including A2B.

### **5. Rural and vulnerable communities will be disadvantaged**

As A2B has informed the Commission throughout the Review, A2B presently provides services to the rural, disadvantaged and vulnerable communities of Victoria at a loss.

A2B will be unable to continue providing those services (in their current form) if the Commission were to lower the maximum non-cash payment service fee as it has proposed in its Draft Decision.

As the Commission is aware, A2B provides services under a contract with the Victorian Government in respect of the Victorian Government's Multiple Purpose Taxi Program (MPTP) pursuant to which [REDACTED]

[REDACTED]

[REDACTED]

It is unlikely that rideshare providers such as Uber will have a presence in regional areas due to the low volume of trips in those areas. Even if Uber were to have a presence in all regional areas, Uber requires Passengers to book and pay through their smartphone application, a facility not used by all MPTP participants. The A2B solution does not require participants to hold or use credit cards. For these reasons, there is simply no realistic alternative to A2B or other Taxi payment processors to provide MPTP services.

Rideshare providers will not be able or willing to install the necessary mobility equipment in their cars to provide the wheelchair services (which A2B estimates to cost approximately \$70,000 per car) which make up a large proportion of MPTP participants.

The Draft Decision states that the proposed reduction in the surcharge will provide consumers with a saving of approximately \$3 million.<sup>25</sup> However, this ignores the fact that [REDACTED] because it is commercially unsustainable to do so, rural and vulnerable communities will be unfairly disadvantaged and will have to pay more for personal transport.

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<sup>25</sup> Draft Decision, page 3

The Draft Decision assumes that a maximum surcharge of 4.3% is sufficient for "servicing low income and vulnerable customers":<sup>26</sup>

*"Our bottom-up cost assessment shows that a maximum surcharge of 4.3 per cent (including GST) would be sufficient to allow taxi payment processors to recover the reasonable costs of non-cash payments; including... servicing low income and vulnerable customers"*<sup>27</sup>

## 6. Timing of the Decision

Section 124(4) of the CPVI Act requires the Commission to complete a "**review**" of a price determination no later than 2 years after it is made. That is, the Commission must make their decision at the end of this two-year regulatory period rather than at the start.

The Commission's determination on the maximum surcharge was due by 2 July 2019 (and was made on 1 July 2019, which is referred to as the **First Determination**). This purpose of the determination that was due by 2 July 2019 was intended to review the industry over the previous two years.

Instead, following consultation on its Draft Decision, the Commission plans to issue a new determination (if required) that will reflect the findings from its Final Decision.

The Commission intends its Final Decision (currently scheduled to be released in September 2019) to constitute a review of the First Determination (made on 1 July 2019) under section 124(4) of the CPVI Act.

A2B submits that the Commission is, in effect, making a decision at the start of a regulatory period rather than waiting until the end to "review" its price determination and respond to prevailing industry conditions contrary to the intention of section 124(4).

It is incumbent upon the Commission to conduct its review only after it has had the opportunity to properly assess the market and taken into account all the available evidence. As set out in submissions, correspondences, emails and meetings, the CPVI Act reforms (**CPV Reforms**) have had unprecedented effects on the paid personal transport industry – all of which have not yet been realised. The Commission should note the high rate of Taxi growth in Victoria is continuing with the resultant uncertainty in relation to terminal usage, not only for the industry but for the Commission to base its assumptions on a rapidly moving target.

As discussed in detail in A2B's 24 June 2019 submission, on 20 February 2019, the Victorian Government's Legislative Council agreed to review the CPV Reforms to assess the effects it is having on the personal paid transport industry including payment processing. The Legislative Council will report on the operation of the CPV Reforms and investigate what further reforms they believe are required to ensure Victorians benefit from the best functioning industry possible. The Victorian Government is required to respond to the report. This report has not yet been received.

As such, A2B submits that the Commission must wait before completing its review or making any further decisions until at least after the Victorian Government's response to the Legislative Council's report on the CPV Reforms can be considered so that interested parties as well as the Commission:

- Give full and proper consideration to matters relating to the Draft Decision; and

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<sup>26</sup> Draft Decision, page 17.

<sup>27</sup> Draft Decision, page 17.



- Be informed by the Victorian Government's views and the Legislative Council's report on the findings from its inquiry.

For the reasons set out in this submission and A2B's previous submissions, A2B submits that the Commission has not taken into account all of the evidence available to it and to properly discharge its duties, submits that the Commission must wait until the end of the next review period to give itself an opportunity to take into account all of the evidence available to it to make a decision regarding the Service Fee.

## 7. *Factual inaccuracies, inappropriate benchmarks and assumptions in the Draft Decision*

The Draft Decision makes numerous statements in respect of its proposed maximum non-cash payment service fee of 4.5% which suggest strongly that the factual basis on which it arrives at its proposed maximum service fee is fundamentally flawed.

A2B considers many of the assumptions and benchmarks adopted by the Commission are inappropriate, misinformed, incomplete or factually incorrect.

Each of these is described below.

### a) **The Commission's two terminal assumption**

Central to the Commission's view that the 5% maximum service fee should be lowered to 4.5% is the assumption that there are two terminals in the typical Taxi (**Two Terminal Assumption**), an assumption that the Commission restates throughout its Draft Decision.

The Two Terminal Assumption has a direct bearing on the Commission's benchmarking and underlies the Commission's analysis of the reasonable cost of providing non-cash payment processing.

The Commission reasons, "*The difference between having one terminal or two terminals is that with two terminals fewer transactions are processed through each terminal. The costs of processing non-cash payments must then be recovered from a smaller number of transactions.*"<sup>28</sup>

The Commission is correct that the cost of processing non-cash payments must be recovered from a smaller number of transactions where there are multiple terminals. However, in A2B's experience, a typical Taxi has 4-5 terminals and virtual terminals across the multiple Drivers across the shifts of one Taxi. It would be rare for a Taxi to be using only two terminals. This would mean that each Taxi payment processor must recover its costs from an even smaller number of transactions than the Commission has accounted for.

In addition, the monthly revenue for Taxi payment processors would also be materially inflated as a result of the Two Terminal Assumption because the Commission states "*we have halved the value of transactions processed through payment terminals to calculate the monthly revenue in our two terminal benchmarking analysis.*"<sup>29</sup> The value of transactions processed per terminal should be lower than half as Taxis typically have more than two terminals.

It is important that the Commission revises its Two Terminal Assumption and conduct its assessment on the basis there are 4-5 terminals and/or virtual terminals in the average Taxi to be more reflective of the intensity of competition in the payment processing market.

<sup>28</sup> Draft Decision, pages 12 and 93

<sup>29</sup> Draft Decision, page 41

The Commission further reasoned that the Two Terminal Assumption is “consistent with [its] obligation, under section 8A of the Essential Services Commission Act 2001, to have regard to the degree of and scope for competition within the taxi payments industry...”<sup>30</sup> and that “If [the Commission] did not allow for two terminals in [its] benchmarking, the consequences might be that taxi drivers would have no choice but to use the terminals provided by their networks.”<sup>31</sup>

A2B submits that the Commission will more accurately have regard to the “degree of and scope for competition within the taxi payments industry” by using 4-5 terminals for its benchmarking.

Taxi payment processors like A2B cannot require Drivers to use their terminals, as this gives rise to competition issues under the *Competition and Consumer Act 2010* (Cth). The relatively large number of terminals in a typical Taxi is a reflection of the intensity of competition in the industry experienced by payment processors, which is beneficial to consumers.

The Commission also appears to assume that deploying a terminal in a Taxi allows payment processors to necessarily generate revenue through that terminal. This is an incorrect assumption because, a Taxi Driver need not use that terminal at all and can choose to use one of the other terminals to process the Taxi fare.

Based on A2B’s conservative estimates, its terminals process approximately only [REDACTED] (and a lower percentage in major cities) of non-cash Taxi fares.

The lack of a guaranteed revenue stream per terminal is one reason why banks do not provide in-Taxi payment processing services.

The cost of capital beta would be higher for A2B because it is a higher risk business. A reason for this is because of the abundance of electronic payment devices and options in a Taxi competing with A2B’s. A2B can deploy capital but will not necessarily get a return e.g. if the Driver does not ever use A2B’s terminal and uses another terminal instead. The volatility in the volume of fares being processed by each terminal would further contribute to the riskiness of A2B’s payments business.

## **b) Inappropriate benchmarking**

The Commission’s benchmarking exercise is incorrect and misinformed for a number of reasons.

- *The Commission incorrectly used small businesses with revenues similar to Taxis for its benchmarking.*<sup>32</sup>

On this basis, The Commission’s benchmarking suggests that Taxis could process non-cash payments for a service fee as low as 2.5%.<sup>33</sup> This comparison is incorrect.

*“Benchmarking uses information on prices or costs from comparable markets to assess reasonable costs. An obvious benchmark ... is the charge for similar services outside of the taxi payments industry. The underlying cost of processing non-cash payments should be quite similar and the market in which such services are supplied is likely to be competitive. The technology in payment terminals is almost identical and (with the exception of Cabcharge payment instruments) the same kinds of payment instruments are used in taxis as for other small businesses”*<sup>34</sup>

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<sup>30</sup> Draft Decision, page 41

<sup>31</sup> Draft Decision, page 41. See also page 59.

<sup>32</sup> Draft Decision, page 10

<sup>34</sup> Draft Decision, page 40

The Commission has used “charges from payment processors to small businesses for processing non-cash payments” as a benchmark. The Commission has assumed that it is sufficient to use that benchmark for small businesses having revenues similar to Taxis as if revenues alone justify the use of that benchmark.<sup>35</sup> This is not correct.

Unlike traditional merchants, Taxi payment processors do not determine, nor do they receive, any component of the Taxi fare. This means that Taxi payment processors cannot recover their costs through means other than the Service Fee. Other payment processors have extremely diversified businesses where they can allocate costs in different areas of their businesses.

Even though the Commission acknowledged that Taxi payment processors are of a smaller scale than some other payment processors included its benchmarking, and as a result may face higher costs in some areas<sup>36</sup>, the Commission “has not adjusted its benchmarking to reflect this because it does not have information on the scale of taxi payment processors and other payment processors.”<sup>37</sup> A2B considers that failing to take into account this factor results in a material difference to the Commission’s benchmarking.

- *The Commission incorrectly used banks and other payment providers for its benchmarking.*

The Commission considers payment terminals from banks and merchant aggregators to be the appropriate services for its benchmarking exercise and the Commission considers that these payment terminals provide the same service to consumers that payment terminals in Taxis provide to Passengers; making them comparable.<sup>38</sup> This is an incorrect assumption. The dearth of bank issued payment terminals in Taxis is not co-incidental. Bank models and their costs as benchmarks are unsuitable because:

The prevalence of bank and aggregator terminals in Taxis is low, precisely because these are not suitable for Taxis, or offer cost models which become prohibitive for the Taxi industry. Bank cost models impose minimum charges, typically minimum monthly over a long contract making them unsuited to seasonal and casual work. Banks reduce credit risk by declining to work with those without trading history. Banks will also not serve customers who are not permanent residents (unlike many Taxi Drivers with student work rights). The majority of customers for the prices benchmarked, conduct other lines of business with the banks and they cross-subsidise. The entire environment for Taxi terminals: mobile, low usage, high maintenance, is unlike a typical customer environment for a bank benchmark product.

The benchmark models are not installed in vehicles. Installation of terminals is an important feature and gives rise to reasonable but significant costs. Installed terminals:

- Allow greater usage – can be used by multiple Drivers.
- Provide greater connectivity – antenna on the roof of vehicle provides better performance in black spots and under awnings or in carparks.
- Provide greater accuracy of location information – improves service and chargeback performance and outcomes.
- When fixed to the car, terminal does not run out of battery power and.
- A fixed terminal is not lost or forgotten.

*The Commission incorrectly compared Taxi payment processors ability to recover costs against Taxi Drivers’ ability to recover their costs in its benchmarking exercise.*

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<sup>35</sup> Draft Decision, page 10

<sup>36</sup> Draft Decision, page 56

<sup>37</sup> Draft Decision, page 56

<sup>38</sup> Draft Decision, page 10

- *The Commission incorrectly looked at and used other jurisdictions in Draft Decision.*<sup>39</sup>

Comparing the landscape of the non-cash payment surcharge in Australia to other jurisdictions is not appropriate for many reasons. First and foremost, the banking sector and in particular, "non-cash payment surcharges" in other jurisdictions are regulated very differently to those in Australia. By comparing Taxi only, the Commission's conclusions are misleading, incorrect and suggest that there is some correlation between regulation of the banking sector and structure of the personal paid transport industry in Australia and other jurisdictions.

For example, the Commission concludes that the prevalence of non-cash payments is higher in jurisdictions where acceptance of non-cash payments is mandatory and non-cash surcharging is not allowed.<sup>40</sup> The Commission used anecdotal evidence from New York and Las Vegas as evidence.<sup>41</sup> These jurisdictions cannot directly be compared to Australia where, unlike the Commission's observations about the United States, credit card acceptance is high<sup>42</sup> even in a non-mandatory and surcharge allowable environment.

The Commission also concluded that mandatory non-cash payment acceptance has been introduced in other jurisdictions to increase Driver safety but that there is a reluctance by Drivers to accept these payment methods as they may be charged a fee for processing card payments. To help deal with this issue, regulators in other jurisdictions have intervened.<sup>43</sup> While it is true that non-cash payment promotes Driver safety, most intervening jurisdictions have mandated credit cards in the interests of promoting tourism, it is not true that there is a reluctance for Drivers to accept these payments in Australia. The reason is twofold; firstly, the Commission has provided evidence that card payments represent at least 63% of all payments made in Australia<sup>44</sup>; and secondly, Drivers are not charged any fees by Taxi payment processors in Australia.

In addition, unlike in the other jurisdictions mentioned, the Commission has not taken any action to assist those in the Taxi industry to recover any associated costs. Rather, the Commission has not increased Taxi fares since 2014 and is now proposing to lower the "maximum non-cash payment surcharge".

It is also inappropriate for the Commission to compare States and Territories<sup>45</sup> without taking into account the different regulatory and competitive settings.<sup>46</sup> The approach taken by the Commission does not satisfy its duty to consider consistency between states on a national basis.

### **c) Bank presence in in-Taxi payment processing**

The Commission considers that banks and merchant aggregators service many small businesses using less than four terminals. It also observed that all of the major Taxi payment processors use the major banks as their acquirers and so the major banks effectively already service the Taxi payments industry. Banks have also said that some Drivers can and do use their payment terminals.<sup>47</sup> A2B queries the Commission's conclusions as it is not aware of any bank which services the Taxis. The only bank A2B is aware of that serviced Taxis was Suncorp via aggregators.

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<sup>39</sup> Draft Decision, pages 26-31.

<sup>40</sup> Draft Decision, page 26 and 30.

<sup>41</sup> Draft Decision, pages 30-31.

<sup>42</sup> Draft Decision, page 19.

<sup>43</sup> Draft Decision, page 29.

<sup>44</sup> Draft Decision, pages 19 and 23.

<sup>45</sup> Draft Decision, pages 60 and 71.

<sup>46</sup> ESC Act, section 8A(f).

<sup>47</sup> Draft Decision, page 55

**d) A2B's model is characterised as a rental model**

A2B submits that the cost of deployment of equipment should be taken into account in the Commission's assessment of costs.

The Draft Decision alludes to Driver ability to recoup costs for the terminal. However, A2B considers this is not applicable to the Taxi payment processor business. In fact, A2B does not charge Taxi Drivers for the use of its terminals.

**e) The Commission has not isolated costs**

The Commission acknowledges that it has not isolated "*all costs related to non-regulated services with accuracy*".<sup>48</sup> This indicates that it may have isolated costs that should be included as reasonable costs of processing non-cash payments.

**f) Three and Four Party Schemes**

The Commission justifies the exclusion of issuing costs from its determination of A2B's reasonable costs of non-cash payment processing on the basis that "In payment systems these costs are generally recovered through account fees and interest charges".<sup>49</sup> Rather than allow A2B to recover the costs it incurs as an issuer of Cabcharge card products, the Commission instead allows A2B to include as a cost of payment acceptance, a notional interchange between the issuing and acquiring side of its business set at the RBA regulated weighted average rate of 0.5%.<sup>50</sup>

It is not clear what the Commission considers the 'acquiring' side of A2B's payments business to be or why it considers the application of a notional interchange fee to be appropriate in the context of a three party card scheme. Interchange fees are not a feature of three party card schemes such as the Cabcharge card scheme because the issuer and acquirer of card transactions is the same entity. It is therefore not necessary for one to pay the other in order to transfer rents between scheme participants.

What the Commission seems to overlook is that payment processors (who are neither issuers nor acquirers in the context of card schemes) pay merchant services fees in respect of the transactions they process. These fees compensate issuers and acquirers in both four and three party card schemes for the costs that they incur. The merchant services fees paid by A2B and presumably all other payment processors are considerably higher than 0.5%. It is therefore not clear why the Commission considers it appropriate to limit A2B from recovering its issuing costs in the manner that it has.

Since the relevant costs are determined not by reference to notions such as issuer but by the broad CPVI statute, all costs associated with issuing, acquiring and merchant services need to be included in a cost stack when determining the reasonable level of the Service Fee.

**g) The Commission has mistaken economic efficiency for competitive efficiency**

The proliferation of smartphone based booking, dispatch and payments applications is very strong evidence of the ease of providing an alternative way to book and pay for personal

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<sup>48</sup> Draft Decision, page 8

<sup>49</sup> Draft Decision, page 38.

<sup>50</sup> Draft Decision, page 39.

transport services. In addition, there are some smartphone applications (like Ingogo) which provide the ability to pay for the trip in-Taxi as opposed to linking the booking and payment. This provides Drivers and Passengers with a competitive alternative to stand-alone in-Taxi payment devices such as A2B's.

To suggest that two payment terminals per car is a good proxy for the number of options in a Taxi is misinformed and completely incorrect. Not only can a Taxi have any number of Drivers with their own terminal but any smart phone with an app (or numerous apps) from a competitor in the personal transport sector is a real and potential substitute for the Cabcharge Payments terminals.

A2B's products have different end-customers and are not mutually exclusive. A Taxi Driver or Passenger can use A2B's booking and dispatch system without their payment system and vice versa.

There are many alternatives on the market for both booking and dispatch as well as payments. These are an expected and essential hall mark of a competitively efficient ecosystem that provides choice to Passengers.

However, some of A2B's competitors, like Uber or Ola use products that lock out the use of any other payment systems including cash. For example, when a Passenger uses Uber to book a ride, the driver is completely unable to use A2B's or any other payment system for the payment and charges relating to the payment are not disclosed.

To use an issuer model and an RBA methodology to determine the reasonable cost of acceptance to determine the appropriate level of the Service Fee completely ignores the competitive landscape and realities of the sector. Further the Commission has ignored its responsibility to ensure the viability of the essential service and preferred the unregulated and opaque ride-share business model.

#### **h) The Commission placed too much reliance on the 2012 Taxi Industry Inquiry**

As a result of the 2012 Taxi Industry Inquiry (**2012 Inquiry**), the non-cash payment surcharge was capped at 5% (including GST) in 2014. The Commission asserts that the "taxi non-cash payment transaction industry has been successfully operating on that basis since 2014".<sup>51</sup>

The Commission has not conducted any research into the effects of this change in the 5 years since it has taken effect and provided no evidence that Taxi payment processors have been successfully operating since 2014. Rather, the Commission has relied on the conclusions of the 2012 Taxi Industry Inquiry in making its assertions.<sup>52</sup> That 2012 Inquiry did not conduct any research prior to making its decision to cap the Service Fee to 5%. Nor did the Inquiry seek to define or understand the difference between a Service Fee and a surcharge.

The Commission stated that "*This reduction was made on the basis that half of the surcharge was being rebated to drivers as commissions.*"<sup>53</sup> With A2B's 40 year history in Taxi payments we can categorically state that this was never the case for Cabcharge payments. In addition, our cost information was neither requested nor considered as part of the Fels review.

Putting aside the CPV Reforms and structural changes to the personal paid transport industry that have occurred since 2014, the Commission has not taken into account increasing costs and growth of the Australian or Victorian economies. Taxi payment processors are not immune to changes in the economy especially increases in cost inputs. Taxi payment processor revenues

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<sup>51</sup> Draft Decision, page 4.

<sup>52</sup> Draft Decision, pages 6 and 70-71.

<sup>53</sup> Draft Decision, page 37.

are based on a percentage of the Taxi fare. The Commission has not increased Taxi fares since 2014 limiting the ability of Taxi payment processors to recover the increasing costs due to growth in the Victorian economy over that time.

## **Conclusion**

The Commission has been tasked with an important and difficult task of determining and measuring the Service Fee. The Service essentially removes the obligation of the Passenger for paying the Driver at the conclusion of a trip. This service is not a surcharge and cannot be measured as one.

The Commission's difficulty essentially commenced in 2012 with the release of the Fels report on the Taxi industry. The key recommendation of concern to the Commission that sprang from that report was that the fee for processing non cash payments in Taxis was to be capped at 5%. No data was gathered or analysed from the industry to justify the recommended 5% cap. In addition, the Service Fee was mischaracterised as something akin to a surcharge.

To properly discharge its duties the Commission first needs to define and understand what the Service Fee is. The Commission's next task is to create a tool to properly measure the Service Fee. In coming to a recommendation in its Draft Decision, the Commission has done neither of these two things.

When measured by the A2B methodology, as provided in its 1 March 2019 submission or by using the Commission's own methodology, A2B's reasonable costs exceed 5%.

Clearly, there is a lot that the Commission needs to understand, consider and take into account before it can confidently give proper weight to its overarching statutory objectives with regard to the price, quality and reliability of this essential service, and discharge its duty to comply with its statutory objectives.

Further, the environment within which the Commission has been asked to make these decisions is subject to unprecedented technological, regulatory and competitive changes that are still shaping the Personal Paid Transport sector and its participants. To this end the Legislative Council is currently conducting public hearings and will be making recommendations in relation to the impact of the Victorian Government's regulatory framework on the commercial passenger vehicle industry.

In this context and considering the current level of understanding of the sector and the Service Fee the Commission should extend its self-imposed projected timeframe so that it can make a properly informed decision and discharge its overarching duty than to promote the long term interests of Victorian consumers.

## ***Claim for confidentiality***

This submission is confidential and commercially sensitive to A2B and A2B would suffer a detriment if the Commission were to release the Confidential Information.

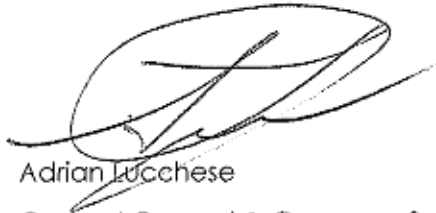
A2B is of the view that the Confidential Information contains commercially and competitively sensitive information which discloses, amongst other things, A2B's business operations, cost model and financial position. The Confidential Information is not in the public domain and is presented at a level of granularity in the Submissions that is not available publicly.

Disclosure of the Confidential Information would provide A2B's competitors and key customers access to information they would not otherwise have and allow them to adjust their own competitive position in a way they would ordinarily be unable to do. In addition to causing detriment to A2B's competitive position, this will likely have the undesirable effect of dampening competition.

In accordance with section 61 of the *Essential Services Commission Act 2001 (ESC Act)* and consistent with the Commission's submissions policy<sup>54</sup> and Consultation Paper,<sup>55</sup> A2B asks the Commission to treat as confidential the Confidential Information.

Should the Commission decide to disclose any part of the Confidential Information, A2B asks the Commission to provide it with adequate opportunity (and not less than 10 business days) before disclosing any part of the Confidential Information to provide reasons why A2B considers the information is of a confidential or commercially sensitive nature and why the public benefit in disclosing the information does not outweigh the detriment caused to A2B.<sup>56</sup>

Yours sincerely

A handwritten signature in black ink, appearing to read 'Adrian Lucchese', is written over a faint, circular stamp or watermark.

Adrian Lucchese

General Counsel & Company Secretary

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<sup>54</sup> Available at: <https://www.esc.vic.gov.au/about-us/our-policies/our-submission-policy>

<sup>55</sup> Consultation Paper (p. 4), "We treat all submissions as public information unless the submitter has asked us to treat some or all of a submission as confidential or commercially sensitive."

<sup>56</sup> A2B understands that information provided in response to the Information Request will be treated as if it is covered by section 38 of the *Essential Services Commission Act*, according to the page 4 of the Information Request.



# Assessment of A2B's reasonable costs of processing non-cash payments

Confidential

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## 1. INTRODUCTION AND SUMMARY

1. I have been asked by A2B Australia Ltd (A2B) to review and comment on the bottom-up costing analysis prepared by the Essential Services Commission of Victoria (ESC) in support of its draft decision to reduce the maximum non-cash payment surcharge for taxis from 5% to 4.5% (Including GST).
2. The non-cash payment transaction industry is a regulated industry in Victoria that is overseen by the ESC. Under the Commercial Passenger Vehicle Act 2017 (the CPVI Act), the ESC is tasked with role of setting the maximum fee that persons facilitating the making of non-cash payment transactions can impose on consumers that hire commercial passenger vehicles by way of a non-cash payment surcharge.<sup>1</sup> In determining the maximum non-cash payment surcharge payable by consumers, the ESC must ensure that persons facilitating the making of non-cash payment transactions are able to recover the reasonable cost of accepting and processing such transactions.<sup>2</sup> This is consistent with the ESC's objective of promoting efficiency in the non-cash payment transaction industry as well as its broader regulatory objectives, including ensuring the financial viability of that industry in the long-term interests of Victorian consumers.<sup>3</sup>
3. In its Tax Non-Cash Payment Surcharge review 2019 Draft Decision (Draft Decision), the ESC determined that the maximum non-cash payment surcharge for taxis be reduced from 5% to 4.5% (Including GST) from 1 January 2020.<sup>4</sup> This decision was, in part, based on the ESC's bottom-up cost assessment, which indicated that the reasonable costs incurred by taxi payment processors in accepting and processing non-cash payments ranged between 2.7% and 4.3%.<sup>5</sup>
4. A2B has asked me to review and comment on the ESC's bottom-up cost assessment as it applies to A2B and provide my own estimate of A2B's reasonable costs of processing non-cash payments.
5. For ease of reference, in the remainder of this report I refer to the 'non-cash payment surcharge' as the Service Fee. This terminology more accurately reflects the nature of the fee that is paid by consumers for the processing of in-taxi non-cash payments, i.e., a fee

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<sup>1</sup> See Commercial Passenger Vehicle Industry Act 2017 (CPVI Act), s.122. A 'non-cash payment surcharge' is defined as a fee or charge:

(a) added to the amount otherwise payable by the hirer in respect of the hiring of a commercial passenger vehicle because the payment of the amount otherwise payable is made wholly or partly by means of a non-cash payment transaction; or

(b) payable by the owner or driver of a commercial passenger vehicle or by all or any of them because the payment of an amount payable in respect of the hiring of the vehicle is made wholly or partly by means of a non-cash payment transaction.

<sup>2</sup> CPVI Act 2017, s.122(2).

<sup>3</sup> CPVI Act 2017, s.122 and Essential Services Commission Act 2001 (Vic), s.8 and 8A.

<sup>4</sup> ESC, Tax Non-Cash Payment Surcharge review 2019 Draft Decision, 30 May 2019, (Draft Decision), p. 1.

<sup>5</sup> Draft Decision, p. 6.

for the services provided by in-taxi payment processors, which are independent of and separate to taxi operators and drivers that supply taxi services.

- 1.1. Approach to estimating A2B's reasonable costs of non-cash payment processing
  6. When businesses produce multiple products or services there are a range of measures that can be used to establish the costs they incur in producing just one type of product or service:
    - a. At one end of the spectrum is *incremental cost* – this is a measure of the additional cost of producing the product or service given all the firm's other products or services are already being produced;
    - b. At the other end of the spectrum is *stand-alone cost* – this is a measure of the cost of producing the particular product or service if that were the only product or service being produced.
  7. In between these two measures is what is commonly referred to as *fully allocated cost* measures. These cost measures recognise that some costs are common to the production of different products or services and so should be allocated in some way between those products and services.
  8. I consider a fully allocated cost measure to be appropriate for determining A2B's reasonable costs of in-taxi payment processing. A fully allocated cost approach is consistent with the principle that in-taxi payment processors should not be required to price in a way that may jeopardise their ability to recover all of their costs (as may occur with incremental pricing) and is also consistent with the principle that in-taxi payment processors not be able to "double recover" any costs (as may occur with stand-alone cost pricing).
  9. In applying a fully allocated cost measure I first consider whether each cost that A2B incurs is associated with an activity that facilitates the processing of non-cash payments. Where the cost is not associated with an activity that facilitates payment processing, I exclude it from my analysis. For all other costs I consider whether it is:
    - a. A cost that can be directly attributed to A2B's in-taxi payment processing activities in Victoria; or
    - b. A common cost associated with A2B's activities in Victoria and other states of Australia; and/or
    - c. A common cost associated with A2B's activities as an in-taxi payment processor and as an issuer of Cabcharge card products.
  10. For those costs that are common across A2B's operations across Australia or its activities as a payment processor and as an issuer of card products, I have identified what I consider to be the most appropriate mechanism to attribute or allocate that cost to A2B's non-cash payment processing activities in Victoria.
  11. I note that my approach to estimating A2B's reasonable costs differs from that applied by the ESC. The ESC does not set out in its Draft Decision the framework it has applied to assess the reasonable costs of in-taxi payment processors. However, in its assessment of A2B's reasonable costs the ESC excludes some costs associated with activities that facilitate the processing of non-cash payments on the basis that:

- a. A2B outsources these activities but can and does provide them in-house (e.g., payments to Melbourne-based taxi networks); and
  - b. They are not considered by the Reserve Bank of Australia (RBA) as costs of payment acceptance in the context of the RBA's merchant surcharging rules (e.g., installation, training and administration costs).
12. It is not clear to me why the ESC considers it appropriate to exclude from its bottom-up cost analysis costs that A2B incurs that are related to activities that facilitate the processing of non-cash payments or why it considers the RBA's merchant surcharge rules to be an appropriate basis on which to prohibit A2B from recovering such costs through the Service Fee. In my opinion, in determining A2B's reasonable costs of non-cash payment processing, some allowance should be made for all direct and common costs that A2B incurs engaging in activities that facilitate the processing of non-cash payments.
- 1.2. Comments on the ESC's estimate of A2B's reasonable costs
  13. Adopting the framework I outline in section 1.1 above, I estimate A2B's reasonable costs of in-taxi non-cash payment processing to be in the range of ██████████ to ██████████ for the six month period ended 31 December 2018. My estimate is considerably higher than that of the ESC, which estimates A2B's reasonable costs to be only ██████████ over this six month period.
  14. The main reasons for the difference between my estimate and that of the ESC is that:
    - a. I allow for a greater portion of A2B's issuing costs to be included as reasonable costs of non-cash payment processing. Whereas the ESC allows A2B to recover a *notional interchange fee* equal to 0.5% of the value of Cabcharge card transactions processed I allow A2B to recover a *merchant services fee* equal to ██████████ to ██████████ of the value of all Cabcharge card transactions processed;
    - b. I consider all payments that A2B makes to taxi networks to be reasonable costs of non-cash payment processing. The ESC excludes from its estimate of A2B's reasonable costs those payments made to taxi networks that operate in Melbourne; and
    - c. For the purpose of estimating a return on capital I apply the post-tax weighted average cost of capital (WACC) estimate derived by A2B's advisors PWC, adjusted to a pre-tax rate ██████████. The ESC estimates its own range for A2B's pre-tax WACC based on an analysis of A2B's asset beta and applies the mid-point of its range of estimates (9.5%).
  15. I disagree with the ESC's reasoning in respect of each of these aspects of its Draft Decision.
- 1.2.1. Application of a *notional interchange fee* for the recovery of issuing costs
  16. In my opinion the ESC's application of a *notional interchange fee* in respect of Cabcharge card payments, which limits the proportion of A2B's issuing costs that it can recover through the Service Fee, is inappropriate both in concept and in its practical application.
  17. First, payment processors such as A2B do not directly pay interchange fees, they pay merchant services fees. The merchant services fees that A2B pays in respect of the credit card transactions it processes is, on average ██████████ for MasterCard credit cards (excluding MasterCard International cards) and ██████████ for Visa credit cards (excluding Visa International cards), which is almost ██████████ the *notional interchange fee* that the ESC

intends to allow for the recovery of A2B's issuing costs. The merchant services fees that A2B pays in respect of third party scheme cards is higher at [REDACTED] and is higher again in respect of MasterCard, Visa and UnionPay International cards at between [REDACTED] and [REDACTED]. These merchant services fees are not regulated by the RBA and, for third party cards, do not involve an interchange fee component.

18. The application of a notional 0.5% interchange fee would effectively result in A2B being treated more harshly than all other issuers and acquirers in four and three party card schemes in terms of the manner in which they are able to recover their costs. Such inconsistent or differential treatment of A2B is likely to lead to perverse outcomes. For example, if the Service Fee was set at a level equal to A2B's reasonable costs of payment processing, under the ESC's approach:
  - a. Other third party card schemes would have an advantage over A2B in the offer of travel card products to corporate customers as they would not face any regulatory restrictions in terms of the proportion of their issuing and acquiring costs that they could recover from in-taxi payment processors through the imposition of merchant service fees; and
  - b. A2B would not be capable of recovering its reasonable costs of non-cash payment processing if were to lose Cabcharge account holders following the imposition of account fees or interest charges. If Cabcharge account holders were to cancel their account following the imposition of such charges but payment for some of the taxi trips that employees of these account holders take were still processed by A2B as bank issued or third party card transactions, then A2B:
    - i. Would earn less revenue as a result of processing fewer taxi fares;
    - ii. Would be required to pay merchant services fees in respect of those lost Cabcharge card transactions that it managed to recapture, which would range anywhere from [REDACTED] to [REDACTED] of the GST inclusive value of the taxi fare; but
    - iii. would not experience any significant reduction in the other costs it incurs as an issuer and acquirer of Cabcharge cards.

As a result, A2B's reasonable costs would increase as a proportion of the value of taxi fares processed.

19. The ESC must take account of both of these potential outcomes given the requirement for it to ensure that in-taxi payment processors are able to recover their reasonable costs of payment processing and its broader regulatory objectives of ensuring the financial viability of the in-taxi payment processing industry.
20. Second, there is no clear conceptual rationale for applying something akin to an interchange fee in respect of payments made in a three party scheme. Interchange fees are not required in three-party schemes where the issuer and acquirer of card transactions are the same entity. In three party schemes issuers are able to decide how they recover their issuing costs from merchants on the one hand and cardholders on the other through the imposition of merchant services fees and account fees or other charges imposed on cardholders respectively. There is therefore no need for an operator of a three party card scheme to pay itself a notional interchange fee in order to recover a portion of its issuing costs from merchants.
21. In my opinion, rather than allowing for a notional interchange fee the ESC should allow A2B to recover a notional merchant services fee when estimating A2B's reasonable costs of

non-cash payment processing. In determining the value of the notional merchant services fee that should be applied, regard should be had to:

- a. The merchant services fees that A2B and other merchants in the taxi industry pay their acquirers in respect of cards of other three party card schemes;
- b. The size of A2B's Cabcharge card customer base as well as the scope and value of transactions over which A2B can recover its costs; and
- c. The nature of Cabcharge card products and the costs incurred in producing or providing those products relative to those incurred by other three party card schemes in the offer of their own card products.

#### 1.2.2. Exclusion of payments made to taxi networks in Melbourne

22. In my opinion, the ESC has no basis on which to exclude from A2B's reasonable costs the payments that A2B makes to taxi networks that operate in Melbourne (13CABS and Silvertop). The payments that A2B makes to taxi networks in Melbourne are for services that A2B would otherwise undertake itself to facilitate payment processing. The costs associated with the outsourcing of these services should therefore be included as reasonable costs of non-cash payment processing.
23. The ESC's acceptance of the *full value* of the payments that A2B makes to taxi networks in regional Victoria but *none* of the payments that A2B makes to taxi networks in Melbourne for the provision of the same services is logically inconsistent.

#### 1.2.3. ESC's estimate of A2B's WACC

24. The ESC has provided no basis for its estimation of A2B's WACC using A2B's observed asset beta. The approach adopted by the ESC is inconsistent with the approach that other regulators and consultants take to the estimation of a company's WACC in other contexts.
25. Absent any clear basis for adopting a different approach, in my opinion the ESC should adopt the WACC estimate provided by A2B, which was prepared by its external consultants, PwC Australia.

#### 1.3. Implications of excluding issuing costs for the determination of the Service Fee

26. The exclusion of issuing costs from A2B's cost stack in the ESC's Draft Decision and the inclusion of a notional interchange fee set at only 0.5% of the value of taxi fares processed suggests that the ESC considers that A2B should recover a large proportion of its issuing costs from account holders in the form of account fees, interest charges or other fees.
27. I agree with the ESC that only a portion of the costs that A2B incurs as an issuer of Cabcharge card products should be included as a reasonable cost of non-cash payment processing. However, I recognise that A2B does not currently charge Cabcharge account holders any such fees other than fees on late balances. As a result, if the Service Fee was set at a level that reflected A2B's reasonable costs of processing non-cash payments, A2B's payments business would make a loss equal to the value of that portion of its issuing costs that it cannot recover through the Service Fee. For the six months ended 31 December 2018, I estimate this loss to be between [REDACTED] and [REDACTED].
28. I also recognise that if A2B was to charge account holders for the services it provides it would lose some custom. If A2B were to impose additional fees on Cabcharge account holders some may cancel their account altogether and others may either reduce the scope

of services they acquire from A2B or reduce the volume of Cabcharge cards they are issued. Both of these potential outcomes will result in a reduction in the value of taxi fares that A2B processes relative to the value of transactions that it would process if it did not charge account holders one or more additional fees.

29. Any reduction in the value of taxi fares that A2B processes will have implications for the minimum Service Fee that A2B requires to recover its reasonable costs of non-cash payment processing. This is because a significant portion of A2B's costs are fixed or fixed over a certain volume of transactions. As a result, A2B's costs will not decline in line with a reduction in the volume or value of taxi fares that it processes. In determining the minimum Service Fee that A2B requires to recover its reasonable costs, the ESC must take this inevitable loss of volume into account.
30. I note that if A2B was to charge account holders additional fees for Cabcharge card services, this would also likely have a broader effect on the taxi industry. If Cabcharge's corporate customers were to cancel their account, their employees may opt to take work related trips using rideshare services as opposed to taxi services or may opt to pay in cash rather than by card. To the extent that this occurs, the imposition of additional fees in respect of Cabcharge card products will result in a reduction in the number and total value of taxi fares taken by consumers as well as a reduction in the volume and value of taxi fares processed by non-cash payment processors.

#### 1.4. Structure of report

31. The remainder of this report is structured as follows:
  - a. In Section 2 I set out my interpretation of the term 'reasonable cost' as it applies in the context of the CPIV Act and the basis on which I estimate A2B's reasonable costs of processing non-cash payments in taxis; and
  - b. In Section 3 I identify the costs incurred by A2B in respect of its non-cash payment processing activities in Victoria, comment on the ESC's treatment of these costs in its bottom-up analysis and set out my proposed treatment of each cost item. At the conclusion of this section I set out my estimate of A2B's reasonable costs of non-cash payment processing.



## 2. DEFINITION OF THE TERM 'REASONABLE COST'

32. When setting the maximum Service Fee payable in respect of non-cash payments in taxis, the ESC must ensure that taxi payment processors are able to recover the reasonable costs that they incur in accepting and processing non-cash transactions.<sup>6</sup> The term 'reasonable cost' is not defined in the CPVI Act, but is considered to include any fees payable for the acquisition of transactions involving the use of debit, credit or charge cards.<sup>7</sup>
33. The term 'reasonable cost' is not a term of art in economics. Rather, it is a term that must be considered in the context in which it is applied. In the sections below I first explain the various cost measures that could be applied to establish the reasonable cost of accepting and processing non-cash payments. I then set out my understanding of the context in which the ESC is required to set the maximum Service Fee levied on consumers in respect of non-cash payments made in taxis.
34. In light of that context, I set out my proposed approach to establishing A2B's reasonable costs for the purpose of determining the *minimum* Service Fee that A2B would require to recover its reasonable costs of in-taxi payment processing. This can be used to inform the ESC's determination of the *maximum* Service Fee to be applied from 1 January 2020.

### 2.1. Range of cost measures that could be applied to establish the 'reasonable cost' of accepting and processing non-cash payments

35. In-taxi payment processors in Australia carry out a range of different business activities in addition to payment processing. For example, A2B, GM Cabs and Ingogo each offer consumers taxi booking apps. A2B and GM cabs also operate their own taxi networks. A2B and Ingogo both offer payment products to corporate customers and provide those corporate customers with a credit facility.
36. When businesses produce multiple products or serve multiple customer segments there are a range of measures that can be used to establish the costs they incur in producing just one type product or service or in serving just one customer segment:
  - a. At one end of the spectrum is *incremental cost* – this is a measure of the additional cost of producing the product or serving the customer segment, given all the firm's other products are already being produced and all its other customer segments are already being served;
  - b. At the other end of the spectrum is *stand-alone cost* – this is a measure of the cost of producing the particular product if that were the only product produced or serving the customer segment if it were the only customer segment served.
37. The difference between incremental cost and stand-alone cost is costs that are shared between products and/or customer segments and would not be avoided if any one product or any one customer segment were no longer served. In an incremental cost measure these costs are excluded as they are not incremental to any product or customer group. In a stand-alone cost measure these costs are included and allocated in full to each product and customer segment.

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<sup>6</sup> CPVI Act 2017, s.122(2).

<sup>7</sup> CPVI Act 2017, s.122(3).

38. Where many of the costs incurred by a business are shared between different products or customer segments, the difference between incremental cost and stand alone cost can be substantial. In such a circumstance, neither incremental costs nor stand-alone costs are likely to be appropriate cost benchmarks for the purpose of establishing "cost-oriented" prices for particular products or services:
- a. If incremental cost is used as the relevant cost benchmark for pricing purposes a firm may not be able to recover its shared costs, which may threaten its long-term viability; whereas
  - b. If stand alone cost is used as the relevant cost benchmark for pricing purposes a firm would be able to recover all of its shared costs from the provision of a single product or customer segment. As a result it may be able to over-recover its shared costs by charging a price equal to stand alone cost for more than one product or service.
39. In between incremental cost and stand-alone cost are measures of cost that allocate shared costs in some way across the products and customer segments that share the costs. These measures are often called *fully allocated cost* measures.
- 2.2. Appropriate cost measure for determining the maximum Service Fee for processing non-cash payments in taxis
40. In determining the maximum Service Fee that may be levied on consumers for the provision of in-taxi payment processing services, the ESC is required to ensure that in-taxi payment processors are able to recover their reasonable costs.<sup>8</sup> The ESC is also required to have regard to its broader regulatory objective of protecting the long term interests of Victorian consumers.<sup>9</sup> In doing so it must take into account the price, quality and reliability of essential services as well as other factors such as:<sup>10</sup>
- a. The efficiency of the industry and incentives for long term investment;
  - b. The financial viability of the industry;
  - c. The degree of, and scope for, competition within the industry;
  - d. The benefits and costs of regulation; and
  - e. Consumers and users of products and services, including low income and vulnerable consumers.
41. Although the CPVI Act does not define the term 'reasonable cost', in my opinion the broader objectives of the ESC lend themselves to application of a fully allocated cost measure for the purpose estimating the reasonable costs of in-taxi payment processors. A fully allocated cost approach is consistent with the principle that in-taxi payment processors should not be required to price in a way that may jeopardise their ability to recover all of their costs (as may occur with incremental pricing) and is also consistent with the principle that in-taxi payment processors not be able to "double recover" any costs (as may occur with stand-alone cost pricing).

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<sup>8</sup> CPVI Act 2017, s.122(2).

<sup>9</sup> Essential Services Commission Act 2001 (Vic), s.8.

<sup>10</sup> Essential Services Commission Act 2001 (Vic), s.8A.

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42. Under a fully allocated cost approach, costs should, as far as possible, be attributed to the products or customer groups that cause them on the basis of relevant cost drivers. Some costs can be attributed to products or customer segments directly. Other common costs are only indirectly attributable (i.e., costs that are common to more than one product or customer segment but increase when additional customers are served) or not attributable at all (i.e., shared costs that do not vary with the number of products or customers served, such as some head office and IT costs).
  43. For the purpose of my analysis I have estimated A2B's reasonable costs of providing in-taxi payment processing services in Victoria by first identifying whether each of the costs incurred by A2B are costs associated with an activity that facilitates the processing of non-cash payments. For those costs that are associated with such an activity, I then consider:
    - a. Whether the cost item is directly attributable to A2B's payment processing activities in Victoria; or
    - b. Whether the cost item is common cost across:
      - i. A2B's payment processing activities in Victoria and the rest of Australia; and/or
      - ii. A2B's activities as a payment processor and as an issuer and acquirer of card products.
  44. For those costs that are common across A2B's various business activities and/or geographies and can be attributed to these activities and geographies on the basis of a cost driver, I have identified the cost driver that has been used to attribute these costs to A2B's non-cash payment processing activities in Victoria.
  45. For those common costs that are truly shared costs, and so cannot be attributed to any one business segment or geography on the basis of a cost driver, I have allocated these costs to:
    - i. A2B's activities in Victoria on the basis of revenue (or a proxy for revenue); and
    - ii. A2B's payment processing activities and, separately, its issuing activities, on the basis of the proportion of all direct and common costs that have been attributed to each of these activities.
  46. Although my estimate of A2B's reasonable costs can be used to determine the *minimum* Service Fee that A2B requires to recover its costs based on current market conditions, in determining the *maximum* Service Fee that it will allow in-taxi payment processors to levy on consumers the ESC should allow sufficient headroom above this level to ensure that A2B and other in-taxi payment processors can recover their reasonable costs over time. Such headroom should be sufficient to take account of:
    - a. Potential changes in market conditions that may have an effect on the volume and value of taxi fares processed by one or more payment processors – a reduction in the value of fares processed will lead to an increase in the Service Fee that payment processors require to recover their reasonable costs;
    - b. Potential changes in the cost of the products and services used as inputs into payment processing, e.g., merchant services fees, labour costs, etc; and
    - c. Potential changes in consumers' use of particular payment products – if consumers start shifting to the use of payment products that involve the imposition of higher merchant service fees, this will increase the reasonable cost of payment processing without changing the value of taxi fares processed and so necessitate an increase in

the minimum Service Fee required for payment processors to recover their reasonable costs.

47. Maintaining sufficient headroom above payment processors reasonable costs is also consistent with the ESC's broader objective of protecting the long term interests of Victorian consumers. In particular, the maximum Service Fee should be set at a level that allows for a sufficient margin above payment processors reasonable costs so as to:
  - a. provide payment processors with incentives to invest in the in-taxi payment industry and develop new products and services;
  - b. ensure the financial viability of efficient players in the industry; and
  - c. not put at risk the provision of services under the MPTP, which payment processors may cease to offer if the Service Fee is set at a level that does not allow them to recover their reasonable costs over time.

### 3. COSTS INCURRED BY A2B IN ACCEPTING AND PROCESSING NON-CASH PAYMENTS IN TAXIS

48. In the context of the ESC's Taxi Non-Cash Payment Surcharge Review, A2B identified the range of costs that its subsidiary, Cabcharge Payments Pty Ltd (Cabcharge Payments) incurred in the provision of non-cash payment processing services in Victoria for the six months ended 31 December 2018. These included:
- a. Merchant services fees payable in respect of taxi trips paid for using bank issued and third party cards;
  - b. Costs associated with the issue of Cabcharge cards including the cost of printing single use Cabcharge e-tickets and other Cabcharge cards, labour costs involved dealing with account holders and the administration of the Cabcharge card scheme and the holding of working capital to fund Cabcharge account holder credit;
  - c. Payments to taxi networks for the installation, repair and maintenance of payment terminals, administering payments made to drivers, trip investigations and other services provided to A2B;
  - d. Payments to taxi drivers to compensate them for the costs they incur in maintaining terminals and learning to use terminals;
  - e. Direct and indirect labour costs associated with A2B's payment processing activities and its activities as an issuer and acquirer of Cabcharge card products;
  - f. Other operating costs such as costs associated with maintaining payment infrastructure, the cost of sales and promotional activities and the cost of fraud;
  - g. Depreciation of assets;
  - h. Return on capital; and
  - i. Tax expenses.
49. This section identifies the nature of these cost items and discusses the manner in which the ESC has treated each for the purpose of determining A2B's reasonable costs of accepting and processing in-taxi non-cash payments in Victoria. Where I disagree with the ESC's approach, I set out my reasons and provide the basis for my own estimate of A2B's reasonable costs.
- 3.1. Merchant services fees
50. A2B pays merchant service fees to acquirers in respect of all taxi fares paid for by way of bank issued and third party cards.
51. The ESC considers the merchant services fees paid by A2B, which totalled just over [REDACTED] for the six months ended 31 December 2018, to be a reasonable cost of accepting and processing non-cash payments.
52. I agree with the ESC's treatment of merchant service fees as a direct cost of non-cash payment processing. I have only included in my analysis the merchant services fees paid by A2B that were paid in respect of fares processed by way of A2B's FAREWAYplus and Spotto Terminals.

### 3.2. Issuing costs

53. A2B does not pay merchant service fees in respect of taxi fares paid for by way of Cabcharge card products. However, it does incur a number of costs as both an issuer and acquirer of Cabcharge cards. These costs include:
- a. the costs associated with producing disposable Cabcharge cards;
  - b. the direct and indirect labour costs associated with the operation of the Cabcharge Card scheme (e.g. dealing with account holders, maintaining IT systems, billing etc); and
  - c. the use of working capital to fund account holder credit.
54. The ESC does not accept the costs incurred by A2B as an issuer of Cabcharge card products to be reasonable costs of non-cash payment processing.<sup>11</sup> It therefore excludes the costs that A2B incurs as both an issuer and acquirer of Cabcharge card products from its bottom-up analysis of A2B's reasonable costs.<sup>12</sup> The rationale provided by the ESC for the exclusion of A2B's issuing costs in particular, is its view that 'In payment systems these costs are generally recovered through account fees and interest charges'.<sup>13</sup> The ESC provides no support for this assertion.
55. Although the ESC does not consider issuing costs to be reasonable costs of non-cash payment processing, it allows for the recovery of a portion of A2B's issuing costs by way of a notional interchange fee in respect of payments made using Cabcharge cards. It sets this notional interchange fee to the RBA regulated weighted average fee (0.5%) that applies in respect of certain cards transactions in designated four party card schemes, namely transactions paid for by way of Visa and MasterCard credit cards and American Express companion cards issued by parties other than American Express.
56. No rationale was provided by the ESC in its Draft Decision for the inclusion of a notional interchange fee, although in subsequent correspondence the ESC noted that the majority of cards processed in taxis are from four party card schemes and that issuers of these cards must generally recover their issuing costs through account and interest charges.<sup>14</sup> The ESC acknowledged that the situation is not quite as straightforward for three party schemes such as the Cabcharge card scheme (where interchange fees are not charged by issuers to acquirers as they are the same entity) but provided no indication of how this fact was relevant to its decision to apply a notional interchange fee in respect of Cabcharge card transactions.
57. In its bottom-up cost analysis the ESC applied the notional interchange fee to its estimate of the Service Fee income generated by A2B in respect of taxi fares paid for by way of a Cabcharge card product. However, we understand from further correspondence that the notional interchange fee was intended to apply to the value of taxi fares processed by A2B

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<sup>11</sup> Draft Decision, p. 38.

<sup>12</sup> Given that A2B is both an issuer and an acquirer of Cabcharge card products, it is not easy to distinguish the costs it incurs as an issuer from those it incurs as an acquirer.

<sup>13</sup> Draft Decision, p. 38.

<sup>14</sup> Email from Jonathan Roberts, Project Manager at the ESC to Adrian Lucchese, Group General Counsel and Company Secretary of A2B, dated 17 July 2019.

that were paid for by way of a Cabcharge card product.<sup>15</sup> As a result of this error, the ESC underestimated its own view of A2B's reasonable costs by [REDACTED]

58. In my opinion, there is no strong rationale for limiting the quantum of issuing costs that A2B can recover through the Service Fee to the regulated weighted average interchange fee set by the RBA in respect of four-party card schemes.
59. First, interchange fees are not costs that are directly incurred by in-taxi payment processors. Rather, payment processors, including A2B, pay *merchant service fees* in respect of the payments that they process that are paid for by way of bank issued and third party cards. These merchant service fees allow for the recovery of costs associated with both issuing and acquiring and are not regulated by the RBA. The merchant services fees that A2B pays its acquirers as a proportion of the dollar value of taxi fares processed in respect of each type of bank issued and third party card is set out in Table 1 below.

**Table 1 Merchant service fees paid by A2B by card type**

Card Type	Merchant Service Fees
<b>Bank Issued Cards</b>	
Eftpos & eftpos prepaid	[REDACTED]
MasterCard Debit & Prepaid	[REDACTED]
Visa Debit & Prepaid	[REDACTED]
MasterCard credit	[REDACTED]
Visa Credit	[REDACTED]
UnionPay International	[REDACTED]
Visa International	[REDACTED]
MasterCard International	[REDACTED]
<b>Third Party Cards</b>	
American Express	[REDACTED]
Diners Club	[REDACTED]

Source: A2B.

60. As demonstrated in Table 1 above, the merchant service fees paid by Cabcharge in respect of taxi trips paid for by way of bank issued and third party cards are considerably higher than 0.5%.
- a. The only type of card in respect of which A2B pays a merchant service fee of 0.5% or less are [REDACTED] cards.

<sup>15</sup> Email from Jonathan Roberts, Project Manager at the ESC to Adrian Lucchese, Group General Counsel and Company Secretary of A2B, dated 17 July 2019.

- b. The merchant service fees that A2B pays in respect of other debit and prepaid cards range between [REDACTED] and [REDACTED]
  - c. The merchant services fees that A2B pays in respect of transactions made by way of those credit cards that are the subject of the RBA's 0.5% weighted average interchange fee cap (i.e., Visa and MasterCard credit cards) range from [REDACTED] to [REDACTED] which are almost [REDACTED] notional interchange fee that the ESC intends to apply in respect of Cabcharge card transactions. These fees are higher than the RBA weighted average fee cap because:
    - i. Under the RBA's interchange fee regulation, issuers may charge any one acquirer up to 0.8% of the value of transactions made by way of these cards (i.e., issuers must not charge more than 0.5% on average but are free to charge different interchange fees to different acquirers);<sup>16</sup> and
    - ii. [REDACTED]  
[REDACTED] The total merchant service fee charged by NAB is not regulated by the RBA.
  - d. The merchant service fees that A2B pays in respect of transactions made by way of cards that are not the subject of the RBA's interchange fee regulation are [REDACTED] for three party card schemes and range between [REDACTED] and [REDACTED] in respect of Visa, MasterCard and UnionPay international cards.<sup>17</sup>
61. Given that A2B pays merchant services fees that are considerably more than 0.5% of the value of taxi fares it processes to compensate its acquirers for the interchange fees that are charged by issuers (which may be more than 0.5%) and the costs they incur as acquirers, there is no basis on which the ESC should limit A2B, as an *issuer and acquirer* of Cabcharge cards, from charging its related payment processing business more than 0.5% of the value of taxi fares processed that are paid for by way of a Cabcharge card product. By limiting the value of the costs that A2B incurs as an issuer and acquirer of Cabcharge cards that can be recovered through the Service Fee to just 0.5% of the value of taxi fares it process that are paid for by way of a Cabcharge card product, the ESC is effectively:
- a. imposing more stringent regulation on A2B than the RBA imposes on other issuers and acquires in four-party card schemes; and
  - b. treating A2B differently to other operators of three party card schemes that are not subject to the RBA's interchange fee regulation.
62. Such inconsistent or differential treatment of A2B is likely to lead to perverse outcomes. For example, if the Service Fee was set at a level equal to A2B's reasonable costs of payment processing, under the ESC's approach:

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<sup>16</sup> See RBA Questions & Answers in relation to Card Payments Regulation at:  
<https://www.rba.gov.au/payments-and-infrastructure/review-of-card-payments-regulation/q-and-a/card-payments-regulation-qa-conclusions-paper.html#interchange-fees-q3>

<sup>17</sup> The ESC's own benchmarking analysis demonstrates that for smaller merchants, merchant service fees for acceptance of American Express and Diners Club Cards are in the range of 2.33% to 2.94% per transaction.



- a. Other third party card schemes would have an advantage over A2B in the offer of travel card products to corporate customers as they would not face any regulatory restrictions in terms of the proportion of their issuing and acquiring costs that they could recover from in-taxi payment processors through the imposition of merchant service fees (ie, these third party card issuers would not be required to recover a large portion of their issuing costs from corporate customers in the form of account fees or interest charges); and
  - b. A2B would not be capable of recovering its reasonable costs of non-cash payment processing if were to lose Cabcharge account holders following the imposition of account fees or interest charges. If Cabcharge account holders were to cancel their account following the imposition of such charges but payment for the taxi trips that employees of these account holders take were still processed by A2B as bank issued or third party card transactions, then A2B:
    - i. would be required to pay merchant service fees in respect of these transactions, which would range anywhere from [REDACTED] to [REDACTED] of the GST inclusive value of the taxi fare; but
    - ii. would not experience any significant reduction in the other costs it incurs as an issuer and acquirer of Cabcharge cards, since these costs are largely fixed.
63. The ESC must take both of these potential outcomes into account given the requirement for it to ensure that in-taxi payment processors are able to recover their reasonable costs of payment processing and its broader regulatory objectives of ensuring the financial viability of the in-taxi payment processing industry.
64. Second, there is no clear conceptual rationale for applying something akin to an interchange fee in respect of payments made in a three party scheme. As noted by the RBA, the rationale for interchange fees is that they encourage the growth of payment networks by redistributing revenues between participants to induce them to join.<sup>18</sup> Unless issuers in four party card schemes are able to recover the costs they incur (i.e., the cost of card production, funding cardholder interest free credit periods, administration costs and the cost of fraud) they will not have an incentive to join that card scheme. In the early days of payment networks, the imposition of interchange fees was the method by which issuers could recover the costs they incurred not just from their cardholders but from merchants that also valued their participation in the card scheme. This had the effect of encouraging take-up of credit cards by cardholders as it reduced the cost to them of using a credit card to pay for goods and services (ie, both cardholders and merchants valued the use of credit cards but unless merchants contributed to the costs incurred by issuers in providing credit and other associated services to cardholders there would be limited take-up of credit cards by cardholders).
65. Unlike the case for four-party card schemes, interchange fees are not required in three-party schemes where the issuer and acquirer of card transactions are the same entity. In three party schemes issuers are able to decide how much they charge their cardholders and the merchants that accept their cards. That is, they can balance the means by which they recover their costs of issuing and acquiring so as to grow their card scheme. There is

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<sup>18</sup> RBA, Debit and Credit Card Schemes in Australia, A study of interchange fees and access, October 2000, p. ii.

therefore no need for an operator of a three party card scheme to pay itself a notional interchange fee in order to recover a portion of its issuing costs from merchants.

66. Third, even if the ESC was to consider regulation akin to the RBA's interchange fee regulation to be appropriate to apply in respect of Cabcharge card payments, it would not be appropriate to simply apply the same weighted average fee cap that the RBA applies in respect of Visa and MasterCard card payments. The RBA weighted average interchange fee cap of 0.5% was put in place in 2005 based on an analysis of the issuing costs incurred by financial institutions in respect of Bankcard, Visa and MasterCard credit cards.<sup>19</sup> This interchange fee cap was set at a level that would compensate financial institutions for the range of eligible issuing costs they incurred including authorisation and processing costs, fraud-related costs and the cost of funding the interest-free period in respect of the cards they issued.<sup>20</sup> The fee cap was determined on the basis of an estimate of the portion of these costs that should be recovered from merchants as a percentage of the value of transactions processed by way of these cards.
67. However, there is no reason to expect the issuing costs that financial institutions incur in respect of Visa and MasterCard cards, which are used by consumers to purchase a wide range of goods and services, to be same as those incurred by A2B in respect of Cabcharge card products, which are used solely by employees of account holders to pay for taxi services. Whereas the RBA's analysis, which was conducted in the year 2000, indicated that the eligible issuing costs of financial institutions represented approximately 0.89% of the average value of credit card transactions, an analysis of A2B's costs indicates that the total issuing costs it incurs represent [REDACTED] of the value of all Cabcharge card transactions that it processes, with the costs that it incurs in funding credit representing [REDACTED] of the value of these transactions.<sup>21</sup>
68. Given the potential for significant differences in the issuing costs of major financial institutions and those of A2B as a proportion of the value of the Visa/MasterCard and Cabcharge card transactions that they process respectively, it is not appropriate for the ESC to apply the same weighted average interchange fee cap that it applies to issuers of Visa and MasterCard cards to A2B as an issuer of Cabcharge card products.

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<sup>19</sup> See RBA Payments System Board Annual Report – 2005, Credit and Charge Cards at: <https://www.rba.gov.au/publications/annual-reports/psb/2005/credit.html>

The cost study undertaken by the RBA in 2000 considered the costs incurred by four major banks and some smaller institutions that together accounted for around 95 per cent of credit card transactions in Australia. See

<sup>20</sup> See: RBA Common Benchmark for the Setting of Credit Card Interchange Fees – November 2005, Guidance Note at: <https://www.rba.gov.au/payments-and-infrastructure/credit-cards/cr-fees-benchmark/guidance.html>

<sup>21</sup> The RBA noted that the average credit card payment in 1999 was around \$100 per transaction. It estimated issuing costs to be approximately \$1.93 per transaction, of which \$0.89 related to funding of the interest free period, credit losses, fraud, authorisation and processing. See RBA, Debit and Credit Card Schemes in Australia, A study of interchange fees and access, October 2000, pp. 43 – 47.

I estimate A2B's issuing costs as they relate to its Victorian operations to be approximately [REDACTED] for the six months ended 31 December 2018, of which [REDACTED] is a return on working capital calculated on the basis of a pre-tax WACC of [REDACTED]. The total GST inclusive value of taxi fares that were paid for by way of a Cabcharge card product in Victoria for that same six month period was [REDACTED]

69. Although I do not consider the application of a notional interchange fee set at 0.5% of the value of taxi fares processed to be appropriate, based on the reasons set out in paragraphs 56 to 66 above, it may also not be appropriate to classify all of A2B's issuing costs as reasonable costs of non-cash payment processing. If all of A2B's issuing costs were to be considered reasonable costs of payment processing and included in A2B's cost stack, the maximum Service Fee may be set at a level that would allow all other in-taxi payment processors that are not also issuers of card products to earn revenues in excess of their reasonable costs.
70. The question then arises as to what proportion of the costs incurred by A2B as an issuer and acquirer of Cabcharge cards is appropriate to include as a reasonable cost incurred by A2B in the processing of non-cash payments. That is, what notional merchant service fee should be applied in respect of Cabcharge card transactions to allow A2B to recover from merchants (in this case, taxi payment processors) a proportion of the costs A2B incurs as an issuer and acquirer in a three party card scheme?
71. There is no one correct approach to determining the notional merchant service fee that should apply in respect of Cabcharge card transactions, with a 'reasonable' fee likely to sit within a wide bound. This is reflected in:
- a. The wide range of merchant services fees that A2B currently pays its acquirers in respect of the various cards it processes. As demonstrated in Table 1 above, A2B pays between [REDACTED] and [REDACTED] of the value of all credit card transactions to its acquirers in the form of merchant services fees.
  - b. The wide range of merchant services fees charged by acquirers in four and three party schemes to different sized merchants. For example, whereas A2B pays merchant service fees of between [REDACTED] and [REDACTED] to process Visa and MasterCard credit card transactions, the ESC's benchmarking analysis suggests smaller merchants may pay up to 1.76%.<sup>22</sup> Similarly, whereas A2B pays American Express and Diners Club merchant services fees of [REDACTED] the ESC's benchmarking analysis suggests that smaller merchants are more likely to pay somewhere in the range of 2.33% to 2.97%.<sup>23</sup>
72. The reasonableness of the merchant services fees charged in respect of a card scheme is likely to depend on the size of the scheme in terms of the volume and value of transactions over which issuers and acquirers can recover their costs. Three party schemes have more scope to lower their merchant services fees when their cards are widely accepted by merchants and consumers can and do use them to purchase high value goods. The higher the value of transactions processed, the lower the merchant services fee has to be to enable issuers and acquirers to recover their costs.
73. The reasonableness of the merchant services fees charged in respect of a card scheme is also likely to depend on the magnitude of the benefits provided to cardholders and merchants under that scheme. Card products that are costly to provide because they offer cardholders and/or merchants significant benefits are likely to involve higher merchant services fees.

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22 See ESC benchmarking analysis at <https://www.esc.vic.gov.au/transport/commercial-passenger-vehicles/commercial-passenger-vehicle-prices/taxi-non-cash-payment-surcharge-review-2019#abs-container2>

23 See ESC benchmarking analysis at <https://www.esc.vic.gov.au/transport/commercial-passenger-vehicles/commercial-passenger-vehicle-prices/taxi-non-cash-payment-surcharge-review-2019#abs-container2>

74. Although I have not come to a view on the magnitude of the notional merchant services fee that should be applied in respect of Cabcharge cards, in estimating A2B's reasonable costs of payment processing I have had regard to available information in relation to the merchant services fees payable by A2B and other merchants in respect of both four party and three party cards. In particular:
- Data provided by A2B indicates that the merchant services fees it pays in respect of the credit cards it processes fall within the range of [REDACTED] to [REDACTED] for four-party cards (Visa and MasterCard) and [REDACTED] for three party cards (American Express and Diners Club); and
  - The ESC's benchmarking analysis indicates that smaller merchants pay between 0.80% and 1.76% in respect of four-party cards (Visa and MasterCard) and between 2.33% and 2.97% in respect of three-party scheme cards (American Express and Diners Club).
75. For the purpose of my analysis I adopt two different point estimates for a notional merchant services fee to apply to Cabcharge card transactions:
- The first is [REDACTED] which is the merchant services fee that Cabcharge currently pays in respect of transactions processed by way of other three party scheme cards, American Express and Diners Club.
  - The second is 2.33%, which is the lower bound of the ESC's own estimate of the lowest merchant services fee that merchants the size of taxi drivers would be required to pay an acquirer to process American Express and Diners Club cards.
76. Although I have adopted these two point estimates for the purpose of my analysis, there are a number of reasons why it might be appropriate to apply a notional merchant services fee greater than [REDACTED] in respect of Cabcharge cards:
- First, both the American Express and Diners Club card schemes are larger than the Cabcharge card scheme in terms of their customer base the total value of transactions from which these schemes can recover their costs. Given that there are scale economies in issuing and acquiring, other things equal, schemes that process a greater value of transactions will require a smaller merchant services fee to recover their costs.
  - Second, the average value of American Express and Diners Club card transactions is likely to be larger than the average value of Cabcharge card transactions. This is because American Express and Diners Club cards can be used to purchase a range of goods and services such as meals, flights and hotels. By contrast, Cabcharge cards can only be used to purchase travel by taxi.
  - Third, A2B provides Cabcharge account holders with tailored products that involve significant labour costs in the context of a card scheme. In particular, A2B offers account holders single use tickets that may specify certain criteria in regard to their use, e.g., days and times of day that they may be used by staff. Loading these cards with the particular specifications of an account holder involves some manual labour.
77. The proportion of costs that A2B incurs as an issuer and acquirer in respect of the Cabcharge card scheme that would be recovered through a notional merchant services fee of [REDACTED] would be [REDACTED] and that the proportion that would be recovered through a notional merchant services fee of 2.33% would be to [REDACTED]%. That is, even applying a notional

merchant services fee of 2.33%, A2B would still be required to recover almost [REDACTED] of its issuing costs directly from income derived outside of the Service Fee.

78. If A2B were required to charge Cabcharge account holders additional fees for the services it provides, it could expect to experience a reduction in the volume and value of Cabcharge card transactions that it processes. This is because, when faced with an additional charge, some account holders may seek to cancel their account whereas others may reduce the scope of services they acquire from Cabcharge. Such a reduction in the value of transactions processed would have implications for the minimum Service Fee that A2B would require to recover its reasonable costs. Given that many of the costs incurred by A2B do not change with the volume of transactions processed, a reduction in both the volume and value of transactions processed will put upward pressure on the Service Fee A2B requires to recover its reasonable costs.

### 3.3. Payments to taxi networks

79. A2B pays taxi networks fees for the provision of various services that facilitate the making of non-cash transactions in taxis including:
- the installation of FAREWAYplus terminals in taxis – the installation of FAREWAYplus terminals involves the removal of parts if the taxi to enable extensive cabling work, which connects the payment terminal to the battery of the vehicle. This requires the taxi to be taken out of operation, with the works completed in an authorised workshop;
  - the maintenance and repair of FAREWAYplus terminals; and
  - other administrative activities involved in the processing of non-cash payments such as facilitating payments to drivers and assistance with transaction investigations.
80. A2B outsources these activities to taxi networks because they are better placed than A2B to deal directly with taxi operators and drivers. Because taxi networks already deal directly with drivers in the provision of their own services, they are able to carry out these activities more efficiently than A2B could if it was to conduct these activities in-house.
81. The ESC considers costs associated with the maintenance and repair of payment terminals to be reasonable costs associated with the processing of non-cash payments.<sup>24</sup> However, it remains silent in the Draft Decision as to whether it considers the costs associated with the other services that taxi networks provide to A2B (e.g., installation of payment terminals, facilitating payments to drivers and assistance with transaction investigations) to also be reasonable costs of payment processing.
82. Although the ESC accepts the maintenance and repair of terminals to be reasonable costs of payment processing, it does not include all payments that A2B makes to taxi networks in its bottom-up analysis of A2B's costs. Rather, in its bottom-up analysis the ESC includes as reasonable costs:
- All payments* made by A2B to taxi networks in regional Victoria, which amounted to [REDACTED] in the six months to 31 December 2018; but
  - None of the payments* made by A2B to taxi networks in Melbourne (13CABS and Silvertop), which amounted to almos [REDACTED] in the six months to 31 December 2018.

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<sup>24</sup> Draft Decision, p. 37.

83. The ESC accepts as reasonable costs the payments made by A2B to taxi networks in regional and rural Victoria on the basis that this arrangement replaces the workshops that it has in larger cities.<sup>25</sup> In subsequent correspondence, the ESC has informed A2B it has excluded from A2B's cost stack the payments that it makes to taxi networks in Melbourne because:<sup>26</sup>
- a. A2B has its own workshops in metropolitan Melbourne.
  - b. The ESC understands that A2B has separate contracts with metropolitan networks for maintenance, repair and installation of payment terminals.
  - c. Other payment processors are able to install, maintain, repair, and administer their terminals as well as train drivers without paying a commission to networks.
  - d. Training, installation, and administration costs would generally be considered merchant's internal costs. The RBA does not include these costs as costs of accepting non-cash payments in the context of its merchant surcharging rules.
  - e. Taxi networks provide a range of services to taxi operators and drivers, including the disbursement of fare revenue and fit-out and repair of vehicles. Taxi drivers pay taxi networks a fee for these services (network fees), which they recover through taxi fares. Taxi networks also offer taxi driver training courses, for which taxi drivers pay a fee. Given that these services, which are paid for by drivers, are the same services that A2B pays taxi networks to provide, the fees paid by A2B for the provision of these services should not be recovered through the Service Fee, ie, the cost of these services should not be recovered from consumers through both taxi fares and the Service Fee.
84. None of these explanations support the ESC's decision to exclude from A2B's reasonable costs the total value of payments made to the 13CABS and Silvertop taxi networks, ie, denying A2B recovery, through the Service Fee, of *any* costs associated with the installation, maintenance and repair of terminals installed in Melbourne-based taxis and the other activities carried out by these taxi networks on A2B's behalf in the Melbourne area.
85. First, whether or not A2B has its own workshops in Melbourne, carries out a subset of the activities that it pays taxi networks to provide and can do so more efficiently than the taxi networks is irrelevant to the question of whether the costs associated with these activities are, by their nature, reasonable costs of processing non-cash payments.
86. All of the activities undertaken by taxi networks for which they are paid a fee by A2B are activities that facilitate the acceptance and processing of non-cash payments. In particular:
- a. The installation of payment terminals within taxis is an efficient means to distribute terminals under a network model. Each taxi that belongs to a network may be used by multiple drivers over the course of a day. By installing the payment terminal within the taxi, A2B can minimise the number of payment terminals that it needs to distribute to

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<sup>25</sup> Draft Decision, p. 37.

<sup>26</sup> Draft Decision, p.37 and Email from Jonathan Roberts, Project Manager at the ESC to Adrian Lucchese, Group General Counsel and Company Secretary of A2B, dated 17 July 2019.

The ESC also noted that A2B provided the ESC with evidence that it was cheaper for regional networks to repair and maintain terminals rather than for A2B to provide those services in house, which was corroborated by regional networks.

each taxi network.<sup>27</sup> I understand from A2B that the installation of its FAREWAYplus payment terminals within taxis also has other benefits for both taxi networks and drivers over the use of handheld terminals including lower risk of power outage, greater reliability in terms of terminal reception, particularly in non-metropolitan areas, and greater accuracy of trip reporting (i.e., greater accuracy in the recording of the point of origin and destination and the time taken for each taxi trip). I understand from A2B that this latter benefit is particularly important for the investigation of trip queries.

- b. As accepted by the ESC, the maintenance and repair of both installed and handheld terminals is a cost that payment processors must carry out as part of the business of payment processing.
  - c. Putting systems and arrangements in place to facilitate the payment of taxi fares to drivers and investigating transaction queries are also necessary activities that all non-cash payment processors need to undertake in order to provide in-taxi payment processing services. As outlined in A2B's submission to the ESC dated 5 April 2019, the investigation of queries relating to taxi trips is considerably more complex than the investigation of transactions in other contexts.<sup>28</sup>
87. Given that the activities carried out by taxi networks, for which they are paid a fee by A2B, are activities that facilitate the processing of non-cash payments, some allowance should be made for the recovery of the costs incurred by A2B in relation to these activities through the Service Fee. Under the ESC's approach, *none of the costs* associated with these activities as they relate to taxis that belong to either the 13CABS or Silvertop networks have been included in A2B's cost stack as reasonable costs of non-cash payment processing.
88. Whether or not A2B separately provides a service of installing, maintain and repairing terminals to taxi networks in Melbourne (and so generates revenue that covers the cost of this activity) is irrelevant to the question of whether the payments made by A2B's payment processing business to Melbourne-based taxi networks are reasonable costs of processing non-cash payments. The payments made by A2B to taxi networks are for a bundle of services which taxi networks may carry out themselves or arrange to be carried out by third parties. The fact that some taxi networks contract the installation, maintenance and/or repair of terminals to A2B does not deny that there is a cost associated with this activity (and the arrangement of this activity), which A2B's payment processing business pays for as part of the payments it makes to taxi networks. If A2B was not able to recover this cost through the Service Fee, it would be incurring a cost in providing payment processing services for which it would not be compensated (i.e., A2B would incur a cost in the form of the fee paid to the taxi network, receive a portion of this fee back from the taxi network for carrying out the installation and also incur the costs of the installation). The cost of installation, repair and maintenance of terminals must therefore be recovered from consumers through the Service Fee, irrespective of whether the arrangement of those services are conducted in-house by payment processors or outsourced to taxi networks.

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<sup>27</sup> If A2B's FAREWAYplus terminals were not installed in taxis, networks would need to ensure that the mobile payment terminal that is allocated to each taxi is handed over from one driver to another at the beginning and end of their shift (which would involve some administrative costs and possibly also loss of terminals from time to time) or require each driver to have their own terminal. In either case, the number of terminals that A2B would need to distribute to networks is likely to be higher if its terminals were not installed in the taxi.

<sup>28</sup> See A2B Submission to the ESC dated 5 April 2019, pp. 6 – 7.

89. To clarify, I understand that A2B does not install, maintain or repair payment terminals for the Silvertop taxi network. Although it does provide these services for 13CABS from its workshop in Melbourne, none of the costs associated with the activities undertaken at A2B's workshop in Melbourne are included elsewhere in its cost stack.
90. Whether or not other in-taxi payment processors have arrangements in place with taxi networks for the provision of these services is also irrelevant to the question of whether they are reasonable costs of in-taxi payment processing. Unlike A2B, other payment processors primarily provide drivers with mobile payment terminals. These payment terminals are not as widely distributed as A2B's terminals and are used by drivers in addition to the FAREWAYplus payment terminals installed in their taxis. Although the mobile terminals provided by other payment processors do not require installation, they do require repair and maintenance. The costs incurred by A2B and other payment processors in repairing and maintaining these terminals should be considered a reasonable cost of non-cash payment processing, irrespective of whether payment processors arrange for such repairs and maintenance themselves or outsource this function to taxi networks.
91. Whether or not terminal installation, training and administration costs are accepted by the RBA as costs of acceptance under its merchant surcharging rules is also irrelevant to the question of whether such costs are reasonable costs of in-taxi payment processing. The RBA's merchant surcharge rules apply to merchants that charge consumers a fee associated with card payments for goods and services which the merchant also supplies.<sup>29</sup> Although merchants may be restricted from recovering certain costs associated with the acceptance of card payments, they do not prohibit merchants from recovering these costs from consumers through the prices they set for the underlying goods and services that they provide. By excluding the cost of terminal installation, training and administration from A2B's cost stack, the ESC is effectively prohibiting A2B from recovering these costs at all, since there is no other practicable means by which A2B can recover these costs from consumers.
92. Finally, whether or not a subset of the services provided by taxi networks to A2B can also be characterised as services provided by taxi networks to taxi operators and drivers, for which they are paid a fee from taxi operators/drivers, is also irrelevant to the question of whether the fees paid by A2B to taxi networks are reasonable costs of non-cash payment processing. Taxi networks carry out a bundle of services for taxi operators and drivers for which they are paid network fees. Because network fees are for a bundle of services, it is not possible to attribute a particular portion of the fee paid to any one service provided. Even if one could, this would not imply that taxi networks are being over-compensated for the services they are providing both A2B and taxi operators/drivers or that those networks would continue to provide these services in the same manner if they did not receive a fee from A2B. It is not uncommon for firms that provide the same service to more than one party to recover only a portion of the cost of providing that service from both.
93. There is also no reason in principle why consumers should not pay for the costs incurred in relation to the services provided by taxi networks to both A2B and taxi operators/drivers

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<sup>29</sup> I note that the RBA's merchant surcharge rules are designed to ensure that consumers are given appropriate price signals about the relative costs of the payment instruments that they use. Such concerns do not arise in the context of the taxi industry given the desirability of having a single Service Fee that applies to all types of card transactions. See Draft Decision, p. 15. It is therefore not clear why the ESC has had reference to the RBA's merchant surcharge rules in its assessment of the reasonable costs incurred by in-taxi payment processors.



through both taxi fares and the Service Fee. To the extent that Taxi networks recover a portion of the costs that they incur in the provision of these services from A2B and another portion of these costs from their members, then it is appropriate that these costs be recovered from consumers through both taxi fares and the Service Fee. To the extent that taxi networks are earning excess profits from the supply of services to both A2B and taxi operators/drivers, this should be addressed through regulation of taxi networks, not regulation of the Service Fee.

94. Absent any evidence that the payments made by A2B to taxi networks exceed the amount that A2B would incur if it was to carry out those same activities in-house, the full value of the payments made by A2B to all taxi networks should be included as reasonable costs of non-cash payment processing.
95. I consider A2B's payments to taxi networks to be a direct cost of non-cash payment processing. A2B has advised that total payments made to taxi networks in respect of its Victorian operations totalled [REDACTED] for the six months ended 31 December 2018.

#### 3.4. Payments to taxi drivers

96. As is the case for taxi networks, A2B also pays fees to taxi drivers with hand-held Spotto terminals. This fee is intended to compensate taxi drivers for the various activities that they need to undertake to process payments, including record keeping, day-to-day maintenance of the terminal and training and development, the cost of which they cannot recover through taxi fares.<sup>30</sup> The fee paid to drivers does not cover the cost of repairing Spotto terminals, which is the responsibility of A2B.
97. The ESC does not consider commissions paid to drivers to be a reasonable cost of processing non-cash payments.<sup>31</sup>
98. I agree with the ESC that payments to drivers are not reasonable costs of non-cash payment processing. Although drivers may incur costs in relation to their use of Spotto terminals, which they cannot recover through taxi fares, these are not costs that A2B would be required to incur if it did not make payments to drivers. A2B also does not compensate drivers that use FAREWAYplus terminals for the costs they incur in undertaking these same activities.

#### 3.5. Direct and indirect labour costs

99. A2B employs a number of staff that are engaged in activities that relate solely to its Cabcharge Payments business. These staff are engaged in the following broad activities:
- a. Cabcharge corporate accounts - staff that support account services including call centre staff, the marketing and sales team and staff that deal with invoicing and collections;
  - b. EFTPOS department - staff that assess and maintain faulty hardware and decide whether it requires repair or replacement;

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<sup>30</sup> See A2B Submission to the ESC dated 5 April 2019, pp. 8-9.

<sup>31</sup> Draft Decision, p. 37.

- c. Card production – staff that produce all types of Cabcharge cards, including MPTP cards;<sup>32</sup>
  - d. Merchant partners - staff that provide client support and engagement with taxi networks that are looking to install FAREWAYplus terminals in their fleet;
  - e. Spotto - staff that provide client support and engagement with taxi drivers that are looking to access a Spotto terminal;
  - f. Management – the CEO of Cabcharge Payments;
  - g. IT Switch – staff that operate A2B's switch;
  - h. IT Spotto - staff responsible for developing the Spotto terminal product and App and ensuring that the Spotto terminal complies with regulatory requirements; and
  - i. IT Cabcharge corporate accounts – staff involved in developing new products for Cabcharge account holders and supporting billing activities in relation to these customers.
100. A2B also employ staff that are engaged in support functions across the whole of its business. These include the CEO of A2B as well as the staff that work in A2B's legal, finance, human resources and IT departments.
101. The ESC considers the cost of staff that are engaged in activities that relate solely to payment processing (i.e. staff in the EFTPOS, Merchant partners, Spotto and IT Spotto departments), to be reasonable costs of non-cash payment processing and has accepted A2B's attribution of the cost of these staff to Victoria on the basis of:
- a. The number of terminals deployed by A2B in Victoria as a proportion of the total number of terminals deployed by A2B nationally. This allocation mechanism was used to attribute the cost of staff in the EFTPOS, Merchant Partners and Spotto departments; or
  - b. The GST inclusive value of taxi fares processed by A2B in Victoria as a proportion of the GST inclusive value of taxi fares processed by A2B in across Australia. This is a proxy for the share of A2B's payments revenue which is generated from its Victorian operations and was used to attribute the cost of staff in the IT Spotto department.
102. However, consistent with its view that A2B should not be able to recover, through the Service Fee, all of the costs it incurs as an issuer of Cabcharge card products, it excludes from its bottom-up analysis of A2B's costs the cost of those staff engaged in activities that relate to A2B's role as an issuer. More specifically, it excludes the cost of staff in the following departments: Cabcharge corporate accounts; Card production; and IT Cabcharge corporate accounts. The ESC allows A2B to recover only a portion of the cost of these staff through the Service Fee by way of the notional interchange fee that it includes in its analysis, as discussed in section 3.2 above.
103. Of the remaining categories of staff, the ESC considers:
- a. Cabcharge Payments management and the cost of staff that operate the A2B switch to be shared costs within A2B's payments business that should be:

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<sup>32</sup> The cost of E-tickets is labour intensive as staff are required to load the ticket with the specified requirements of the account holder (ie. must be no more than [REDACTED]).

- i. Allocated to A2B's Victorian activities on the basis of the GST inclusive value of taxi fares processed by A2B in Victoria as a proportion of the GST inclusive value of the taxi fares processed by A2B across Australia; and
    - ii. Allocated to A2B's payment processing activities, and separately, its issuing activities, on the basis of the split of all attributable costs incurred by A2B in relation to these two activities.
  - b. The cost of A2B staff that provide broad management or support functions across all of A2B's activities to be a shared cost across all of A2B that should be:
    - i. Allocated to A2B's payments business in Victoria on the basis of the proportion of all A2B revenue generated from Cabcharge Payments' Victorian operations; and
    - ii. Allocated to A2B's payment processing activities, and separately, its issuing activities, on the basis of the split of all attributable costs incurred by A2B in relation to these two activities.
- 104. I broadly agree with the ESC's approach to the treatment of A2B's direct and indirect staff costs, with the following exceptions.
- 105. First, I understand that the information A2B provided the ESC in relation to the value of taxi fares processed included data in relation to A2B's Giraffe terminals, which are used in hire cars, not taxis. I have identified the number of terminals deployed and the value of taxi fares processed by terminal type and have attributed:
  - a. the cost of staff in A2B's EFTPOS and Merchant Partners department on the basis of the number of FAREWAYplus and Spotto terminals deployed by A2B in Victoria as a proportion of the total number of terminals deployed by A2B nationally;<sup>33</sup> and
  - b. the cost of staff in A2B's IT Spotto department on the basis of the GST inclusive value of taxi fares processed by A2B using its FAREWAYplus and Spotto terminals in Victoria as a proportion of the GST inclusive value of all taxi fares processed by A2B across Australia.<sup>34</sup>
- 106. I also use the cost attribution mechanism described in paragraph 25105.b to allocate the cost of Cabcharge management to A2B's Victorian operations.
- 107. For staff in A2B's Spotto department, I have allocated the cost of these staff on the basis of the number of Spotto terminals deployed in Victoria as a proportion of the total number of Spotto terminals deployed nationally.<sup>35</sup> This is because these staff solely conduct activities in relation to A2B's Spotto terminal.
- 108. Second, I also understand that A2B's switch is used to facilitate the processing of all taxi fares paid for by way of bank issued and third party cards. It is not used to facilitate the processing of taxi fares paid for by way of a Cabcharge card. I therefore consider the cost

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33 This results in a slightly smaller attribution of this cost item to A2B's in-taxi payment processing activities in Victoria than that applied by the ESC [REDACTED] compared to [REDACTED].

34 This results in a slightly smaller attribution of this cost item to A2B's in-taxi payment processing activities in Victoria than that applied by the ESC [REDACTED] compared to [REDACTED].

35 This results in a slightly greater attribution of this cost item to A2B's in-taxi payment processing activities in Victoria than that applied by the ESC [REDACTED] compared to [REDACTED].

of staff involved in the operation of A2B's switch to be a direct cost of non-cash payment processing that can be fully attributed to A2B's payment processing activities. I allocate this cost to A2B's Victorian activities on the basis of the cost attribution mechanism described in paragraph 105.b above.

109. In addition, I understand that for internal reporting purposes A2B allocates █% of the cost of staff that provide management or support functions across all of A2B's activities to its payments business. A2B considers this to be an accurate reflection of the time spent by these staff on matters related to its payment business, including both its payment processing activities and activities as an issuer of payment products. For the purpose of my analysis I have adopted the same approach as the ESC in first allocating indirect labour costs to A2B's payments business for all of Australia (ie, on the basis of Cabcharge Payments revenue as a proportion of total A2B revenue, which for the six months ended 31 December 2018 was █ but note that an activity-based allocation mechanism, if one were to be developed, may justify a larger proportion of these costs (possibly up to █%) being allocated to A2B's Cabcharge Payments business.

### 3.6. Other operating costs

110. A2B incurs a range of other operating costs in the provision of payment processing services, including:
- a. Payment infrastructure costs;
  - b. Sales and promotion costs; and
  - c. Fraud costs.
111. Payment infrastructure costs include:<sup>36</sup>
- a. the cost of mobile communications, including the provision of third party infrastructure, sim cards and mobile data;
  - b. the cost of operating A2B's switch; and
  - c. costs associated with EFTPOS installation, testing, repair, consumables such as cabling, brackets, print rolls and postage and freight costs (note that this does not include the costs that A2B incurs installing, maintaining or repairing its terminals at its workshop in Melbourne).
112. Sales and promotion costs primarily comprise costs associated with the promotion of Spotto terminals to taxi drivers, although the precise nature of sales and promotion costs may differ from year to year.
113. Fraud costs relate to chargebacks that A2B is not able to successfully challenge or recover from drivers.
114. In the cost information it provided to the ESC, A2B had:

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<sup>36</sup> A2B submission to the ESC, 1 March 2019, p. 11.

- a. Attributed Payment infrastructure costs to its Victorian operations primarily on the basis of the number of terminals deployed in Victoria as a percentage of the number of terminals deployed nationally;<sup>37</sup>
  - b. Attributed Sales and promotion costs to its Victorian operations on the basis of the number of Spotto terminals deployed in Victoria as a percentage of the number of Spotto terminals deployed nationally; and
  - c. Attributed fraud costs to its Victorian operations on the basis of the number of terminals deployed in Victoria as a percentage of the number of terminals deployed nationally.
115. The ESC has accepted each of these costs as reasonable costs of non-cash payment processing. It considers payment infrastructure costs and the cost of fraud as being directly attributable to A2B's payment processing activities. The ESC accepted the figure provided by A2B in respect of the cost of fraud but thought that the figure provided by A2B in respect of its Payment infrastructure costs to be for the whole of Australia.<sup>38</sup> It therefore included only [REDACTED] of these costs in A2B's cost stack.
116. The ESC considers sales and promotion costs to be a shared cost and allocates this cost to A2B's activities as a payment processor and separately, to its activities as an issuer, on the basis of the split of all attributable costs incurred by A2B in relation to its payment processing and issuing activities.
117. I agree with the ESC's treatment of Payment infrastructure costs as being directly attributable to A2B's payment processing activities but have included the amount advised by A2B as being attributable to Victoria, with a small downward adjustment to take account of the fact that a small proportion of the terminals deployed in Victoria are Giraffe terminals.<sup>39</sup>
118. I also agree with the ESC's treatment of Sales and promotion costs as a cost that can be:
- a. Attributed to A2B's Victorian operations on the basis of the number of Spotto terminals deployed in Victoria as a percentage of the number of Spotto terminals deployed nationally; and
  - b. Allocated to A2B's payment processing activities, and separately, its issuing activities, on the basis of the split of all attributable costs incurred by A2B in relation to these two activities.
119. Finally, I agree with the ESC's treatment of Fraud costs as being directly attributable to A2B's payment processing activities. I have not applied any downward adjustment in respect of this cost given that A2B earns rental income from Giraffe terminals, not Service Fee income, and so chargebacks do not apply in respect of these terminals.

### 3.7. Return on and of capital

120. A2B has invested in a number of assets including its FAREWAYplus and Spotto terminals, its switch infrastructure and various other assets required to facilitate non-cash payment

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<sup>37</sup> The one exception was Communications costs, which were calculated based on actual number of FAREWAYplus and Spotto terminals multiplied by the average sim cost.

<sup>38</sup> Email from Jonathan Roberts, Project Manager at the ESC to Adrian Lucchese, Group General Counsel and Company Secretary of A2B, dated 17 July 2019.

<sup>39</sup> I have therefore taken the figure of [REDACTED] as advised by A2B, multiplied this by (35.8%/36.6%).

processing. A2B also requires working capital to support its payment product business. This is because there is a timing difference between the time that A2B pays taxi drivers fares paid for using a Cabcharge card and the time that A2B receives the funds in respect of such fares from Cabcharge account holders.

121. In its bottom-up cost analysis the ESC allowed A2B a return on and of capital for a portion of its physical assets. However, it did not allow A2B a return on its working capital as it considers this to be a cost associated with A2B's activities as an issuer of card products.<sup>40</sup>
122. In calculating a return on and of capital for A2B, the ESC:
  - a. Classified A2B's assets as those that are directly attributable to its payment processing business, directly attributable to its activities as an issuer of Cabcharge cards or shared between these two parts of A2B's business;
  - b. Accepted the depreciation charges identified by A2B in respect of those assets that are directly attributable to its payment processing activities and those that are shared between its payment processing and issuing activities;
  - c. Estimated the portion of A2B's assets and the proportion of depreciation on those assets that can be attributed to A2B's Victorian operations based on the number of terminals deployed in Victoria as a proportion of the total number of terminals deployed across Australia; and
  - d. Calculated a return on capital in respect of these assets based on its own estimate of A2B's pre-tax weighted average cost of capital (WACC), which it estimates to be between 9% and 10% (mid-point of 9.5%) based on the following parameters:
    - i. Current ten year risk free rates;
    - ii. A gearing ratio of between zero and 15%;
    - iii. A debt risk premium of just over 2% based on the return available in respect of BBB rated bonds; and
    - iv. An estimate of A2B's equity beta, which varies around 0.8 depending on whether the time period chosen for the analysis is five or ten years.
123. The ESC adopts a pre-tax WACC in order to account for tax expense.<sup>41</sup> It does not include a separate allowance for income tax in its assessment of A2B's costs, although does include an allowance for some tax costs that it could not distinguish from other costs incurred by A2B.
124. Although I agree with the general approach adopted by the ESC, I do not agree with the parameters that the ESC has chosen to estimate a return on and of capital for A2B. In particular, I do not agree with:
  - a. The ESC's identification of assets that are directly attributable to A2B's payment processing activities, directly attributable to A2B's activities as an issuer of card products or shared between A2B's payment processing and issuing activities; or
  - b. The ESC's estimate of A2B's WACC.

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<sup>40</sup> Draft Decision, p. 38.

<sup>41</sup> Draft Decision, p. 39.

3.7.1. A2B's asset base

125. Of the assets that A2B has identified as relating to its payments business across Australia, which collectively had a net book value of [REDACTED] as at 31 December 2018, the ESC estimates that:
- [REDACTED] or [REDACTED] are directly attributable to A2B's payment processing activities;
  - [REDACTED] or [REDACTED] are directly attributable to A2B's issuing activities; and
  - [REDACTED] or [REDACTED] support both A2B's payment processing and issuing activities.
126. The basis on which the ESC attributed assets to A2B's payment processing and issuing activities is not clear. In conducting its bottom up analysis the ESC did not seek clarification from A2B as to the nature of its assets and the extent to which they supported one or other of its payment processing or issuing activities or both of these activities.
127. A2B has advised that the net book value of its assets as at 31 December 2018 should be attributed as follows:
- [REDACTED] or [REDACTED] are directly attributable to A2B's payment processing activities; and
  - [REDACTED] or [REDACTED] are directly attributable to A2B's issuing activities.
128. The main difference between the ESC's attribution or allocation of assets and A2B's attribution of assets is the treatment of A2B's switch, which had a net book value of [REDACTED] as at 31 December 2018. The ESC identified this as an asset that supports both A2B's payment processing and issuing activities. However, this asset is used solely in relation to the processing of taxi fares paid for by way of bank issued and third party cards. It is therefore an asset that can be directly attributed to A2B's payment processing activities.
129. I have attributed those of A2B's assets that are directly attributable to its payment processing activities to its Victorian operations on the basis of the number of FAREWAYplus and Spotto terminals deployed by A2B in Victoria as a proportion of the total number of terminals deployed by A2B nationally (including Giraffe terminals)

3.7.2. A2B's WACC

130. The ESC was provided with an estimate of A2B's post-tax WACC as determined by its advisors PWC as at 30 June 2018.<sup>42</sup> PWC estimates A2B's WACC on a regular basis to, among other things, inform A2B's impairment testing for financial reporting purposes.<sup>43</sup>
131. It is not clear why the ESC chose not to adopt PWC's estimates of A2B's WACC for the purpose of determining an appropriate return on capital for A2B and other in-taxi payment processors for the six month period to 31 December 2018. The ESC provides no explanation in its Draft Decision as to why it considers PWC's estimate to be inadequate for this purpose.<sup>44</sup> The ESC has also not responded to A2B's request for clarification of the

<sup>42</sup> A2B Submission to the ESC dated 10 May 2019.

<sup>43</sup> PWC, Cabcharge Australia Limited, Weighted Average Cost of Capital, 26 July 2018.

<sup>44</sup> Draft Decision, p. 36.

basis on which the ESC chose to deviate from the assumptions adopted by PWC in its assessment of A2B's WACC.<sup>45</sup>

132. As part of its bottom-up analysis, the ESC derived its own pre-tax WACC estimates for A2B and other payment processors and applied the mid-point of the range of estimates that it derived, which was 9.5%.<sup>46</sup> Although we have not been provided with the ESC's calculations<sup>47</sup>, we understand that one of the main differences between the approach adopted by the ESC and that adopted by PWC is the methodology used to estimate A2B's asset beta and hence, equity beta. Whereas PWC estimated an asset beta for A2B based on an average of A2B's asset beta and the asset beta for a range of comparable companies, the ESC used A2B's actual equity beta without regard to any benchmark based on the asset beta of other firms that operate in the same industry.<sup>48</sup>
133. It is not clear why the ESC considers the estimation of A2B's WACC based on A2B's asset beta alone to be appropriate for the purpose of estimating the WACC for A2B and other payment processors. The use of observed asset betas for a single firm for the purpose of estimating that firm's WACC has been specifically rejected by other regulators in other contexts. For example, in its recent Review of Auckland International Airport's pricing decisions and expected performance (July 2017 – June 2022), the New Zealand Commerce Commission (NZCC) rejected Auckland Airports' claim that the NZCC should use the most recent estimates of Auckland Airport's observed asset beta to reflect the impact of its forecast capital expenditure plan, and the increase in operating leverage that this will introduce over time.<sup>49</sup> In response to this suggestion the NZCC noted:<sup>50</sup>

*Although Auckland Airport's observed asset beta is a useful reference point, we consider that asset beta estimates for a single company and over shorter reference periods are unreliable. Asset betas are 'noisy', and there is a significant risk of estimation error when focussing on the observed beta for an individual company. For this reason, we have used a comparator sample approach when determining asset beta estimates in the IMs.*

134. The NZCC noted that its approach of establishing an asset beta based on a sample of comparable firms (an approach which it also applies in the context of telecommunications regulation), has support from other economic consultancies. In particular, in the context of its WACC determination for Chorus' unbundled copper local loop and unbundled bitstream

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<sup>45</sup> On 12 July 2019 A2B asked the ESC to advise it of the rationale and basis upon which the ESC estimated an average equity beta for A2B of 0.62 and a pre-tax WACC of 9.5. A2B also requested that the ESC set out the basis on which it considered it reasonable to deviate from the assumptions adopted by PWC in its assessment of A2B's WACC. The ESC responded that it used A2B Australia's actual equity beta rather than an average of comparators, although provided no basis for preferring this approach to that adopted by the ESC.

<sup>46</sup> Draft Decision, p. 36.

<sup>47</sup> A2B requested that the ESC provide its WACC calculation on 25 July 2019. This has not yet been provided to A2B.

<sup>48</sup> Email from Jonathan Roberts, Project Manager at the ESC to Adrian Lucchese, Group General Counsel and Company Secretary of A2B, dated 17 July 2019.

<sup>49</sup> NZCC, Review of Auckland International Airport's pricing decisions and expected performance (July 2017 – June 2022), A181 – A194, pp. 138 – 141.

<sup>50</sup> NZCC, Review of Auckland International Airport's pricing decisions and expected performance (July 2017 – June 2022), A185, pp. 139.



access services, the NZCC received submissions that emphasised the importance of using a comparator sample when considering asset beta, rather than focussing on a single company. For example, the NZCC noted:<sup>51</sup>

*CEG submitted that "beta is subject to very significant measurement error and can change materially over time. This makes it preferable to have regard to asset beta estimates from a large sample of companies".*

*PwC submitted that "due to the high level of estimation error around a single company's beta, the beta analysis should always be based on a group of comparable firms, rather than relying on direct observations of the regulated firm's own beta".*

*Frontier Economics submitted that "regulators rarely rely on a single firm to estimate beta; rather, regulators prefer to rely on a sample of firms to minimise the effect of estimation error from any single comparator influencing the overall beta".*

135. Absent any strong rationale for adopting A2B's actual equity beta as opposed to the equity beta estimated by PWC, I consider it appropriate to use the WACC estimates derived by PWC as at 30 June 2018 for the purpose of estimating an appropriate return on capital for A2B for the six month period ended 31 December 2018. For the purpose of my analysis I have adopted the Vanilla Post-tax WACC that was the mid-point of the range of WACC estimates derived by PWC assuming 15% gearing and have converted this to an Officer Pre-tax WACC assuming:
- A company tax rate of 30%; and
  - A gamma of 0.585.<sup>52</sup>
136. On this basis I estimate A2B's pre-tax WACC to be [REDACTED]. Had I adopted PWC's mid-point Vanilla Post-tax WACC estimate assuming no gearing, the equivalent Officer pre-tax WACC would have been [REDACTED]. I have taken a conservative approach and used the lower of the two estimates, although note that given that the return on capital component of A2B's total costs is quite small, due to the low value of its asset base, doing so does not have a significant effect on the results on my analysis.

### 3.8. Tax expenses

137. A2B incurs income tax expenses as well as other tax costs, such as the cost of GST on inputs related to the offer of Cabcharge card services.
138. Although the ESC applied a pre-tax WACC when estimating A2B's return on capital, which avoids the need to include income tax as a separate item, it included in A2B's cost stack an allowance of [REDACTED] in 'Tax and other costs' on the basis that it was not provided with information from A2B separating income tax from other costs.<sup>53</sup> The ESC noted that this amount was likely an overestimate of the reasonable costs of A2B for this cost category.

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<sup>51</sup> NZCC, Review of Auckland International Airport's pricing decisions and expected performance (July 2017 – June 2022), A187, pp. 140.

<sup>52</sup> This is the value of gamma applied by the Australian Energy Regulator. See AER rate of Return Instrument, December 2018, para 27, p.19.

<sup>53</sup> See model provided by the ESC in the spreadsheet titled "(C-19-15370) -- SS - A2B - Bottom Up Cost Assessment - CONFIDENTIAL - 20190704.XLSX", Tab A2B- BUC assessment-VIC, cell G46.

139. I have not included an allowance for income tax in my analysis of A2B's reasonable costs but have included an amount of [REDACTED] which represents the amount of GST that A2B pays in relation to the inputs that it purchases that is not capable of being recovered by way of an input tax credit. This cost was allocated to A2B's Victorian operations on the basis of the number of terminals deployed in Victoria as a proportion of the number of terminals deployed nationally. I have directly attributed this cost to A2B's issuing activities and applied the same downward adjustment to this cost item as I applied to A2B's payment and infrastructure costs to take account of the fact that a small proportion of the terminals deployed in Victoria are Giraffe terminals.<sup>54</sup>

### 3.9. Summary of A2B's reasonable costs of payment processing

140. I set out in Table 2 below a summary of my estimate of the reasonable costs incurred by A2B for the six months ended 31 December 2018.

**Table 2 Reasonable costs incurred by A2B in processing non-cash payments in Victoria, 1 July 2018 to 31 December 2018**

	\$mill	Attributable Cost of Payment Processing Activities	Attributable Cost of Issuing Activities	Shared Cost – Allocated to Payment Processing	Shared Cost – Allocated to Issuing Activities
<b>OPERATING COSTS</b>					
<b>Taxi Payment Costs</b>					
Merchant service fees (For Bank Issued and Third Party Cards)	[REDACTED]	[REDACTED]			
Notional merchant service fee payable in respect of Cabcharge cards [REDACTED]	[REDACTED]	[REDACTED]			
Fees paid to Taxi Networks	[REDACTED]	[REDACTED]			
Card Production Costs	[REDACTED]		[REDACTED]		
<b>Labour Costs</b>					
Cabcharge corporate accounts	[REDACTED]		[REDACTED]		
Eftpos department	[REDACTED]	[REDACTED]			
Card production	[REDACTED]		[REDACTED]		

<sup>54</sup> I have therefore taken the figure of [REDACTED] as advised by A2B, multiplied this by (35.8%/36.6%)

	\$mill	Attributable Cost of Payment Processing Activities	Attributable Cost of Issuing Activities	Shared Cost – Allocated to Payment Processing	Shared Cost – Allocated to Issuing Activities
Merchant partners	█	█			
Spotto	█	█			
Management	█			█	█
IT Switch	█	█			
IT Spotto	█	█			
IT Cabcharge corporate accounts	█		█		
Indirect Labour Costs	█			█	█
Payment Infrastructure	█	█			
Sales and Promotions	█			█	█
Fraud costs	█	█			
GST not recovered	█		█		
<b>DEPRECIATION</b>					
Depreciation	█	█	█	-	-
<b>RETURN ON CAPITAL</b>					
Return on PP&E	█	█	█	-	-
Return on working capital	█		█		
<b>TOTAL COSTS</b>	█				

Source: CRA analysis based on data provided by A2B.

## Adrian Lucchese

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**From:** Adrian Lucchese  
**Sent:** Thursday, 25 July 2019 5:31 PM  
**To:** 'Jonathan.Roberts [REDACTED]'  
**Cc:** Craig.Madden [REDACTED]; Marcus.Crudder [REDACTED]  
**Subject:** RE: Update on A2B request for extension of deadline for submissions on ESC draft decision on non-cash payment surcharge

Hi Jonathan,

Thanks for your response.

It raises a number of important issues and further confirms that there is much that the ESC needs to consider before it can be in a position to release a final report where it is proposing to make a new price determination. In the circumstances, we believe that it would be important for us to meet the Commissioners before their 31 July meeting.

Would it be possible for you to please arrange the meeting.

The usual attendees from A2B would be present as well as our economic adviser from CRA.

We would be happy to accommodate the ESC's availabilities as much as possible for such a meeting.

We also request that you provide this email to the Commissioners so that they can take account of these matters when they meet on 31 July 2019.

In the meantime please see our responses below (in blue) which we would be happy to further discuss at or after our meeting with the Commissioners.

1. Commissions paid to 13CABS and Silvertop were excluded for the following reasons:

- Other payment processors are able to install, maintain, repair, and administer their terminals as well as train drivers without paying a commission to networks.
- Training, installation, and administration costs would generally be considered merchant's internal costs. The RBA does not include these as costs of accepting non-cash payments.
- Taxi operators pay networks fees each month for a variety of services. These include the traditional booking services, but also a number of ancillary services such as disbursing fare revenue and vehicle fit-out/repair. The cost of network fees are recovered by taxi operators through taxi fares. We also note that taxi networks offer taxi driver training courses. The fees for these courses are unregulated and paid by drivers. It seems that these ancillary services, which are paid for by operators and drivers (installation, maintenance, repair, administration, and training) are the same services that A2B pays commission to networks for. These services should not be paid for through the surcharge as well as through taxi fares and fees paid by drivers.
- Other stakeholders have told us that A2B has separate contracts with metropolitan networks for maintenance, repair and installation of payment terminals.
- A2B Australia provided evidence that it was cheaper for regional networks to repair and maintain terminals (A2B's letter 5 April 2019) rather than for A2B to provide those services in house. Regional networks corroborated this information.
- A2B provided information suggesting that Cabcharge has its own workshops for installation of payment terminals in Melbourne (page 11 of A2B's letter 5 April 2019).

A2B reiterates that the costs that it incurs to install, maintain, repair and administer payment terminals, train drivers to use its payment terminals and facilitate the numerous other activities conducted by taxi networks on behalf of A2B (as outlined in detail A2B's submission dated 5 April 2019), are costs incurred in the provision of the non-cash payment processing services it provides and should be able to be recovered by A2B through the service fee. In response to the points raised above:

- Whether or not other payment processors have arrangements in place with taxi networks in relation to these activities, for which they pay network fees, is irrelevant. A2B's FAREWAYplus payment terminals are installed in most taxis in Australia. As outlined in its submission, Cabcharge Payments has arrangements in place with taxi networks for the provision of these services because they are better placed than A2B to undertake them cost efficiently.

- . A2B is concerned by the ESC's continued references to the RBA's merchant surcharge rules in the context of this Inquiry. As we have explained in our submissions and consultation, the service fee that taxi payment processors charge consumers is not a surcharge (even if, from a consumers perspective, the service fee is payable at the same time that it pays the taxi fare to which the service fee applies). Rather, A2B is a provider of non-cash payment processing services and provides these services to consumers as a stand-alone activity (ie, the services A2B provides consumers are separate to and distinct from the transport services that are provided to consumers by taxi operators/taxi drivers). A2B recovers the cost of this activity from consumers through the imposition of a service fee. Given that there is no practicable means by which A2B can recover these costs from consumers other than through the service fee, A2B considers that the ESC has no reasonable basis for excluding these costs.
- . The services provided by taxi networks on A2B's behalf, for which A2B pays a fee, are separate to and distinct from the services provided by taxi networks to taxi operators.
- . Whether or not A2B has separate contracts with metropolitan networks for maintenance, repair and installation of payment terminals, whether it is cheaper for regional networks to repair and maintain terminals than for A2B to provide those services in-house or whether Cabcharge Payments has its own workshops for installation of payment terminals in Melbourne are irrelevant to the question of whether the activities carried out by all taxi networks, for which A2B pays a fee, relate to the provision of non-cash payment processing services. To the extent that the activities undertaken by taxi networks on A2B's behalf are necessary to facilitate the provision of non-cash payment services, the reasonable costs incurred by A2B in relation to these activities should be capable of being recovered through the service fee and are a necessary part of being able to provide the in-Taxi payment services.

2. It seemed in the modelling provided by A2B Australia that the ██████████ spent on payment infrastructure was for the whole of Australia rather than just Victoria. We encourage you to raise this point in your submission.

We are surprised that the ESC assumed an adjustment to this data was necessary without first clarifying its understanding and look forward to receiving the ESC's revised calculations taking this error into account.

3. It was not clear in the modelling provided by A2B that sales and promotion costs related solely to Spotto. We encourage you to raise this point in your submission.

We are surprised that the ESC assumed an adjustment to this data was necessary without first clarifying its understanding and look forward to receiving the ESC's revised calculations taking this error into account.

4. The majority of cards processed in taxis are from four party card schemes. In these schemes issuing and accepting parties are separate businesses. As a result issuing parties must generally recover their issuing costs through account and interest fees. We have acknowledged that the situation is not always quite as straightforward (as demonstrated by the inclusion of a notional interchange fee in our model) especially for three party schemes. If A2B could submit evidence, of the extent to which issuing costs are recovered by Amex and/or Diners Club through merchant service fees, this would be helpful.

A2B disagrees with the ESC's inclusion of a notional interchange fee in respect of payments made using Cabcharge card products on the basis that 'in payment systems, issuing costs are generally recovered through account fees and interest charges'.

Interchange fees are fees charged by issuers to acquirers in the context of four party card schemes. They are not charged by acquirers to parties that accept payments from consumers. Rather, acquirers in both three and four party schemes charge parties that accept non-cash payments from consumers merchant services fees. These fees are charged by acquirers to recover all or part of the costs they incur (including, in the case of four party schemes, the interchange fees they pay to issuers) and are not regulated by the RBA (ie, they are not limited to fees that reflect the cost of providing acquiring services).

As acknowledged by the ESC in its Draft Decision, one of the key costs faced by taxi payment processors are merchant service fees. The ESC's own benchmarking analysis indicates that the merchant services fees charged by acquirers to merchants that have a volume of card transactions similar to that of taxi operators/drivers range from between 1.69% and 2.97%, depending on the type of card for which a payment is processed. This is considerably higher than the 0.5% notional interchange fee incorrectly applied by the ESC in respect of Cabcharge Card payments.

In A2B's view, if the ESC considers it appropriate to exclude the activities of A2B as a three party card scheme operator from the determination of the service fee, it should exclude from A2B's cost stack the costs that A2B incurs as both an issuer and acquirer of Cabcharge cards and allow for a notional merchant service fee in respect of Cabcharge card payments (ie, a notional fee paid by A2B's payment processing business, which accepts payments from consumers, to its Cabcharge Card business, which accepts payments as an acquirer). In this way, Cabcharge Card payments would be treated in a similar way to all other card payments accepted by non-cash payment processors.

A2B notes that by including a notional interchange fee as opposed to a notional merchant services fee in A2B's cost stack, the ESC is effectively regulating Cabcharge's activity as an issuer of card products (ie, it is limiting Cabcharge from recovering its costs of issuing through the service fee in the same way that the RBA limits issuers from recovering the cost of issuing certain Visa, MasterCard and American Express cards through interchange fees). If this were the proper way to measure and regulate the non-cash Taxi Payment Service Fee then the RBA not the ESC would be the appropriate regulator. To have employed only the methodology of the RBA the ESC has erred and not discharged its statutory duties and objectives.

5. Thank you for pointing that out. We had intended the interchange fee to be applied to total turnover. We encourage you to raise this point in your submission. We also encourage you to submit your views on using the RBA benchmark rate as a notional interchange fee.

Thank you for acknowledging this error.

We will raise it in A2B's further submission although, as noted in response to point 4 above, A2B does not agree with the ESC's application of a notional interchange fee. It is clear that the ESC needs more time to be in a position to understand and define the Service Fee so that it can properly discharge its duties. In the context of the current review by the Victorian Legislative Council and Victorian government of the whole of the Passenger Vehicle Industry in Victoria, it is even more important for the ESC to take adequate steps to understand not only what it is regulating but also the regulatory, social and competitive landscape in which it is making its decision.

6. It was not clear in the modelling provided by A2B what the Cabcharge switch was. It appeared to be a switch solely for Cabcharge payment products. We encourage you to raise this point in your submission.

We are surprised that the ESC assumed an adjustment to this data was necessary without first clarifying its understanding and look forward to receiving the ESC's revised calculations taking this error into account.

7. See page 36 of our draft decision. We used A2B Australia's actual equity beta rather than an average of comparators'.

A2B requests that the ESC provide its calculation of A2B's pre-tax WACC.

8. We are open to considering an alternative method to account for GST. If you choose to submit an alternative method it would need to include a numerical example and account for the impact of GST credits. The approach you seem to propose in your last email does not appear to account for GST credits. Our approach accounts for GST credits by using the GST exclusive cost and revenue data provided by A2B Australia. We have attached a numerical example comparing a GST exclusive and inclusive approach.

Both approaches to calculating the service fee set out in the ESC's example provided in its 17 July 2019 email are inaccurate. The correct method for calculating the service fee required to cover A2B's reasonable costs of processing non-cash payments should take into account that:

- The costs included in the ESC's cost stack are exclusive of GST (ie, GST credits are accounted for since any GST paid by A2B paid for which it receives a GST credit has been excluded from the analysis). The service fee revenue retained by A2B after remitting GST to the ATO must be sufficient to cover these costs.
- The service fee that A2B charges is applied to the GST inclusive value of taxi fares processed. A2B's payment business does not receive any GST credits from the ATO in respect of taxi fares.
- The service fee that A2B charges is GST inclusive in respect of payments made by way of bank issued or third party cards (ie, A2B is required to remit one eleventh of the value of the service fee income to the ATO in respect of these payments). A2B does not charge GST in respect of payments made by way of Cabcharge products. In order to calculate the service fee required to cover A2B's reasonable costs it is therefore necessary to deduct one eleventh of the value of the service fee income collected by A2B in respect of trips for which payment was made using a bank issued or third party card from A2B's total service fee revenue.

Our expert economist's calculations show that the ESC's GST error alone creates a 10% variance in its calculations. When all of the ESC's errors (for example its misunderstanding and mischaracterisation of Taxi Network activities, not seeking clarification from industry participants and the subsequent exclusion or modification of significant legitimate costs of in-Taxi electronic payment processing services from its calculations, misunderstanding the role and nature of in-Taxi electronic payments and therefore using incorrect data in its calculations thereby understating the industry's reasonable costs of acceptance) are taken into account the minimum service fee would exceed the current 5% Service Fee cap.

If necessary, we would be happy to provide a numerical example at our proposed meeting.

Again, as previously advised there is a lot that the ESC needs to understand, consider and take into account before it can confidently give proper weight to its overarching statutory objectives with regard to the price, quality and reliability of essential services, and discharge the duty to comply with its statutory objectives. In this context the ESC should extend its self-imposed projected timeframe as it is more important to make a properly informed decision and discharge its duties than to expedite the process and risk not promoting the long term interests of Victorian consumers.

Please let me know when you can arrange for A2B and its economic adviser to meet with the Commissioners and also confirm that this correspondence together with our email of 12 July 2019 will be provided to the Commissioners with sufficient time for them to review prior to their 31 July 2019 meeting.

Kind regards

Adrian



**Adrian Lucchese**  
Group General Counsel  
& Company Secretary  
[Redacted]  
[A2BAustralia.com](http://A2BAustralia.com)

**From:** Jonathan.Roberts [Redacted] <Jonathan.Robert [Redacted]>  
**Sent:** Wednesday, 17 July 2019 4:36 PM  
**To:** Adrian Lucchese <Adrian.Lucchese [Redacted]>  
**Cc:** Craig.Madder [Redacted] Marcus.Crudden [Redacted]  
**Subject:** RE: Update on A2B request for extension of deadline for submissions on ESC draft decision on non-cash payment surcharge

Hi Adrian,

Happy to provide clarifications and thanks for moving the NDA forward with Deloitte. The additional information you provided below is also very helpful.

Please find responses to your questions below. If you or your colleagues disagree with any of the positions we have taken you are encouraged to explain why you disagree, with evidence, in your submission.

1. Commissions paid to 13CABS and Silvertop were excluded for the following reasons:

- Other payment processors are able to install, maintain, repair, and administer their terminals as well as train drivers without paying a commission to networks.
- Training, installation, and administration costs would generally be considered merchant's internal costs. The RBA does not include these as costs of accepting non-cash payments.
- Taxi operators pay networks fees each month for a variety of services. These include the traditional booking services, but also a number of ancillary services such as disbursing fare revenue and vehicle fit-out/repair. The cost of network fees are recovered by taxi operators through taxi fares. We also note that taxi networks offer taxi driver training courses. The fees for these courses are unregulated and paid by drivers. It seems that these ancillary services, which are paid for by operators and drivers (installation, maintenance, repair, administration, and training) are the same services that A2B pays commission to networks for. These services should not be paid for through the surcharge as well as through taxi fares and fees paid by drivers.
- Other stakeholders have told us that A2B has separate contracts with metropolitan networks for maintenance, repair and installation of payment terminals.
- A2B Australia provided evidence that it was cheaper for regional networks to repair and maintain terminals (A2B's letter 5 April 2019) rather than for A2B to provide those services in house. Regional networks corroborated this information.
- A2B provided information suggesting that Cabcharge has its own workshops for installation of payment terminals in Melbourne (page 11 of A2B's letter 5 April 2019).

2. It seemed in the modelling provided by A2B Australia that the ██████████ spent on payment infrastructure was for the whole of Australia rather than just Victoria. We encourage you to raise this point in your submission.

3. It was not clear in the modelling provided by A2B that sales and promotion costs related solely to Spotto. We encourage you to raise this point in your submission.

4. The majority of cards processed in taxis are from four party card schemes. In these schemes issuing and accepting parties are separate businesses. As a result issuing parties must generally recover their issuing costs through account and interest fees. We have acknowledged that the situation is not always quite as straightforward (as demonstrated by the inclusion of a notional interchange fee in our model) especially for three party schemes. If A2B could submit evidence, of the extent to which issuing costs are recovered by Amex and/or Diners Club through merchant service fees, this would be helpful.

5. Thank you for pointing that out. We had intended the interchange fee to be applied to total turnover. We encourage you to raise this point in your submission. We also encourage you to submit your views on using the RBA benchmark rate as a notional interchange fee.

6. It was not clear in the modelling provided by A2B what the Cabcharge switch was. It appeared to be a switch solely for Cabcharge payment products. We encourage you to raise this point in your submission.

7. See page 36 of our draft decision. We used A2B Australia's actual equity beta rather than an average of comparators'.

8. We are open to considering an alternative method to account for GST. If you choose to submit an alternative method it would need to include a numerical example and account for the impact of GST credits. The approach you seem to propose in your last email does not appear to account for GST credits. Our approach accounts for GST credits by using the GST exclusive cost and revenue data provided by A2B Australia. We have attached a numerical example comparing a GST exclusive and inclusive approach.

Please let me know if you have any further questions.



Kind regards,

**Jonathan Roberts**

Project Manager (acting), Transport, Price Monitoring and Regulation Division  
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From: Adrian Lucchese <Adrian.Lucchese@esc.vic.gov.au>  
To: "Jonathan Roberts" <Jonathan.Roberts@esc.vic.gov.au>  
Cc: "Marcus Crudder" <Marcus.Crudder@esc.vic.gov.au>, "Craig Madder" <Craig.Madder@esc.vic.gov.au>  
Date: 12/07/2019 05:00 PM  
Subject: RE: Update on A2B request for extension of deadline for submissions on ESC draft decision on non-cash payment surcharge

Hi Jonathan,

Thank you for your update and the extension of time in relation to receipt of A2B's submission on the ESC's draft decision. I have contacted Kris Funston (who is currently on leave) and have arranged a teleconference on Monday with him to move matters along with Deloitte.

In the meantime to assist us with preparation of our submission, assist with further consultation with the ESC and frame discussions with Deloitte could you please provide responses to the following preliminary questions:

1. **Could the ESC provide insight into the basis of its view that payments made by A2B to taxi networks are a reasonable cost of non-cash payment processing in areas where A2B does not have a workshop but not in areas where it does (ie, Melbourne)? That is, on what basis does the ESC exclude payments made by A2B to Silvertop and 13CABS from A2B's cost stack for the purpose of estimating the service fee required to cover A2B's reasonable costs of non-cash payment processing?**

A2B notes that it pays taxi networks [redacted] of the dollar value of taxi fares processed to compensate them for a range of services they provide including the installation, maintenance and repair of terminals as well as administration and the provision of training to drivers. These activities are a necessary part of providing non-cash payment processing services. By excluding the

payments that A2B makes to Silvertop and 13CABS, the ESC is effectively denying A2B recovery of the cost of these activities as it relates to these two taxi networks through the service fee. It is not clear why the ESC considers that the payments made by A2B to Silvertop and 13CABS should be recovered by means other than the service fee. It would also be useful to understand what other mechanism the ESC believes that A2B should use to recover its reasonable cost of processing in these circumstances and why it should employ a different model for regional areas than for the Melbourne CBD.

In a comment to cell E28 of its analysis, the ESC considers that there may be double or even triple counting of the costs of installation and maintenance of FAREWAYplus terminals in A2B's cost stack. A2B confirms that it does not conduct any installation or maintenance of FAREWAYplus terminals for Silvertop taxis. There is therefore no potential 'double counting' in relation to the payments made to this taxi network or any other network. Although A2B does carry out the installation and maintenance of terminals in its own workshops for 13CABS, the costs that A2B incurs in relation to this activity are not included elsewhere in A2B's cost stack. As a result, there is again no 'double counting' of the cost of this activity. The costs of all other activities carried out by 13CABS under its agreement with A2B are also not included elsewhere in A2B's cost stack.

In relation to the installation costs that A2B has capitalised in its 'Capital employed' spreadsheet, A2B notes that these relate to the replacement of all FAREWAYplus terminals that occurred nation-wide over an 18 month period ending in December 2016. At this time, all FAREWAYplus terminals were required to be replaced as a result of the switch from the 2G network to the 3G network (ie, the then existing FAREWAYplus terminals were not compatible with the 3G network). This replacement of all FAREWAYplus terminals was a necessary cost of processing non-cash payments that was not covered by the agreements that A2B has with each taxi network. There is therefore no 'triple counting' of the cost of installation of terminals.

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A2B notes that Payment Infrastructure Costs incurred in respect of its Victorian operations totalled [REDACTED] for the six months ended 31 December 2018 (ie, this is the portion of A2B's total Payment Infrastructure Costs that have been allocated to Victoria, largely on the basis of the volume of terminals deployed in Victoria as a percentage of all terminals deployed).

**3. Please advise of the rationale and basis upon which the ESC considers Sales and promotion costs to be a shared cost between A2B's non-cash payment processing and issuing activities?**

A2B notes that sales and promotion costs relate solely to the promotion of Spotto terminals and are therefore a direct cost associated with the provision of non-cash payment processing services.

**4. Please advise of the rationale and basis upon which the ESC asserts that in payment systems, issuing costs are generally recovered through account fees and interest charges?**

A2B understands that other three party card schemes such as American Express and Diners Club recover the costs of issuing and acquiring through a combination of merchant service fees, account fees and interest charges. A2B is not aware of any analysis that indicates that the issuing costs incurred by these three-party schemes are 'generally recovered through account fees and interest charges'.

**5. Please advise of the rationale and basis upon which the ESC considers the inclusion of a notional interchange fee it has set at 0.5% of the value of service fee income to be an appropriate means to compensate A2B for the cost of payment acceptance?**

A2B understands that the ESC has, as far as possible, excluded those costs incurred by A2B that relate to the issuing of Cabcharge products (See Draft Decision, p. 38). However, it includes in A2B's cost stack a notional interchange fee based on the weighted average regulated interchange fee set by the Reserve Bank of Australia (RBA) in respect of Visa and MasterCard credit cards as well as American Express companion cards. The ESC considers this regulated interchange fee to be an appropriate benchmark for A2B's cost of payment acceptance in respect of Cabcharge Cards (See Draft Decision, p. 39). This notional interchange fee is calculated as 0.5% of the value of the *service fee income* generated by A2B in Victoria, and has been further weighted down by reference to the value of all Cabcharge Card payments processed in Australia as a proportion of total card payments processed by A2B. Consequently, and consistent with other third party schemes, the ESC's notional interchange fee should have been applied to the value of Taxi fares processed. However, from the data that the ESC has provided it would appear that the ESC has mistakenly applied its notional interchange fee to A2B's service fee income.

Further, a notional interchange fee is an inappropriate benchmark for estimating A2B's costs of acceptance of Cabcharge Cards. A2B notes that all payment processors (including A2B) pay *merchant services fees* in respect of all non-cash payments (excluding Cabcharge Card payments). The merchant services fees charged by acquirers to payment processors are applied to the *value of taxi fares processed*, are not regulated by the RBA and are considerably higher than 0.5%. The ESC's own benchmarking analysis shows that third party card schemes such as Diners and AMEX charge between 1.76% and 2.97% with an average of 2.59%.

**6. Please advise of the rationale and basis upon which the ESC excludes the cost of the Cabcharge Switch from A2B's asset base, on which a return on and of capital is estimated for inclusion in A2B's cost stack?**

A2B notes that the Cabcharge Switch is used to process all non-cash card payments, except for those made using a Cabcharge

Card product. The use of a switch is a necessary cost incurred in the acceptance of non-cash payments. All processors of non-cash payments incur the costs associated with the operation of a switch.

**7. Please advise of the rationale and basis upon which the ESC estimated an average equity beta for A2B of 0.82 and a pre-tax WACC of 9.5%? On what basis does the ESC consider it reasonable to deviate from the assumptions adopted by PWC in its assessment of A2B's WACC?**

A2B notes that PWC estimated an equity beta for A2B in the range of [REDACTED] to [REDACTED] (assuming a normalised level of long-run gearing of 15%) and [REDACTED] to [REDACTED] (assuming A2B's actual level of gearing, which is almost [REDACTED]).

**8. Please advise of the rationale and basis upon which the ESC concluded that its calculation of the implied surcharge for A2B is GST inclusive?**

The ESC has calculated the implied surcharge required by A2B to cover its reasonable costs to be the GST exclusive value of its reasonable costs divided by the GST inclusive value of total taxi fares processed. The ESC notes the following in support of this calculation:

*"GST is accounted for as all inputs in this model are GST exclusive (A2B submission 10 May p. 4). Multiplying turnover and cost by 1.1 would lead to the same implied surcharge. There are some inaccuracies in this method, Cabcharge payment instruments are exempt from GST and labour and finance costs do not attract GST. We estimate that these differences would largely offset each other."*

A2B notes that ESC's calculation of the implied surcharge is inaccurate and is not inclusive of GST. The service fee charged by A2B is GST inclusive. A2B is required to remit 9.1% of the service fee income derived from payments made using cards other than Cabcharge Cards to the Australian Taxation Office (ATO). As a result, A2B's reasonable costs associated with processing of non-cash payments made using a card other than a Cabcharge Card must be recovered from 91.1% of the total value of the surcharges imposed in respect of these payments, where the surcharge is applied to the GST inclusive value of Taxi fares processed. The ESC's approach to estimating the implied surcharge does not account for this and therefore underestimates the implied surcharge that A2B would require to cover its reasonable costs of processing non-cash payments.

Even though it is clear that there is much to discuss and further consultation is needed to enable the ESC to give proper weight to its overarching statutory objective to protect the long term interests of Victorian consumers with regard to the price, quality and reliability of essential services, and to assign proper weight to its other statutory objectives, you have indicated in your email that the ESC has imposed upon itself a tight time frame to facilitate the making of a timely final decision. We would therefore be grateful if you could provide responses to our enquiries by COB 17 July 2019.

If you have any questions or require additional time to respond please contact me.

Kind regards

Adrian



**Adrian Lucchese**  
Group General Counsel  
& Company Secretary

[A2BAustralia.com](http://A2BAustralia.com)

From: [Jonathan.Robert](mailto:Jonathan.Robert@[REDACTED]) <[Jonathan.Robert](mailto:Jonathan.Robert@[REDACTED])>

Sent: Wednesday, 10 July 2019 5:30 PM

To: Adrian Lucchese <[Adrian.Lucchese](mailto:Adrian.Lucchese@[REDACTED])>

Cc: [Marcus.Crudder](mailto:Marcus.Crudder@[REDACTED]); [Craig.Madder](mailto:Craig.Madder@[REDACTED])

Subject: Update on A2B request for extension of deadline for submissions on ESC draft decision on non-cash payment surcharge

Hi Adrian,

Thanks for confirming that you received our spreadsheet. Please let me know if you or your consultants have any questions.

We thought it might be helpful to give you an update on our consideration of your request for an extension of the deadline for submissions to our draft decision.

We have considered your request at ESC staff level and consider that we can give A2B Australia two more weeks to provide its submission on our draft decision. This will extend the close of submissions on our draft decision for A2B Australia to 5 August 2019. This is the maximum extension we can offer that can reasonably be accommodated within the timeframes for this review as stated in the draft decision. These timeframes have been set to enable a final report, and if required, a new price determination to be made in September 2019. These timeframes are necessary to facilitate the making of a timely final decision by the commission that provides regulatory certainty for all regulated parties. We also note that we have an obligation to other stakeholders to meet the timeframes outlined in our draft decision so that they can make timely and appropriate business decisions. Accepting that the draft decision was made publicly available on 30 May 2019, we consider that this should provide A2B Australia with sufficient time and opportunity to make submissions (including expert submissions) on our draft decision.

The commission has yet to consider A2B Australia's request to revise the timetable for the review to take into account the Inquiry into the Commercial Passenger Vehicle Industry Act 2017 Reforms, and the Government's response to the Inquiry's findings. Staff have scheduled a briefing to commissioners on this matter for 31 July 2019. If the commissioners decide that a longer extension is appropriate we will inform you immediately.

Kind regards,

**Jonathan Roberts**

Project Manager (acting), Transport, Price Monitoring and Regulation Division  
Office contact days - Tuesday, Wednesday, Thursday and Friday



Level 37, 2 Lonsdale Street Melbourne VIC 3000

[jonathan.roberts@](mailto:jonathan.roberts@esc.vic.gov.au) [REDACTED]

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## Adrian Lucchese

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**From:** Adrian Lucchese  
**Sent:** Friday, 12 July 2019 5:00 PM  
**To:** 'Jonathan.Roberts'; [REDACTED]  
**Cc:** Marcus.Crudder; [REDACTED]; Craig.Madder; [REDACTED]  
**Subject:** RE: Update on A2B request for extension of deadline for submissions on ESC draft decision on non-cash payment surcharge

Hi Jonathan,

Thank you for your update and the extension of time in relation to receipt of A2B's submission on the ESC's draft decision.

I have contacted Kris Funston (who is currently on leave) and have arranged a teleconference on Monday with him to move matters along with Deloitte.

In the meantime to assist us with preparation of our submission, assist with further consultation with the ESC and frame discussions with Deloitte could you please provide responses to the following preliminary questions:

1. **Could the ESC provide insight into the basis of its view that payments made by A2B to taxi networks are a reasonable cost of non-cash payment processing in areas where A2B does not have a workshop but not in areas where it does (ie, Melbourne)? That is, on what basis does the ESC exclude payments made by A2B to Silvertop and 13CABS from A2B's cost stack for the purpose of estimating the service fee required to cover A2B's reasonable costs of non-cash payment processing?**

A2B notes that it pays taxi networks [REDACTED] of the dollar value of taxi fares processed to compensate them for a range of services they provide including the installation, maintenance and repair of terminals as well as administration and the provision of training to drivers. These activities are a necessary part of providing non-cash payment processing services. By excluding the payments that A2B makes to Silvertop and 13CABS, the ESC is effectively denying A2B recovery of the cost of these activities as it relates to these two taxi networks through the service fee. It is not clear why the ESC considers that the payments made by A2B to Silvertop and 13CABS should be recovered by means other than the service fee. It would also be useful to understand what other mechanism the ESC believes that A2B should use to recover its reasonable cost of processing in these circumstances and why it should employ a different model for regional areas than for the Melbourne CBD.

In a comment to cell E28 of its analysis, the ESC considers that there may be double or even triple counting of the costs of installation and maintenance of FAREWAYplus terminals in A2B's cost stack. A2B confirms that it does not conduct any installation or maintenance of FAREWAYplus terminals for Silvertop taxis. There is therefore no potential 'double counting' in relation to the payments made to this taxi network or any other network. Although A2B does carry out the installation and maintenance of terminals in its own workshops for 13CABS, the costs that A2B incurs in relation to this activity are not included elsewhere in A2B's cost stack. As a result, there is again no 'double counting' of the cost of this activity. The costs of all other activities carried out by 13CABS under its agreement with A2B are also not included elsewhere in A2B's cost stack.

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If you have any questions or require additional time to respond please contact me.

Kind regards

Adrian



**Adrian Lucchese**

Group General Counsel  
& Company Secretary

[A2BAustralia.com](http://A2BAustralia.com)

**From:** Jonathan.Roberts [redacted] <Jonathan.Roberts [redacted]>

**Sent:** Wednesday, 10 July 2019 5:30 PM

**To:** Adrian Lucchese <Adrian.Lucchese [redacted]>

**Cc:** Marcus.Cruder [redacted]; Craig.Madden [redacted]

**Subject:** Update on A2B request for extension of deadline for submissions on ESC draft decision on non-cash payment surcharge

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**Jonathan Roberts**

Project Manager (acting), Transport, Price Monitoring and Regulation Division  
Office contact days - Tuesday, Wednesday, Thursday and Friday



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