

SUBMISSION BY NATIONAL BILLING GROUP ON ESC DRAFT DETERMINATION ON NON-CASH SURCHARGES

1. The ESC's Draft Determination is in breach of Section 121 and 122 of the Commercial Passenger Services Act 2017 (CPS Act).¹

Key provisions (CPS Act) that bind the ESC's determination

SECT 121 Application of Essential Services Commission Act 2001

(1) For the purposes of the Essential Services Commission Act 2001 —

(a) this Division is relevant legislation; and

(b) the non-cash payment transaction industry is a regulated industry.

(2) If there is any inconsistency between a provision of this Division and a provision of the Essential Services Commission Act 2001, the provision of this Division prevails.

SECT 122 Objective of the ESC

(1) The objective of the ESC in relation to the non-cash payment transaction industry is to promote efficiency by regulating the amount that may be imposed by way of a non-cash payment surcharge.

(2) In seeking to achieve the objective specified in subsection (1), **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.**

(3) In this section—

"reasonable cost" includes any fees payable for the acquisition of transactions involving the use of debit, credit or charge cards.

NBG holds that in the draft non cash surcharge the ESC has failed to comply with the requirements of Section 121 of the Commercial Passenger Services Act (CPS) when there have been inconsistencies between the requirements of that Act and the Essential Services Commission Act (ESA).

The ESC has given undue weighting to "promoting the long term interests of Victorian Consumers" over the primary function prescribed in the CPS Act that: **"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"**. Further this requirement has precedence over any ESC Act provisions relating to Victorian Consumers.

The draft determination is weighted in favour of consumers. NBG details the impact of this below in our discussions of Moral Hazard, Omitting Fees that clearly fall within Sect 122 and other legislation governing surcharging, and determining a "flat ad valorem surcharge" that requires a payment processor to accept fares below reasonable costs (i.e. at a loss).

The CPS Act at Section 121 provides the ESC with explicit instructions that if there is a conflict between the provisions of the CPS Act and the ESA Act then the CPS Act prevails.

By the ESC electing to "promoting the long term interests of Victorian Consumers" over the requirement "to enable payment processors to recover reasonable costs of accepting and processing" non-cash transactions, as the CPS Act requires; the ESC has strayed beyond its mandate and consequently reached a flawed draft regulatory determination.

NBG's view is that the ESC's decision lack procedural fairness² as the ESC failed to give appropriate weight to the impact on the payment processor in their determination.

¹ See Appendix 1 for an excerpt of the relevant statutory provisions of both the Commercial Passenger Services Act 2017 and the Essential Services Commission Act 2001.

² <https://www.alrc.gov.au/publications/procedural-fairness-duty-and-its-content>

The use by the ESC of price cap building block methodology has as a fundamental tenet the its outcome is to “maximising of consumer welfare”. BUT the CPS Act clearly requires the application of Cost of Service Regulation methodologies if the ESC is to meet the obligations of Section 122 of the CPS Act.

Accordingly, the ESC has to revisit its methodology before the final determination and move to a Cost of Service regulatory methodology as prescribed by Section 122 of the CPS Act.

2. Moral Hazard NOT addressed by the ESC in the draft determination

By focussing on a price cap, a building block methodology, and setting ad valorem non cash surcharges the ESC has not addressed the Moral Hazard issues facing persons providing non-cash payment processing services in taxis in the Draft Determination.

Cost of Service Regulation, as envisaged by Section 122 of the CPS Act, subsume “consumer welfare” by requiring society to bear the full effect of the moral hazard behaviour of consumers NOT the firm. That is the firm should not incur a loss for the provision of the service.

But the approach taken by the ESC is to transfer the full Moral Hazard Risk onto the firm providing the service. This flows from the use of not only price cap regulation but also application of an ad valorem to determine the price cap. Accordingly, there are inadequate price signals to the consumer of the full costs of their payment choice.

In taxi payments the Moral Hazard has been entrenched by the State by prescribing that it is unlawful to refuse the payment of a fare by card. The Consumer does not bear the full cost of the service they receive. The price signals for many fares are weak. This encourages them to continue to use the service and the person providing them the service subsidises their behaviour. This is bad regulation.

From a public policy perspective if the State wants to encourage payment by card below cost then it should subsidise the payment processor. BUT the role of the ESC is to set a fee that enables a payment processor to recover their reasonable costs on any fare NOT just some of them.

NBG’s analysis of 4.09% price cap service fee has identified that for █% of the taxi fares paid by card today the reasonable cost of card acceptance will NOT be recovered by the payment processor.

When the non-cash surcharge service fee on █% of fares fails to recover the reasonable costs, as defined by the ESC, this is clear evidence that the ESC’s draft determination is founded on flawed methodology.

The alternative to Ad Valorem methodology of pricing is Postage Stamp pricing. The ESC failed to give appropriate consideration to the role that postage stamp pricing could play. Incorporating postage stamp pricing into the Determination can enable a payment processor to recover their reasonable costs on more fares than the existing Draft Determination. This would closer align the outcome with the provisions of Sect 122 of the CPS Act. NBG details more on this below with alternative options to consider.

The Methodology applied in the Bottom Up analysis was appropriate to a monopoly industry not one where there are multiple suppliers.

The logical long-term outcome of the ESC’s current approach is that the ESC ultimately will convert the provision of non-cash payment services in taxis to a single supplier market and then its approach will be valid.

3. The ESC draft determination has omitted fees incurred by persons providing non cash payment surcharges that clearly fall within the definition contained in Sect 122 of the CPS Act.

Sect 122 defines "reasonable cost" and includes "any fees payable for the acquisition of transactions involving the use of debit, credit or charge cards". The ESC has rejected payments made to third parties acting as agents, as an alternative to an Employee, of the person providing non cash payment surcharges. Yet these are fees incurred as a necessary cost to deliver the service. Accordingly, agent costs should be included in the building blocks as a reasonable cost.

Such costs are different to "subsidising unrelated services like fast food discounts for taxi drivers"³ and the provision of booking services, car washes, and coffee. Legitimately these should be excluded as they are ancillary services not costs incurred in acquiring transactions as specified in Sect 122(3) of the CPV Act.

The position of the ESC on agent costs is at odds with the Reserve Bank of Australia's Guidelines on Surcharging. These provide that:

"merchants may include some additional types of costs if they are directly related to accepting that particular card type they must be costs paid to an external provider and verified by contracts, statements or invoices."

Fees paid by the Taxi Payment Processor to Agents who are contracted to provide services related to accepting of credit and debit card transactions would fall within the reasonable costs recoverable under the RBA guidelines.

These same fees also would be allowable in the United Kingdom under "The Consumer Rights (Payment Surcharges) Regulations 2012" published by the Department of Business, Energy & Industrial Strategy.

Further Sect 32 of the Sheriff Act 2009 provides further guidance on Agents fees and the recovery of Reasonable Costs. The Sheriff Act includes at Section 32(2) "costs and expenses incurred in engaging and agent to sell property seized under a lawfully executed warrant". This brings Agents fees within the ambit of Reasonable Costs for a State Agency.

Finally, Section 122 of the CPS Act does NOT exclude any class of Fees. Rather Section 122 is all embracing and defines that "reasonable cost" includes any fees payable for the acquisition of transactions involving the use of debit, credit or charge cards".

Accordingly, the ESC exclusion of payments made to agents in its Draft Determination is wrong in law and the ESC needs to include them in its Final Determination.

4. The application of an Ad Valorem surcharge prevents a person providing non cash payment services from recovering their reasonable costs for the acquisition of transactions involving the use of debit, credit or charge cards as required by Section 122 of the CPV Act

An ad valorem methodology enables recovery of reasonable costs in some but not all transactions when the providers costs include a significant "postage stamp" cost base. Setting an ad valorem fee below the reasonable costs for ■% of transactions is a clear contravention of Section 122 of the CPS Act on the part of the ESC.

The structure of the merchant services fees and interchange fees is such that for a ■% of transactions the payment processor cannot recover their "reasonable costs" as defined by Section 122.

³ John Hamill ESC Media Release 30 May 2019 "Cutting costs for taxi users on the cards"

The CPS Act does NOT provide that some transactions will be processed below the recovery of reasonable costs. Rather it makes a positive statement and requires that on all transactions a person providing payment services can recover their reasonable costs in providing the services.

The ESC cannot set a Surcharge Level that only allows reasonable costs recovery on some transactions, even if in its view the losses on some transactions will be compensated by over recovery in others.

The CPS Act simply does NOT provide the ESC with an administrative discretion to require a payment processor to recover fees below their reasonable costs. By pursuing this the ESC exposes the provider to an intolerable market risk as it is prohibited from rejecting these transactions by regulation. This is a significant flaw in the determination and is inherent in setting a common ad valorem surcharge for all transactions.

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7. The ESC has not understood the supply chain and the role of a Merchant Aggregator in the supply chain.

The Draft Determination has maintained a flawed description of the Supply Chain. The Taxi Payment Processor is NOT a Merchant but a Merchant Aggregator. The services provided by and cost structures of a Merchant Aggregator in the payment system are very different to those of a Merchant as characterised by the ESC in its Draft Determination.

The ESC was advised of the appropriate descriptor not only by NBG in its submission but also by MasterCard⁴ in its submission. Despite this the ESC chose to ignore this advice and accordingly reached flawed conclusions on services and cost.

The ESC continues to use the incorrect industry structure for its supply chain analysis, and this results in flawed analysis of the reasonable costs.

8. GST is defined as a Merchant Cost which cannot be recovered from Consumers. This continues a flaw in the initial decisions by the Taxi Services Commission in 2016.

GST is a consumption tax collected by Merchants and passed through to the ATO. It is never imposed on merchants as a cost except in the Taxi industry. Perpetuating the 2016 decisions by the TSC corrupts the intent and operation of the GST.

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⁴ Mastercard Submission dated 8 Feb 2019 found at <https://www.esc.vic.gov.au/sites/default/files/documents/Mastercard.pdf>





10. Benchmarking Analysis is Deceptive:

The ESC's table on Benchmarking analysis fails to disclose the changes that occurred when a jurisdiction moved to a 0% non-cash surcharge. For example, in London UK the removal of the surcharge was accompanied by

1. An 8.33% increase in flag fall specifically to offset the removal of the 10% surcharge. Accordingly every taxi fare increased and those paying cash subsidised fares paid by card.
2. TFL regulated the companies that could process card payments thus providing a free lifetime license to those providers and erecting a barrier to entry as drivers were required to have these facilities.
3. These providers-imposed fees on drivers for the services provided.
4. Drivers were compelled to accept card payments if requested.
5. The net consumer benefit was negative.

A similar outcome can be found in every jurisdiction which has a 0% surcharge throughout the USA and the UK

Accordingly, it is wrong to imply that passengers are not paying a surcharge for card acceptance in jurisdictions with a 0% surcharge.

NBG is available to discuss the matters raised in this submission with the ESC.

22 July 2019

APPENDIX 1

KEY LEGISLATIVE REQUIREMENTS

Commercial Passenger Services Act 2017 – Key provisions (CPS Act)

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 - (b) the non-cash payment transaction industry is a regulated industry.
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- "reasonable cost" includes any fees payable for the acquisition of transactions involving the use of debit, credit or charge cards.

Essential Services Commission Act 2001 – Key Provisions

S 8 (1) Objective of the Commission

In performing its functions and exercising its powers, the objective of the Commission is to promote the long term interests of Victorian consumers.

s. 8 (2) Without derogating from subsection (1), in performing its functions and exercising its powers in relation to essential services, the Commission must in seeking to achieve the objective specified in subsection (1) have regard to the price, quality and reliability of essential services.

s. 8A (1) Matters the Commission must have regard to

In seeking to achieve the objective specified in section 8, the Commission must have regard to the following matters to the extent that they are relevant in any particular case—

- (a) efficiency in 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, including countervailing market power and information asymmetries;
- (d) the relevant health, safety, environmental and social legislation applying to the industry;
- (e) the benefits and costs of regulation (including externalities and the gains from competition and efficiency) for—
 - (i) consumers and users of products or services (including low income and vulnerable consumers);
 - (ii) regulated entities;
- (f) consistency in regulation between States and on a national basis;
- (g) any matters specified in the empowering instrument.