

Payment surcharges

Response to the Which? super-complaint

June 2011

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1 EXECUTIVE SUMMARY

- 1.1 The growth of online trade has brought many benefits. Retailers are able to reach a much wider audience to sell their products and consumers have access to a wider range of retailers.
- 1.2 However, online trade also creates some new concerns. One issue that has become increasingly prevalent is that some retailers are adding extra fees (or surcharges) to the price of a purchase based on a consumer's choice of payment mechanism, such as a debit or credit card. In effect, consumers are 'paying to pay'. These 'payment surcharges' are more common when making online transactions, where consumers are unable to pay by cash or cheque, than they are for face-to-face transactions.
- 1.3 Payment surcharges are particularly common in the airline sector – but are also imposed by some retailers in other sectors, including rail, ferries, taxis, event tickets, cinemas, car dealerships and hotels.
- 1.4 The amount that consumers spend on payment surcharges is high. For example, we estimate that UK consumers spent around £300 million¹ on payment surcharges in 2010² in the airline sector alone
- 1.5 The evidence provided by Which? indicates that consumers strongly object to 'paying for paying' – this is supported by the OFT's own consumer research conducted in 2010, which found that 87 per cent of consumers objected to extra charges for credit cards and 91 per cent objected to extra charges for debit cards.³

¹ Based on per journey surcharges and UK passenger numbers of 10 airlines operating in the UK

² UK airlines total operating revenue 2009 was £17.8bn (CAA data).

³ See OFT 2010 'Advertising of Prices Market Study' www.oft.gov.uk/OFTwork/markets-work/completed/advertising-prices/

The super-complaint

- 1.6 On 30 March 2011, Which? submitted a super-complaint to the OFT about retailers in passenger transport markets imposing surcharges on consumers for paying by debit or credit cards where consumers have no practical alternative ways of paying.
- 1.7 Which? identified three features which it thought resulted in consumer detriment:
- a. lack of transparency. Surcharges are often only revealed towards the end of a lengthy transaction process and so it can be difficult to compare prices across competing retailers
 - b. lack of a reasonable, practical alternative to avoid the fee, and
 - c. surcharges often appear to exceed reasonable estimates of retailers' costs of processing payments.
- 1.8 In line with the Which? super-complaint, our report focuses on the passenger transport sector, namely airlines, ferry operators and rail ticket resellers. However, we believe that the principles established within this report apply equally to all UK commercial traders.

Lack of transparency and reasonable alternatives

- 1.9 The practice of presenting a headline price and then adding extra charges as the consumer goes through the purchasing process, known as 'drip pricing', was highlighted in the OFT's *Advertising of Prices Market Study*. The report established, with a compelling range of evidence, that drip pricing is influential in changing consumers' shopping behaviour. In particular drip pricing:
- reduces the extent to which consumers shop around because searching and comparing between full price offers is more difficult
 - can affect consumer choices as by the time surcharges are revealed they have invested time in the transaction and feel committed to it. Consumers are then less likely to be willing to invest more time in

comparing offers, particularly if they expect to encounter similar practices elsewhere, and

- can affect consumers' purchasing decisions as they focus (or 'anchor') on the headline price and then fail to adjust their assessment of the total value of the offer sufficiently as additional charges are revealed, therefore overestimating the total value.

1.10 The OFT recognises that there may be some consumer benefits from separating optional charges from the headline price as it allows consumers to tailor products to include the options they want or need, but the study concluded that it is **misleading to separate compulsory charges from the headline prices**.

1.11 With the benefit of this previous research and evidence gathered as part of the research for the super-complaint, the OFT therefore considers that consumer detriment is most likely to arise where features a) and b) of the Which? super-complaint are both present. With respect to payment surcharges, the OFT has concluded that:

- payment surcharges are often presented as drip prices. Charges are only added to the total price late in the buying process, often after customers have gone through numerous web pages tailoring the product or service to their needs and providing personal information, and
- when the headline price is unachievable for the majority of consumers, because the payment mechanism which incurs no surcharge is only available to a small minority of consumers, paying some form of surcharge is, in effect, compulsory.

1.12 The OFT has found considerable evidence of practices which include both of these features in the passenger transport markets and, in particular, in the airline sector.

Level of charges

1.13 With respect to the level of surcharges, initial estimates suggest that in some cases the costs retailers incur to process payments may actually

be higher than indicated in the Which? super-complaint. However, getting a true picture would involve a detailed allocation of fixed costs which has not been possible within the super-complaint 90-day timetable.

- 1.14 The OFT does not consider that such a detailed analysis of costs is necessary at this stage. Consumer detriment occurs because the lack of transparency of surcharges and the lack of a practical alternative to avoid the surcharge reduce the extent to which consumers shop around and compare full price offers. This weakens the competitive pressure between retailers and can result in consumers not getting the best deal. We believe that making information on surcharges clearer and more timely would help consumers avoid them and encourage competition between retailers, driving down the price of genuinely optional surcharges.

Conclusions

- 1.15 The OFT accepts that where retailers charge different prices for different payment mechanisms, reflecting their underlying costs, this may benefit consumers by creating a signal to help them make efficient choices between payment mechanisms. However the OFT believes that headline prices need to be presented in a way that gives consumers a proper ability to shop around.
- 1.16 **The OFT's view is that retailers should make headline prices meaningful for comparison purposes by not imposing surcharges for debit cards, which we consider are currently the standard online payment mechanism.** Any costs the retailer incurs for processing debit card payments should be treated as part of the cost of doing business and should be included in the headline price.
- 1.17 Debit cards are the most commonly held payment card in the UK – over 85 per cent⁴ of consumers have access to a debit card – and therefore not surcharging consumers for using a debit card would make the

⁴ UK Card Association. Percentage of adult UK population who own a debit card 2009

headline price achievable for the majority of consumers enabling them to shop around and compare prices more easily. As technological advances, and in particular the growth of online retailing, move consumers away from using cash, we believe they would benefit from a new standard payment mechanism and not surcharging for debit cards would establish this.

- 1.18 Retailers should still be able to impose transparent surcharges to consumers who choose to use payment mechanisms which cost more to process and offer discounts to consumers who choose to use payment mechanisms that cost less to process.
- 1.19 We are also aware that whilst a high proportion of consumers have access to debit cards, many consumers often choose to pay by different payment mechanisms, for example, because they offer consumers the convenience of a credit facility.
- 1.20 For these consumers it is important that they are aware of, and are easily able to access clear information on, the surcharges that may apply when they choose to pay by a mechanism other than debit card. This will allow the consumer to find out more easily what the product will cost them and mean easier price comparisons between traders, increasing the incentives for firms to compete vigorously for consumers.
- 1.21 **We consider information on how much the consumer would have to pay to use mechanisms other than a debit card is necessary price information which consumers need to know in order to shop around effectively and make purchasing decisions and this information should therefore be easily available.**
- 1.22 The OFT's view is that retailers should therefore:
- provide clear information on the surcharges/discounts that apply to different payment mechanisms, when first displaying prices on a website. For example a clear link ('1 click') to a list of payment surcharges, where it is clear to consumers that they need to click on the link to obtain information on additional charges

- on all subsequent web pages, in close proximity to the total price, provide clear information on the surcharges/discounts that apply to different payment mechanisms or a clear link ('1 click') to a list of surcharges/discounts that apply to different payment mechanisms
- provide clear information on the existence of payment surcharges which apply to other payment mechanisms within any adverts (including print, television, outdoor or other media channels) which refer to prices, and
- ensure that consumers purchasing products by telephone or in-store are provided, in a clear and timely manner, with information on how their total cost will vary according to which payment mechanism they choose to use.

Implementation

1.23 In order to remove the detriment caused by drip pricing of what are, in effect, compulsory surcharges, the OFT:

- **Recommends that the Government introduces measures to prohibit retailers from imposing surcharges for payments made by debit card.** We consider that there are a number of options open to Government to implement this recommendation, for example prohibiting surcharges is permitted through the Payment Services Directive (PSD). However, the Consumer Rights Directive (CRD), which is in the process of being adopted,⁵ may also address our concerns. The CRD states that payment surcharges should be limited to retailers' processing costs, which we consider, when implemented in the UK, could significantly reduce consumer detriment. Regulation will ensure that a standard is achieved across the economy and we will work with the Government to ensure that our recommendation is progressed in the most effective and efficient way.

⁵ In June 2011 the CRD was adopted by the European Parliament plenary and is expected to be adopted by the Council of Ministers in due course.

- **In the short-term, seeks to improve the transparency and overall presentation of payment surcharges in the transport sectors, through action to ensure compliance with the Consumer Protection from Unfair Trading Regulations 2008 (CPRs).** Some retailers have already indicated that they are willing to change their practices in line with the OFT's recommendations and we will continue to work with these retailers to ensure the changes are made. For those retailers who are unwilling to make voluntary changes, or where commitments are not implemented within a reasonable timeframe, we will consider enforcement action. In due course we will also consider whether further enforcement action in other sectors is necessary.

1.24 The OFT considers it is necessary to recommend both a regulatory solution and enforcement action under the CPRs. This is to ensure a meaningful and consistent solution to the cross-economy issue of payment surcharges and to tackle individual retailers whose practices we consider are resulting in significant consumer detriment.

Thank you

1.25 As part of this study, we have consulted with consumer groups, trade associations, a large number of businesses from different sectors, other regulators and Government departments. We are grateful for all contributions and willingness to assist the OFT's team in its work.

2 INTRODUCTION

The super-complaint process

- 2.1 The right to submit a super-complaint was created by section 11 of the Enterprise Act 2002 (EA02). A super-complaint is defined under section 11(1) EA02 as a complaint submitted by a designated consumer body that 'any feature or combination of features, of a market in the UK for goods or services is or appears to be significantly harming the interests of consumers'. Which? is a designated consumer body for the purposes of the EA02.
- 2.2 Section 11(2) EA02 requires the OFT, within 90 days after the day on which it receives the super-complaint, to publish a response saying whether it has decided to take any action, or take no action, in respect of the complaint and, if it has decided to take action, what action it proposes to take. The response must state the reasons for the OFT's proposal (section 11(3) EA02).
- 2.3 This report sets out the OFT's reasoned response to the super-complaint from Which?

Issues raised in the super-complaint

- 2.4 On 30 March 2011, Which? submitted a super-complaint to the OFT about retailers in the passenger transport market – defined by Which? as airlines, ferry operators and rail intermediaries – surcharging consumers for paying by debit or credit cards (and in some instances other payment mechanisms) where consumers have no practical alternative ways of paying.⁶
- 2.5 Payment surcharges are additional charges which are presented to the consumer separately from the headline price. The OFT considers that payment surcharges are any charges which vary depending on the

⁶ For further detail on the super-complaint see: www.which.co.uk/documents/pdf/payment-method-surcharges---which---super-complaint-249225.pdf

payment mechanism the consumer chooses to use and/or which are only added to the total price when a consumer selects which payment mechanism they intend to use. As such they differ from booking fees or administration charges where all consumers pay the same fee.

- 2.6 Which? identified three features that they considered individually or in combination significantly harm consumers:
- a. lack of transparency. Surcharges are often only revealed towards the end of a lengthy transaction process and so it can be difficult to compare prices across competing retailers
 - b. lack of a reasonable, practical alternative to avoid the fee, and
 - c. surcharges often appear to exceed reasonable estimates of retailers' costs of processing payments.
- 2.7 Which? considered that these features made price comparisons more difficult therefore weakening the competitive pressure between retailers, and resulting in consumers making poor choices between competing providers. Furthermore Which? considered that consumers are often frustrated at being asked to 'pay for paying'.
- 2.8 In line with the Which? super-complaint the OFT has focused its assessment of payment surcharges in the passenger transport markets where these charges are most prevalent. However, as highlighted by Which?, there are examples of surcharging in other sectors and the principles established in this report apply equally to all UK commercial traders.

Information gathering

- 2.9 We have gathered evidence from a wide range of sources and sought the views of a variety of stakeholders.
- 2.10 Interested parties were invited to comment on the super-complaint and specific information requests were made to traders in the passenger transport markets and payment card issuers. We held meetings with HM Treasury (HMT), the Financial Services Authority (FSA), the Civil

Aviation Authority (CAA), the Office of the Rail Regulator (ORR), and the UK Card Association.

- 2.11 In addition we held two roundtable discussions, one with airlines and travel companies and one with ferry companies and rail ticket intermediaries to hear their views and discuss practical solutions to our concerns.
- 2.12 We have also reviewed the existing legislative framework that affects the practice of payment surcharges particularly in the passenger transport markets.
- 2.13 We have conducted our own in-house research into the practice of payment card surcharging in the passenger transport markets, reviewed the previous consumer research, behavioural psychology literature and experimental evidence conducted by the OFT as part of the *Advertising of Prices* Market Study⁷ published in December 2010, and drawn on existing data on payment card ownership within the UK.

Framework for assessment

- 2.14 The Which? super-complaint is framed as both a competition and a consumer protection issue. Which? is concerned that the lack of transparency around surcharges may result from the market power of some retailers and/or may distort competition by making consumer search and comparison more difficult. Which? also believes that some retailers can surcharge excessively either because they have market power or because surcharges are not transparent.
- 2.15 The OFT considers that effective competition and consumer protection are linked. Well-functioning markets depend both on competition working well and on consumers making good choices. Vigorous competition spurs traders to deliver what consumers want as efficiently and innovatively as possible, whilst well-informed, confident consumers who

⁷ See OFT 2010 'Advertising of Prices Market Study' www.of.gov.uk/OFTwork/markets-work/completed/advertising-prices/

shop around effectively play a key role in driving that competition. If consumers do not select the best deal for themselves, either because they cannot discern which offers are better or are provided with insufficient information to make an informed choice, traders are likely to be less motivated to deliver them.⁸

- 2.16 As discussed further in Chapter 5 it is not clear that market power is a significant driver of whether payment surcharges are either adopted or sustained within an industry. Travel markets are often competitive and may work well for consumers in a broader sense. Nonetheless, surcharging has settled as a standard practice by many providers, in part because competition seems to have focused on headline prices. As some providers try to lower headline prices to attract consumers, they have increased other charges including payment surcharges, which face less competitive constraint due to a lack of transparency.
- 2.17 The OFT therefore considers that consumer detriment from payment surcharges is driven by the lack of transparency and that how consumers understand and respond to surcharges, in particular the effect on their search behaviour, is key to identifying potential detriment. The OFT has therefore focused its investigation on these aspects.
- 2.18 We anticipate that addressing the transparency of surcharges will put pressure on retailers to reduce these surcharges and in response some retailers may choose to increase either headline prices or the prices of other options. Generally, retailers are free to make their own commercial decisions on pricing, provided that charges are transparent (so they are subject to competitive pressures), are clearly and accurately presented in a timely manner so as to avoid unfairly distorting consumers' decisions, and do not result in compulsory charges being presented separately from the headline price.

⁸ For more detail on the interaction between effective competition and consumer protection, see *'The future of the competition regime: increasing consumer welfare and economic growth'* John Fingleton, May 2011. www.offt.gov.uk/shared_offt/speeches/2011/1011.pdf

Structure of the report

- 2.19 Chapter 3 provides an introduction to the relevant UK and EU legislation which may affect the use of payment surcharges in the passenger transport markets.
- 2.20 Chapter 4 briefly considers the payment mechanism market.
- 2.21 Chapter 5 summarises the use of payment surcharges and the features which may affect the adoption of payment surcharges within an industry.
- 2.22 Chapter 6 considers the issues around the presentation of payment surcharges as a drip price and the availability of practical alternatives for consumers.
- 2.23 Chapter 7 briefly considers the issue of whether payment surcharges exceed reasonable expectations of costs incurred to process payments.
- 2.24 Chapter 8 sets out our response to the super-complaint and next steps.

3 THE REGULATORY FRAMEWORK

- 3.1 This chapter briefly describes the regulatory framework, within which it is necessary to consider the practice of payment card surcharging.
- 3.2 Both the OFT and the Civil Aviation Authority (CAA) have previously taken enforcement action to address misleading pricing in the airline sector. In 2007, thirteen airlines signed undertakings with the OFT under The Control of Misleading Advertisements Regulations 1988 (CMARs)⁹ to include taxes and fuel surcharges in headline prices. The CAA has also been working with airlines to ensure fixed compulsory charges are included in all headline prices, as required by the Air Services Regulation (ASR).¹⁰

Consumer Protection from Unfair Trading Regulations 2008 (CPRs)

- 3.3 The Consumer Protection from Unfair Trading Regulations 2008 (CPRs)¹¹ came into force on 26 May 2008 and implemented the Unfair Commercial Practices Directive (UCPD) into UK law. The CPRs contain:
- a general prohibition of unfair commercial practices (regulation 3)
 - prohibitions of misleading practices, whether by action (regulation 5) or omission (regulation 6)
 - a prohibition of aggressive practices (regulation 7), and
 - an outright prohibition of 31 specified practices that are prohibited in all circumstances (Schedule 1).

⁹ The CMARs were superseded by the Consumer Protection from Unfair Trading Regulations 2008 (CPRs) and (in respect of business to business advertising practices and comparative advertising) by the Business Protection from Misleading Marketing Regulations 2008 (BPRs).

¹⁰ www.caa.co.uk/application.aspx?catid=14&pagetype=65&appid=7&newstype=n&mode=detail&nid=1968

¹¹ www.legislation.gov.uk/ukdsi/2008/9780110811574/contents. OFT guidance on CPRs can be found at: www.offt.gov.uk/shared_offt/business_leaflets/cpregs/oft1008.pdf

- 3.4 The CPRs apply to 'commercial practices', that is any act, omission or other conduct by businesses directly connected to the promotion, sale or supply of a product to or from consumers (whether before, during or after a commercial transaction).
- 3.5 A commercial practice is unfair, in terms of the general prohibition (Reg 3), if (essentially) it is unacceptable according to an objective standard of what is professionally diligent.
- 3.6 A commercial practice is a 'misleading action' if it contains false information or information presented in any way that deceives or is likely to deceive the average consumer in relation to a range of matters, including the 'main characteristics of the product' (regulation 5(4)(b)) and/or the 'price or manner in which the price is calculated' (regulation 5(4)(g)).
- 3.7 A commercial practice is a 'misleading omission' if it omits or hides material information or provides such information in a manner which is unclear, unintelligible, ambiguous or untimely (regulation 6(c)). Material information is considered to be information that the average consumer needs to take an informed transactional decision.
- 3.8 For a practice to constitute a breach of regulation 3 (the general prohibition), regulation 5 (prohibition of misleading actions), regulation 6 (prohibition of misleading omissions) or regulation 7 (prohibition of aggressive practices) it must also cause, or be likely to cause, the average consumer¹² to take a transactional decision he would not otherwise have taken.
- 3.9 Whether or not a particular practice breaches the regulations will depend on all the circumstances of the individual case, and a full assessment of the practice will, therefore, always be required. The OFT, Local Authority Trading Standards Services and the sectoral regulators can take

¹² The 'average consumer' is considered to be reasonably well informed, observant and circumspect.

enforcement action under the CPRs in line with their enforcement policies.

Credit Card (Price Discrimination) Order (1990)

- 3.10 The Credit Card (Price Discrimination) Order 1991 came into force on 28 February 1991,¹³ and made it unlawful for any person to make or carry out any agreement relating to credit cards to the extent that it imposes or requires the imposition of a 'no discrimination' or 'no surcharging' rule.
- 3.11 A 'no discrimination' rule prohibits merchants from charging different prices to those who pay by credit card rather than by another means of payment. The Order does not require merchants to charge different prices for credit card transactions, but it does allow them to surcharge if they choose to.

Payment Services Directive 2007/64/EC (PSD)

- 3.12 Article 52(3) of the Payment Services Directive essentially gives Member States the option to forbid or limit surcharges:
- 'the payment service provider shall not prevent the payee from requesting from the payer a charge or from offering him a reduction for the use of a given payment instrument. However, Member States may forbid or limit the right to request charges taking into account the need to encourage competition and promote the use of efficient payment instruments.'
- 3.13 In December 2007 HM Treasury (HMT) consulted on transposing the Directive into UK law. Its conclusions were published in June 2008.¹⁴ On the issue of surcharging HMT stated that 'there was broad support for the Government not legislating to prohibit or limit the right of payees to

¹³ Credit Cards (Price Discrimination) Order 1990 (SI 1990/2159).

¹⁴ http://webarchive.nationalarchives.gov.uk/20100407010852/http://www.hm-treasury.gov.uk/fin_payment_services_directive.htm

request charges when payers chose to use a certain payment instrument'. HMT therefore did not transpose the restrictions of Article 52(3) into UK law via the Payment Services Regulations 2009 (PSRs).

Air Services Regulation (ASR)

3.14 The Air Services Regulation No 1008/2008 came into force on 1 November 2008. Although as an EU regulation it is directly applicable in the UK, there are some aspects which require UK secondary legislation to give effect to it. Currently there is no UK statutory instrument that creates penalties for infringement under the ASR.

3.15 In March 2010, the Department for Transport (DfT) consulted on the draft regulations which will permit the CAA and the OFT to take action to ensure compliance with the ASR on the transparency and non-discrimination of air fares.¹⁵ The draft secondary legislation proposed by the DfT was modelled closely on the regime in Enterprise Act 2002 and proposed that both the CAA and the OFT are enforcers for the purposes of enforcing article 23.¹⁶

3.16 Article 23 of the ASR essentially states that all charges which are unavoidable and foreseeable at the time the headline price is displayed, should be included in that price. It states that:

'The final price to be paid shall at all times be indicated and shall include the applicable air fare or air rate as well as all applicable taxes, and charges, surcharges and fees which are unavoidable and foreseeable at the time of publication. In addition to the indication of the final price, at least the following shall be specified:

(a) air fare or air rate

¹⁵ www2.dft.gov.uk/consultations/closed/2010-16/index.html

¹⁶ Note it is not currently possible to enforce Article 23 of the ASR under the Enterprise Act 2002 (EA 02), as a breach of Article 23 does not meet the criteria of either a 'community infringement' or a 'domestic infringement' as set out in EA02

- (b) taxes
- (c) airport charges and
- (d) other charges, surcharges or fees, such as those related to security or fuel

where the items listed under (b), (c) and (d) have been added to the air fare or air rate. Optional price supplements shall be communicated in a clear, transparent and unambiguous way at the start of any booking process and their acceptance by the customer shall be on an 'opt-in' basis.'

- 3.17 The European Commission has provided the CAA with an information note on the ASR which includes a section on price transparency. This note is not an official interpretation of the Regulation and the views expressed do not bind Member States or other interested parties. However it does provide guidance. Paragraph 9.2.2 states:

'The final price to be paid shall at all times be indicated: this means that the final or 'all-inclusive' price needs to be indicated whenever there is a price quote, and this in all types of information, for example, advertisements or information given by the travel agent or a website. With regard to the booking process, the final price to be paid should be provided right from the beginning of the booking process. For example, websites should show the final price right from the first page and not add other unavoidable elements at a later stage of the booking process.'

Consumer Rights Directive (CRD)

- 3.18 The CRD proposal was issued by the European Commission in October 2008 with the aim of increasing consumer confidence when making cross border purchases, through a reform of some of the existing consumer protection directives. The original proposal merged four existing directives on Unfair Contract Terms, Sale of Goods and Guarantees, Doorstep Selling and Distance Selling, although this was reduced to the latter two directives as the proposal went through the European legislative procedures.

3.19 Other provisions on consumer rights in the Consumer Rights Directive include Article 19¹⁷ which states that:

'Member States shall prohibit traders from charging consumers, in respect of the use of a given means of payment, fees that exceed the cost borne by the trader for the use of such means'.

3.20 In June 2011 the proposed CRD was adopted by the European Parliament plenary and is expected to be adopted as it stands by the Council of Ministers in due course. It will then become binding on member states, with a requirement that they should transpose it into national law within a maximum of two years.

Committee of Advertising Practice (CAP Code) and Broadcasting Committee of Advertising Practice (BCAP Code)

3.21 The CAP code and BCAP code are advertising rules set down by the Advertising Standards Authority (ASA). The advertising codes contain wide-ranging rules designed to ensure that advertising does not mislead, harm or offend. Adverts must also be socially responsible and prepared in line with the principles of fair competition.

3.22 The Codes of Practice are a self-regulatory system recognised as one of the 'established means'¹⁸ of consumer protection. If certain types of adverts, including those that are misleading or contain an impermissible comparison, continue to appear after the ASA Council has ruled against them, the ASA can, where appropriate, refer the matter to the OFT for action under the CPRs.

3.23 Of particular relevance to drip pricing are the following rules

¹⁷ Article 19 within the text adopted by the European Parliament on 23 June 2011.

¹⁸'Established means' is a term used in the CPRs which refers to those systems and mechanisms outside the OFT and other regulators which have the effect of encouraging the control of unfair commercial practices under the Regulations.

- quoted prices must include non-optional taxes, duties, fees and charges that apply to all or most buyers. (3.18 of CAP code and 3.19 of BCAP code), and
- if a tax, duty, fee or charge cannot be calculated in advance, for example, because it depends on the consumer's circumstances, the advertisement must make clear that it is excluded from the advertised price and state how it is calculated. (3.19 of CAP code and 3.20 of BCAP code).

Payment scheme rules

- 3.24 Scheme rules are not regulations, but rules imposed by the payment card networks. Some schemes that issue multiple types of cards (for example, debit and credit cards for consumers, or consumer and corporate cards) apply rules, sometimes known as 'honour all cards' rules, requiring retailers to accept all card types if they accept any. Other schemes sometimes permit retailers, if they so choose, to accept only debit cards. However, typically retailers that accept other card types, such as credit cards, have to accept all card types.
- 3.25 Previously scheme rules included a 'no discrimination' or 'no surcharge' rule which prohibited merchants from surcharging for credit card payments, or from allowing a discount for cash payments. However, merchants, in the UK, have been permitted to impose payment surcharges on credit card transactions since 7 March 1991 when the Credit Cards (Price Discrimination) Order 1990 came into effect.

4 PAYMENT MECHANISMS

- 4.1 In this chapter, we briefly discuss how card networks in the UK operate and the potential benefits of allowing retailers to surcharge for accepting payments.
- 4.2 Payment mechanisms cover any method of payment consumers can use to purchase goods or services. They include cash, cheques, cards such as debit and credit cards, and more recent innovations like PayPal, which have been driven by the growth in online retailing.
- 4.3 All payment mechanisms incur costs for retailers to process. Payment cards and PayPal are subject to network operators' fees for processing transactions and in order to accept cash retailers bear their own costs such as security costs.

Card networks

- 4.4 The two major card networks in the UK, each offering both debit and credit cards, are VISA and MasterCard. Both operate a four-party system consisting of:
- the consumer who owns the card
 - the retailer providing the goods or services
 - the bank that issued the card to the consumer ('issuer'), and
 - the body (often a bank) that deals with the retailer ('acquirer').
- 4.5 When a retailer accepts a card payment, it incurs charges from its acquirer. The acquirer requests funds from the consumer's card issuer and charges the retailer a merchant service charge (MSCs) for processing the transaction. Sometimes acquirers also charge retailers separately for additional services, such as charge-backs where the transaction is reversed and funds returned (refunded) to the consumer.

4.6 In addition, retailers may incur fixed or variable charges if they choose to use intermediaries¹⁹ or choose to buy their own point-of-sale equipment, carry out their own fraud management or develop payment functions on websites. For more information on retailers' costs see Annexe C.

The role of surcharging in payment networks

4.7 The OFT considers there are potentially benefits to both consumers and retailers if retailers are able to impose differential charges for different payment mechanisms. Surcharging or discounting different payment mechanisms can signal the costs of accepting each mechanism and therefore can help consumers make efficient choices between them. Consumers are then able to decide whether the benefits to them of paying by, for example, credit card (such as the credit facility, protection against the effect of fraud²⁰ and Section 75 protection²¹) exceed the cost of paying by credit card. However, to achieve these signalling benefits, surcharges must be broadly in line with efficiently incurred costs.

4.8 Transparent differential pricing can restore the connection between the consumer, who makes the choice on what payment mechanism to use, and the retailer who pays for that choice and so counteract the market power of card networks. If retailers charge consumers the true cost of processing the payment mechanism, this puts direct pressure on payment card providers to compete to ensure that customers use their payment mechanism rather than their competitors'. This may in turn apply pressure on card networks to reduce their MSCs.

¹⁹ Intermediaries assist some retailers in accepting secure payments online or in other 'cardholder not present' contexts such as call centres or mail order. Many also provide fraud detection and management services to help retailers comply with Payment Card Industry Data Security Standards (PCI DSS).

²⁰ Consumers are better able to dispute fraudulent transactions

²¹ Section 75 of the Consumer Credit Act. If consumers pay for items between £100 and £30,000 on a credit card the card issuer is equally liable if something goes wrong with the transaction.

- 4.9 Whilst all payment mechanisms incur some processing costs, consumers have not historically incurred surcharges for paying by cash, that is, retailers have traditionally included the cost of accepting cash in the headline price. Furthermore, whilst the proportion of card payments remained relatively small the cost of surcharging card payments may have outweighed the additional revenue from surcharging, particularly where consumers could freely switch to paying by cash.
- 4.10 However, as card payments increasingly take the place of cash, particularly with the growth of online retailing where consumers do not have the option to switch to cash, consumers no longer benefit from having a standardised payment mechanism that is not surcharged. The OFT considers there are important benefits to consumers in having a realistic payment option that does not incur a surcharge both in terms of constraining retailers' ability to impose surcharges that significantly exceed efficiently incurred costs and easing consumers' comparison of offers between retailers.
- 4.11 The OFT believes there are also wider benefits, in terms of facilitating e-commerce, from establishing a standard payment mechanism that does not incur a surcharge for online retailing. The OFT's e-consumer protection strategy aims to empower consumers by improving transparency of transactions.²² The strategy sets out key priorities to help prevent misleading selling, deceptive online advertising and malicious practices. These measures include providing clarity on consumer law in relation to online shopping – the OFT prioritises investigations that will either have a high deterrent effect or lead to significant behaviour change across online markets, or that will provide clarity on emerging issues.

²² www.of.gov.uk/shared_of/consultations/eProtection/OFT1252.pdf

5 PAYMENT MECHANISM SURCHARGES

5.1 This chapter considers the use of payment mechanism surcharges and discusses features of the markets where payment surcharges are used.

Use of payment card surcharges

5.2 The OFT considers that payment surcharges are any charges which vary depending on which payment mechanism the consumer chooses to use and/or are only added to the total price when a consumer selects which payment mechanism they intend to use.

5.3 We note that consumer expectations are particularly important for identifying potential consumer detriment. In assessing consumer detriment, we consider those charges where the presentation of the charge is likely to lead a reasonably informed consumer to interpret it as a payment surcharge and not solely those charges which are referred to by retailers as payment surcharges.

5.4 The evidence in the Which? super-complaint showed that the use of payment surcharges is variable both across and within industries. However, it suggests that outside the passenger transport markets surcharging is less common, particularly for debit cards.

5.5 In 2007, the OFT conducted a survey of businesses²³ and found 81 per cent of businesses applied no surcharges at all, only 14 per cent of businesses applied surcharges to credit cards, nine per cent to charge cards, and six per cent to debit cards. The survey also found credit card surcharges ranged from less than one per cent of transaction value to over three per cent, whilst charges for debit card surcharges tended to be lower.

²³ Conducted as part of a Competition Act investigation into the charges that credit card networks levy on retailers, see: www.of.gov.uk/OFTwork/competition-act-and-cartels/ca98-current/interchange-fees

- 5.6 Comparing the results of this survey to the data in the super-complaint we found that the list of sectors referred to in the super-complaint covers a similar, but not significantly wider, range of markets as reported in the 2007 study and that the average level of surcharges had not changed significantly for most retailers.
- 5.7 However, in some markets, such as airlines, payment mechanism surcharges are widely used across retailers and have persisted for several years, despite evidence of customer dissatisfaction.²⁴
- 5.8 Furthermore, there is considerable variation in the way payment surcharges are calculated and imposed. Some traders only impose surcharges for credit cards, some set a fixed surcharge per transaction, some set surcharges as a proportion of the transaction value and some impose a fee per ticket or item purchased. A summary of payment card surcharges in the passenger transport markets is at Annexe B.

Online transactions

- 5.9 Surcharging appears to be more prevalent in industries where products are particularly complex, for example where they have several dimensions (such as time, quality and add-ons) along which the product can be tailored. Surcharging is also more prevalent online than offline. These factors are connected. Products which require significant tailoring or which have more complex pricing tariffs which need to be seen and understood by consumers often lend themselves to being sold online. The OFT considers that surcharging is more likely where these factors are present.
- 5.10 Further, online retailers may be more likely to surcharge simply because consumers do not have the option to pay with cash. If in-store retailers attempt to surcharge, consumers are often able to switch to paying with cash. Online, the lack of choice (without incurring the time or financial costs of applying for niche payment mechanisms) means consumers

²⁴ www.which.co.uk/documents/pdf/rip-off-card-surcharges-consumers-speak-out---which---super-complaint-dossier-249652.pdf

often have no choice but to pay the surcharge particularly if they consider all online retailers have similar practices and/or if they have to invest significant time tailoring products on a number of websites in order to discover the surcharges.

Market structure and surcharging

- 5.11 In general, the OFT considers that the ability for a firm to impose payment surcharges is driven by a lack of competitive constraint on the retailers' pricing structure, which is caused by a lack of price transparency and perceived scarcity rather than by market power.²⁵
- 5.12 However, in competitive markets, some of the profit from payment surcharges may be competed away as retailers compete to offer the lowest headline price to consumers.²⁶ In contrast, retailers with significant market power would not face the competitive pressure to reduce their headline price.

Lack of price transparency

- 5.13 Surcharging makes the total price the consumer pays less transparent – and can be used as a deliberate strategy to do so. The OFT considers that surcharging may persist in competitive markets, even where consumers have some awareness that they may incur surcharges, when charges are not easily discoverable. This may be the case when:
- consumers make infrequent purchases, limiting the opportunity for consumers to learn to avoid or fully assess these charges

²⁵ Surcharging may also persist if there are sufficient unaware (naïve) consumers. Firms will not advertise the surcharge, instead choosing to hide the price of the surcharge. Firms will then choose to offer low prices for the basic good and charge inflated prices for the surcharge. Competition will lower the base price since all consumers compare sellers according to the base prices, but competition will not affect the surcharge price, which only the naïve consumer purchases. The market has reached a 'bad equilibrium' due to the number of unaware consumers.

²⁶ More competition results in a higher 'waterbed effect'.

- consumers incur search costs to discover the surcharge, which reduce their incentives to compare prices when surcharges are revealed, and/or
- the product and/or transaction processes are complex, tailored or not standardised between retailers, making comparisons and learning more difficult.

5.14 This lack of transparency reduces shopping around and therefore reduces competition between retailers. Lack of transparency is exacerbated where individual retailers frequently alter the surcharges they impose and where retailers across and between industries impose surcharges set at different levels or calculated in different ways, for example per item or per transaction charges. If surcharges vary over time or between retailers, consumers are unable to learn to take these charges into consideration when comparing headline prices, even where products are purchased relatively frequently.

Perceived scarcity

5.15 Some retailers may be able to drip surcharges to consumers, as the nature of the product or the way in which it is presented creates feelings of scarcity. Where consumers think an offer may not be available for long, they are more likely to check out the offer and more likely to purchase from the first retailer they visit, rather than comparing it with other offers, because they are concerned that they may miss out on the 'deal'.²⁷

5.16 This can be seen with airline prices where availability can change extremely quickly due to the yield management systems the airlines have in place and the limited number of seats for each destination. As such consumers may be more willing to pay surcharges, without comparing full offer prices with other retailers, as they are concerned that the offer

²⁷ See OFT 2010 *Advertising of Prices Market Study*. www.oft.gov.uk/OFTwork/markets-work/completed/advertising-prices/ - Chapter 8 'Time Limited Offers'.

will no longer be available. Retailers may therefore be able to increase surcharges above the competitive level.

Market power

- 5.17 As discussed, we do not consider market power is required for retailers to be able to surcharge. For example, in the airline industry the OFT and European Commission have previously considered that relevant markets should be defined narrowly either on a point-to-point or city-to-city basis. As such airlines may have some market power on some routes but not all and, given the wide use of surcharging across the industry and the fact that it is not route specific, it seems unlikely this has been driven by actual market power.
- 5.18 Indeed, retailers that have market power may be able to extract profits from consumers by increasing any charges, including the headline price. However, retailers with market power who wished to further increase demand by making the price less transparent may choose to impose surcharges.

Conclusion

- 5.19 The OFT considers that actual market power is not the primary driver of whether surcharging is introduced or persists within a market. Instead surcharging is more likely to persist where products or services have the following characteristics:
- consumers make infrequent purchases
 - consumers incur search costs to discover the surcharge
 - the product and/or transaction processes are complex, tailored or not standardised between retailers, and/or
 - the product is time limited or quantity limited.

6 LACK OF TRANSPARENCY AND REASONABLE ALTERNATIVES

- 6.1 The Which? super-complaint considers that the practice of advertising incomplete or partial prices, by omitting surcharges until a later stage of the purchasing process means that consumers are unable to effectively and efficiently shop around and make like-for-like comparisons. Which? also considered that the lack of reasonable or practical alternative payment methods to avoid or mitigate charges exacerbates the consumer detriment.
- 6.2 In this chapter we first explain why we consider only revealing effectively compulsory charges at a late stage of the purchasing process – drip pricing – results in consumer detriment, and then go on to set out the circumstances under which we would consider payment card surcharges should be considered as compulsory charges. Finally we set out the measures we consider necessary to address the consumer detriment.

Drip pricing

Impact on consumer behaviour

- 6.3 Drip pricing refers to the practice of displaying a price for a basic product or service and then adding further charges during the transaction process. Drip pricing can offer significant benefits to consumers when it allows retailers to genuinely tailor their product or service to their customers' needs. However these benefits only arise when the additional charges are optional for consumers.
- 6.4 Where compulsory charges are presented as drip prices, it is likely to result in consumer detriment since drip pricing is effective at changing the way consumers shop and at reducing their ability to compare full price offers across retailers. These effects mean that consumers may miss out on better deals and weakens competition between retailers, potentially allowing retailers to increase overall prices.

- 6.5 In December 2010 the OFT published a market study on the *Advertising of Prices*.²⁸ The study looked at the impact on consumer decision making of six pricing practices. Drip pricing was found to be the most likely to result in consumer detriment.
- 6.6 The study found that consumers may be less willing to shop around and compare prices when additional costs are revealed, because of the time and effort they have already invested in getting to that point in the transaction and the knowledge that they will incur further search costs to obtain full price offers from other retailers.
- 6.7 Furthermore, a review of the relevant behavioural psychology literature²⁹, conducted as part of the study, found that by revealing prices at a late stage of the transaction process and separating them from the headline price a number of behavioural biases are engaged which also make consumers less willing to shop around for the best price and more likely to underestimate the total price paid, in particular:
- people have a desire to be consistent with their previous actions (known as the 'commitment and consistency' principle) which means that even when the price starts to increase they tend to remain committed to the retailer, and
 - people seem to value a product more once they own or feel like they own it, such that they demand more to give up an object than they would be willing to pay to acquire it (known as 'endowment effect and loss aversion'). As consumers go through the transaction process, their feelings of ownership increase and therefore so too does their willingness to pay.³⁰

²⁸ See: www.offt.gov.uk/OFTwork/markets-work/completed/advertising-prices/

²⁹ Section 3.2 of Ahmetoglu et al, 2010, *Pricing practices: their effects on consumer behaviour and welfare*

³⁰ The way information is presented to consumers has increased their valuation of the offer and therefore the amount they are willing to pay for it.

- 6.8 Drip pricing was also found to increase sales as consumers focus (or 'anchor') on the piece of information they consider most important, often the advertised price, and do not fully adjust their calculation of the total price, as additional charges are revealed, thereby overestimating the total value of the deal. The lower up-front price therefore attracts consumers and the first shop (or website) that they visit benefits from higher sales, as some consumers choose not to shop around even when additional charges are revealed. Consumers may therefore miss out on better offers elsewhere.
- 6.9 Of particular importance to the assessment of the Which? super-complaint is the behavioural psychology literature which also showed that simply separating a price into a base price and additional charge, even where they are displayed together, known as 'partitioned pricing', leads to higher demand and perceived value amongst consumers, as well as a lower recalled price, lower price estimation and lower search (shopping around) intentions.

Learning

- 6.10 It is not clear whether consumers are able to learn to avoid or to fully assess drip prices. Only four per cent of the consumers surveyed in the 2010 study were purchasing the product for the first time, and yet three quarters only became aware that there were going to be price rises during the purchasing process and only 26 per cent felt that the offer made it clear what was included in the headline price.
- 6.11 The evidence suggested that whilst some consumers learn to assess or avoid drip or partitioned pricing, learning effects decrease as the time between purchases increases and does not completely eradicate the detriment. The research strongly suggested that consumers are aware of the ways in which they can shop more efficiently and the different behaviours they could adopt next time, but there was little evidence of consumers actually modifying their behaviour as a result of previous experience.

- 6.12 Furthermore, where products are purchased infrequently, are 'low involvement',³¹ or where different traders use different ways to calculate and present charges, learning is more difficult to take forward into the next purchase.

Emotional reaction

- 6.13 To the extent that drip pricing makes it harder to compare prices it is also likely to cause frustration, wasted time and a belief that one could have got a better deal elsewhere. Indeed 75 per cent of consumers surveyed objected to drip pricing.
- 6.14 We also note that whilst 70 per cent of people surveyed thought that all compulsory charges should be included in the advertised price, when asked specifically about credit and debit card charges, 87 per cent of respondents objected to paying extra to use a credit card and 91 per cent objected to extra charges for paying by debit card.

Conclusion of previous research

- 6.15 The *Advertising of Prices* study concluded that **not including in the headline price all compulsory charges that the consumer has to pay is likely to result in consumer detriment.**
- 6.16 The OFT considers that an additional charge presented to the consumer is only truly optional where a reasonable proportion of consumers *can* choose, regardless of whether in reality they **do** choose, to pay the headline price without incurring a non-negligible time or financial cost to do so. Where it is not an option for a reasonable proportion of consumers to pay the headline price we consider the charge is effectively compulsory.

³¹ Products where consumers are less emotionally involved in the purchase, either because it is a frequent, low value purchase, such as milk or bread, or because consumers consider it to be necessities for which they do not gain direct enjoyment, such as gas or electricity.

- 6.17 Which? identified both drip pricing and the lack of a reasonable alternative as potential sources of consumer detriment with respect to payment surcharges in the passenger transport markets. The OFT considers that consumer detriment is more likely where both of these features are present. Specifically, where the payment surcharge is presented to the consumer as a drip price and where the consumer does not have a reasonable alternative payment mechanism to avoid the fee.
- 6.18 The OFT considers that a failure to provide upfront information on effectively compulsory charges can constitute a breach of the CPRs contrary to either or both of Regulations 5 and 6 of the CPRs (and could also constitute a breach of Regulation 3 of the CPRs), depending on the particular circumstances of the case.
- 6.19 In particular:
- regulation 5 of the CPRs states that a commercial practice by a trader is a 'misleading action' where the overall presentation in any way **deceives or is likely to deceive** the average consumer in relation to **the price or the manner in which it is calculated**, and/or
 - regulation 6(c) of the CPRs states that a commercial practice by a trader is a 'misleading omission' where **material information** is provided to the consumer in an unclear, unintelligible, ambiguous or **untimely manner** [emphasis added].
- 6.20 We now go on to consider whether and in what circumstances payment surcharges constitute dripped compulsory charges and therefore may be expected to result in consumer detriment.

Drip pricing of compulsory surcharges in the passenger transport markets

- 6.21 Payment mechanism surcharges are a form of drip or partitioned pricing, the surcharges are by definition not included in the headline price. Across the passenger transport markets the majority of retailers do not add the payment surcharge that the individual consumer selects to pay until the consumer has gone through four to six web pages, where

numerous decisions have to be made to tailor the product and where personal information often has to be provided (See Table 6.1). This can impose a significant time cost on consumers and deter them from spending similar amounts of time assessing other offers. This is particularly the case with airlines, where prices can change in 'real time', heightening consumers' concerns about investing additional time in comparing offers. The lengthy transaction process can increase a consumer's commitment to the purchase, giving them a greater sense of ownership of the product and making them less likely to 'walk away' and consider other offers once the surcharge is revealed.³²

Table 6.1 Number of web pages before the surcharge which applies to the individual consumer is added to the headline price

Trader	Number of pages	Trader	Number of pages
DFDS Seaways	8	Qjump	7
The Trainline	7	British Airways	6
Brittany Ferries	6	BMI Baby	6
Easyjet	6	Iberia	6
Stena Line	6	Jet2	5
LD Lines/Transmanche	5	My Train Ticket	5
Rail Europe	5	Thomas Cook	5
TUI Group Airlines	5	Air Berlin	4
Britain Express	4	Flybe	4
IOM Steam Packet	4	Irish Ferries	4
Monarch	4	Rail Easy	4
Rail Saver	4	Ryanair	4
Virgin Atlantic	4	Eurostar	3
P&O Ferries	3	Norfolkline Irish Sea Ferries	1

Source: OFT web research – conducted April – May 2011. List is not exhaustive.

6.22 It has been argued that the publicity around payment card surcharges within the airline sector means that airline customers have a better

³² 'Commitment and consistency' principle and 'endowment effect and loss aversion'.

understanding of the additional charges they face and are therefore less likely to be misled. However, the results of the 2010 consumer survey do not support this. Of the 794 consumers who answered questions on drip pricing, 176 specifically answered questions on their experience in the airline sector.³³ Of these consumers 78 per cent only became aware that there were going to be price rises during the purchasing process and only 18 per cent felt the offer made it clear what was included in the headline price, compared to 75 per cent and 26 per cent respectively across all respondents.

- 6.23 Furthermore, analysis of the websites of over 30 retailers in the passenger transport sector demonstrates that a range of different business models are employed by retailers affecting the level of surcharges and the way in which surcharges are calculated (for example, which payment mechanisms are surcharged, whether charges are per transaction or per ticket and whether charges are set as a percentage or as a fixed fee). We consider that in addition to the lack of transparency of surcharges, this variation in surcharges makes it considerably more difficult for consumers to compare full price offers from different retailers and reduces the opportunity for learning, thereby further reducing competition between retailers and the competitive constraint on surcharges.
- 6.24 A range of examples of the different types of charges imposed in the passenger transport markets is provided in Table 6.2. Further details on the range of surcharges imposed by retailers in the passenger transport markets are provided in Tables B.1-B.3 (Annexe B).

³³ Respondents were asked to answer questions based on a specific recent experience of 'drip' pricing. Respondent were free to choose an experience from any sector.

Table 6.2 Examples of surcharges in the passenger transport markets.

Trader	Credit card surcharge	Debit card surcharge
British Airways	£4.50 per passenger	£0
BMI Baby	£4.50 per journey (min £6.50)	£3 per journey (min £4)
EasyJet	£8 + 2.5% per transaction	£8 per transaction
Jet2	7% per transaction (min £4.99)	3.5% per transaction (min £4.99)
Ryanair	£6 per journey	£6 per journey
DFDS Seaways	2.5% per transaction (min £4)	£0
Irish Ferries	£5 per transaction	£5 per transaction
The Trainline	£3.50 per transaction	£0
Rail Easy	4.5% per transaction	75p per transaction

Source: OFT web research – conducted April – May 2011. List is not exhaustive.

Compulsory charges

- 6.25 We have established that payment surcharges in the passenger transport markets are often presented to consumers as drip prices. However, clearly where a sufficient proportion of consumers can easily switch to paying using a method which does not incur a payment surcharge the charge may be considered optional and the consumer detriment may be lower.
- 6.26 In the case of payment surcharges, we would consider the charges to be effectively compulsory if a reasonable proportion of consumers could not opt to pay the headline price without incurring additional costs/significant time. Costs may include:

- having to apply for a new payment mechanism which incurs a financial cost, and/or
- having to apply for a new payment mechanism where the application process is complex or lengthy, particularly where that may mean the product or service is no longer available either at all or at the current price.

6.27 The payment mechanisms for which retailers in the passenger transport markets do not impose a surcharge varies between providers. Different retailers do not impose a surcharge, either individually or in combination, on the following cards: credit cards, debit cards, VISA electron, Solo and Pre-paid Mastercard.

6.28 Current ownership levels of these cards varies. Sixty-two per cent of the UK adult population own a credit card, whereas over 85 per cent own a debit card³⁴ (See Table 6.3). Consumers frequently own more than one payment card and often more than one debit card.

Table 6.3 Card ownership in the UK, 2009

Card	Proportion of UK adult population who own card
Credit cards	62%
All Debit cards ³⁵	86%
- VISA Electron	11%
- Solo	4%
Pre-paid MasterCard ³⁶	< 5%

Source: UK Card Association

³⁴ UK Card Association 2009.

³⁵ There are four types of debit card in the UK – VISA debit, Maestro, VISA electron and Solo

³⁶ A maximum (assuming no multiple card ownership) of five per cent of UK adult population own a Pre-paid MasterCard or a Pre-paid VISA card. The proportion of consumers who own a Pre-paid MasterCard will therefore be less than five per cent.

- 6.29 Furthermore it is relatively difficult for UK consumers to gain access to a VISA electron or Solo card. VISA electron cards offer limited functionality, for example no overdraft facility, and tend to be aimed at young people, aged under 16. Of the major UK banks only HBOS still issues VISA electron cards. HBOS offer three accounts with VISA electron cards, two of which are aimed at under-17s. The Solo card scheme was decommissioned in March 2011 and no further cards will be issued.
- 6.30 Approximately five per cent of the UK population currently own a prepaid card and a significant proportion of these may be Pre-paid MasterCard. Anyone can obtain a Pre-paid MasterCard – there are no credit checks – however consumers do incur additional fees to obtain and/or use Pre-paid cards, for example card application fees and card loading fees. In addition, consumers cannot access Pre-paid MasterCard immediately, often having to wait up to 10 working days before the card is received.
- 6.31 The OFT considers that the current ownership levels of VISA electron, Solo and Pre-paid MasterCard mean that where these cards are the only payment mechanisms which do not incur a surcharge, the headline price is unachievable for a reasonable proportion of consumers. In addition, these cards are not sufficiently widely and freely available that consumers could switch to these payment mechanisms without incurring non-negligible time or financial costs.
- 6.32 The OFT therefore considers that where the only payment mechanisms retailers do not surcharge for are VISA electron, Solo and/or Pre-paid MasterCard, a reasonable proportion of consumers would have to pay some form of surcharge and in turn these surcharges should therefore be deemed as 'effectively' compulsory. Presenting payment surcharges as a drip price in these circumstances may be expected to result in consumer detriment.
- 6.33 Conversely, where retailers do not impose a surcharge for debit cards, the majority of consumers can achieve the headline price and the

surcharges that relate to other payment mechanisms may be considered as 'optional'.³⁷ Where information on the surcharges that relate to other payment mechanisms is clearly accessible to consumers, we do not consider separating these charges from the headline price will result in significant consumer detriment.

Non-debit card charges

6.34 It is important to note that even though debit cards are available to a significant proportion of UK consumers, that is not to say that consumers will choose to use debit cards in the majority of cases when purchasing passenger transport tickets. The OFT therefore considers that the charges that relate to other payment mechanisms are also likely to be important to consumers in making transactional decisions.

Table 6.4 Proportion of consumers paying by debit cards

Sector	Proportion of sales using debit card
Airlines	26%-60%
Ferries	25%-57%
Rail intermediaries	32%-78%

Source: based on figures provided by those firms who responded to the OFT information request

Conclusion

6.35 Where payment surcharges are presented to consumers as drip prices and are effectively compulsory for a reasonable proportion of consumers (as the payment mechanisms that do not incur a surcharge are not readily available to a reasonable proportion of consumers) we consider they are likely to result in consumer detriment by affecting consumers'

³⁷ We note that in some sectors consumers can pay by cash or cheque and that in these circumstances, provided there was no separate charge for paying by these mechanisms, these may be considered a reasonable alternative for the majority of consumers. However, non-card payments are rare in the passenger transport market, particularly online and it would need to be a plausible alternative payment mechanism for consumers.

ability to efficiently and effectively shop around and compare full price offers. This lack of transparency can therefore result in consumers not getting the best deal and can weaken the competitive constraint on payment surcharges as consumers do not efficiently compare offers.

6.36 The OFT maintains that there may be some signalling benefits from retailers being able to charge differential prices for different payment mechanisms and as such there may not be a single surcharge which can be easily factored into the headline price.

6.37 **The OFT therefore proposes that retailers make headline prices achievable for a reasonable proportion of consumers by not surcharging for debit card payments, that is including in the headline price the processing costs that relate to debit cards.**

6.38 The OFT considers that debit cards are currently the standard online payment mechanism. Debit cards are the most commonly owned payment card in the UK and as card payments increasingly take the place of cash, particularly with the growth of online retailing where consumers do not have the option to switch to cash, the OFT believes consumers would benefit from having a genuine option to avoid 'paying for paying' in terms of ensuring prices are transparent and consumers can shop around effectively.

6.39 Retailers would still be able to obtain the benefits of differential pricing, by offering discounts to consumers who opt to pay with mechanisms which cost less to process and imposing surcharges on consumers who choose to pay with mechanisms that cost more to process. By including the charge for using a debit card in the headline price this will impose a competitive constraint on the level of surcharges which apply to other payment mechanisms as the majority of consumers are able to avoid these surcharges and achieve the headline price.^{38 39}

³⁸ Only one per cent of the UK adult population has access to a credit card but not a debit card therefore credit card surcharges would only be effectively compulsory for a small minority of consumers.

6.40 The OFT therefore also proposes that sufficient, clear and timely information on the surcharges or discounts that consumers may incur if they choose to pay by other mechanisms is essential.

6.41 Whilst over 85 per cent⁴⁰ of consumers could choose to pay by debit card, in reality the proportion that do is much lower and the costs for paying by other payment mechanisms, such as credit card, can vary significantly between retailers.

6.42 The OFT therefore also proposes that retailers should:

- provide clear information on the surcharges/discounts that apply to different payment mechanisms, when first displaying prices on a website. For example a clear link ('1 click') to a list of payment surcharges, where it is clear to consumers that they need to click on the link to obtain information on additional charges
- on all subsequent web pages, in close proximity to the total price, provide clear information on the surcharges/discounts that apply to different payment mechanisms or a clear link ('1 click') to a list of surcharges/discounts that apply to different payment mechanisms
- provide clear information on the existence of payment surcharges which apply to other payment mechanisms within any adverts (including print, television, outdoor or other media channels), which refer to a price, and

³⁹ We note that credit cards provide a greater level of protection for consumers (Section 75 of the Consumer Credit Act), but do not believe that stopping surcharges for debit cards would necessarily move consumers away from using credit cards. It is already the case that a significant proportion of those retailers that do surcharge only surcharge for credit cards and of those which do surcharge for both credit and debit cards the majority charge a higher surcharge for credit cards. In these circumstances consumers already make a decision on whether to pay more for the additional benefits of credit cards and a significant proportion choose to do so.

⁴⁰ UK Card Association. Percentage of adult UK population who own a debit card 2009

- ensure that consumers purchasing products by telephone or in-store are provided with information on payment surcharges that apply to other payment mechanisms in a clear and timely manner.

Actions to be taken and other options considered

Drip pricing of compulsory surcharges

- 6.43 In order to address the consumer detriment resulting from retailers only adding surcharges which are effectively compulsory to the total price at a late stage of the booking process, the OFT considers that retailers need to make headline prices more comparable, by including in the headline price the costs of paying by debit card – that is not imposing a surcharge to consumers who pay by debit card.
- 6.44 We have considered a number of options to achieve this, including the possibility of enforcement action under the CPRs and a recommendation to Government to amend or implement UK legislation.
- 6.45 In considering enforcement action under the CPRs we have undertaken a preliminary assessment of the specific practices of the individual retailers in the passenger transport markets and have identified a number of retailers where we believe there is a case to be made that the retailer is engaged in commercial practices which may be in breach of the CPRs.
- 6.46 However, a CPRs case will only specifically clarify the issues of that individual case and as such may not provide long-term clarity and certainty with regard to other industries and/or practices. Furthermore it may not provide a wider solution as airlines continue to develop their payment structures.
- 6.47 We consider a legislative solution to be the optimal route in the long term. It would provide greater clarity for both businesses and consumers and could result in wider restrictions on businesses presenting prices in a way which unduly distorts consumers' decisions.
- 6.48 In addition, a legislative approach to prohibit retailers from surcharging for debit cards would create a standard payment mechanism that does

not incur a surcharge for online retailing, which we consider would facilitate price comparisons and therefore trade.

6.49 We therefore:

- **Recommend that the Government introduces measures to prohibit retailers from imposing surcharges for payments made by debit card.**

6.50 The OFT will work with Government to find an effective and efficient way to achieve this recommendation across the economy, which minimises the burden on business. We consider there are a number of ways that this could be attained, including through the UK implementation of the Payment Services Directive (PSD) or the Consumer Rights Directive (CRD).

6.51 Article 52(3) of the PSD gives member states the right to forbid or limit surcharges.⁴¹

'...Member States may forbid or limit the right to request charges taking into account the need to encourage competition and promote the use of efficient payment instruments.'

6.52 However, the issue of payment surcharges is currently being considered at the European level as part of the CRD proposals. A European initiative is likely to be more effective than national legislation as it will apply to firms operating across European borders.

6.53 Article 19 within the CRD text adopted by the European Parliament on 23 June 2011, requires member states to limit payment surcharges to cost.

Article 19 – Fees for use of means of payment

'Member States shall prohibit traders from charging consumers, in respect of the use of a given means of payment, fees that exceed the cost borne by the trader for the use of such means'.

⁴¹ See Chapter 3 for more information on the PSD.

- 6.54 The OFT considers that a cost-reflective solution may not fully address our concerns, as surcharges can legitimately vary between retailers and would still be dripped to consumers through the purchasing process. However, it may sufficiently reduce detriment if the 'cost borne by the trader' is restricted to the marginal cost the retailer incurs for processing each payment, as the additional surcharges will be minimal and the variation in surcharges between retailers will be reduced.
- 6.55 The CRD has been adopted by the European Parliament's plenary and is expected to be adopted by the Council of Ministers in due course. We will work with the relevant Government department to ensure the UK implementation of the CRD effectively addresses our concerns.

General transparency and presentation of surcharges

- 6.56 However, achieving regulatory change may take a number of years and in the meantime we believe that consumer detriment, particularly in the airline sector where the practice of payment surcharging is most common, could be reduced by improving transparency. In particular, in the course of our investigation we have conducted a preliminary assessment of the presentation of payment surcharges on over 30 websites and identified a number of retailers where we consider the transparency levels of effectively compulsory surcharges is likely to breach the CPRs. We therefore propose to:
- **Seek to improve the transparency and overall presentation of payment surcharges in the transport sector, through action to ensure compliance with the Consumer Protection from Unfair Trading Regulations 2008 (CPRs).**
- 6.57 Some traders have indicated that they are willing to change their practices in line with the OFT's recommendations, by not imposing a surcharge for debit cards and by improving the transparency of the payment surcharges which apply to other payment mechanisms. We will continue to work with these traders to ensure these changes are made.
- 6.58 For those traders who are unwilling to make voluntary changes or where commitments to change practices have not been implemented within a

reasonable timeframe, and where there is scope for such action to be effective and consistent with our prioritisation criteria, we will consider enforcement action. In line with the OFT's general prioritisation principles,⁴² we will consider in due course whether enforcement action in other sectors is necessary.

- 6.59 We believe that improved transparency will help consumers avoid surcharges that they do not wish to pay and by enabling consumers to compare full price offers more easily will increase the competitive pressure on retailers to reduce the level of surcharges over time.

⁴² OFTs Prioritisation Principles: www.offt.gov.uk/shared_offt/about_offt/oft953.pdf

7 EXCESSIVE CHARGES

- 7.1 The Which? super-complaint argues that payment card surcharges in the passenger transport markets, and potentially elsewhere, exceed reasonable estimates of retailers' costs of processing card transactions.
- 7.2 The OFT considers that consumer detriment arises because payment surcharges lack transparency and/or because the headline price is not achievable for the majority of consumers as the payment mechanism which does not incur a surcharge is not readily available. The lack of transparency of effectively compulsory surcharges may allow retailers to increase the level of surcharges, as by the time the charges are revealed consumers have invested time in the purchase and are therefore deterred from shopping around and comparing offers, weakening competition between retailers.
- 7.3 As discussed in chapter 6, the OFT considers that these concerns can be best addressed by making the headline price achievable for the majority of consumers by prohibiting surcharging for debit cards and improving the overall presentation and transparency of the surcharges that may apply to other payment mechanisms. This will make it easier for consumers to shop around and compare prices and therefore encourage competition between retailers. We consider that if surcharges for other payment mechanisms are sufficiently transparent this will put pressure on traders, acquirer banks and card networks to reduce charges, by opening up the surcharges to competitive pressures.⁴³
- 7.4 However, if the level of effectively compulsory surcharges truly reflects the marginal costs incurred by the retailer in processing the payment, the impact on the consumer of dripping the surcharge may be reduced, as the charge is likely to be minimal. Although the impact of the drip price effect may not be fully eliminated, as payment processing costs can

⁴³ Transparency will increase the exposure of surcharges to competitive pressures; however given the partitioned nature of the charges we consider the competitive pressure will remain less than on the headline price.

legitimately vary between retailers and consumers would still have to engage in lengthy purchasing processes to obtain total prices.

- 7.5 In response to the super-complaint we have not considered it necessary to reach a conclusion on the marginal cost of processing different payment mechanisms, as we consider establishing a standard free payment mechanism and improving transparency to be more appropriate.
- 7.6 However, in considering the options open to the Government to prohibit retailers from surcharging for debit cards we are mindful of the Consumer Rights Directive (CRD),⁴⁴ which would prohibit retailers from imposing payment surcharges that exceed cost.
- 7.7 Cost regulation can be relatively burdensome on both retailers and the taxpayer in that it can be difficult and expensive to assess and enforce. It would also require tight definition of the costs which retailers could recover, in order to limit the opportunity for retailers to interpret 'cost' more widely.
- 7.8 However, the CRD may provide a framework to address much of the consumer detriment arising from payment surcharges and we will work with the Government to ensure the UK implementation of the CRD – which may take up to two years – effectively addresses our concerns.
- 7.9 For completeness Annexe C sets out some background and data on the costs of processing card transactions collated as part of this study. We note that the costs incurred by retailers appear to be higher than indicated in the evidence submitted in the Which? super-complaint.

⁴⁴ See paragraph 6.53

8 OUTCOMES OF THE SUPER-COMPLAINT

8.1 The possible outcomes of a super-complaint include:

- taking action to improve compliance with the existing law, including enforcement action under the OFT's competition or consumer powers
- making recommendations to Government
- launching a market study into the issue or issues raised in the super-complaint
- making a market investigation reference (MIR) to the Competition Commission (CC)
- accepting undertakings in lieu of a MIR to the CC
- encouraging firms to take voluntary action, or
- a finding that the complaint requires no further action.

8.2 In Chapter 6, we set out the OFT's recommendations in response to the Which? super-complaint, specifically the OFT:

- **recommends that the Government introduces measures to prohibit retailers from imposing surcharges for payments made by debit card, and**
- **seeks to improve the transparency and overall presentation of payment surcharges in the transport sector, through action to ensure compliance with the Consumer Protection from Unfair Trading Regulations 2008 (CPRs).**

8.3 The OFT considers it is necessary to recommend both a regulatory solution and enforcement action under the CPRs. This is to ensure a meaningful and consistent solution to the cross-economy issue of payment surcharges and to tackle individual retailers whose practices we consider are resulting in significant consumer detriment.

Market Study

8.4 We consider that the consumer detriment resulting from the practices identified in the Which? super-complaint can be best addressed through the measures set out above and launching a market study is not merited.⁴⁵

Making a Market Investigation Reference (MIR) to the Competition Commission (CC)

8.5 A possible outcome from a super-complaint is a MIR to the CC. In order to do so the OFT must have reasonable grounds for suspecting that any feature, or combination of features, of a market in the UK for goods or services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK, or part of the UK.⁴⁶

8.6 If this test is met, the decision on whether to make a reference rests on the exercise of the OFT's discretion. The OFT guidance⁴⁷ on MIRs sets out four criteria that must, in our view, be met before we decide to make a reference:

- alternative powers – whether it would not be more appropriate to deal with the competition issues identified by applying CA98 or using powers available to the OFT or, where appropriate, to sectoral regulators
- proportionality – whether the scale of the suspected problem, in terms of its adverse effect on competition or customer detriment

⁴⁵ In prioritising its work, the OFT takes into account a range of factors, including the impact on consumers of our work, as set out in our published guidance: OFT 953 'OFT Prioritisation Principles', October 2008.

⁴⁶ Section 131 of the Enterprise Act 2002.

⁴⁷ OFT guidance: 'Market Investigation References', March 2006.

arising from it, is such that a reference would be an appropriate response to it

- availability of remedies – whether there is a reasonable chance that appropriate remedies will be available, and
- undertakings in lieu – whether it would not be more appropriate to address the problem identified by means of undertakings in lieu of a reference.

8.7 In this case, the OFT considers that, even if the reference test is met, the consumer detriment resulting from payment surcharges can be better remedied through a combination of action under the OFT's consumer protection powers and a recommendation to the Government to prohibit surcharging for debit card payments. The OFT has not therefore reached a firm conclusion as to whether the reference test has been met, nor in respect of which relevant markets.

8.8 If a satisfactory resolution is not obtained, however, the OFT may choose to reconsider whether the reference test is met in relation to particular goods or services, and therefore whether a MIR would be an appropriate response.

8.9 We invite views on our proposed decision not to make a MIR to the CC. Interested parties are invited to submit responses to this consultation by 5pm on Tuesday 6 September 2011, either by email to surcharge.supercomplaint@oft.gsi.gov.uk, or in writing to:

Surcharge Super-complaint (6th Floor)
Office of Fair Trading
Fleetbank House
2-6 Salisbury Square
London
EC4Y 8JX

8.10 We will consider any responses received and will publish our final decision on a market investigation reference in due course.

Further investigation under CA98

8.11 We consider that the consumer detriment resulting from the practices identified in the Which? super-complaint can be best addressed through the measures set out above. There is no evidence that the threshold for a CA98 investigation has been met. There is no evidence that the imposition of payment surcharges results from agreements between firms. There is also no evidence that the practice amounts to an abuse of a dominant position by firms within a UK market either individually or together.

A PARTIES CONSULTED

AIB Merchant Services
Air Berlin PLC
Air France
American Express Services Europe LTD
Assertis LTD
BAI (UK) LTD
Barclays Merchant Services
Britain Express LTD
British Airways PLC
British Midland International LTD
British Retail Consortium
Chamber of Shipping
Cheapflight.com LTD
Citizens Advice
Civil Aviation Authority
Condor Ferries LTD
Consumer Council for Northern Ireland
Consumer Focus
Deutsche Lufthansa AG
DFDS Seaways PLC
Diners Club UK LTD
Easyjet PLC
Elavon Merchant Services
Eurostar International LTD
Expedia INC
Ferries Trains Plains LTD
Flybe Group PLC
HSBC Merchant Services
Iberia Group
Irish Ferries LTD
Isle of Man Steam Packet Company LTD

Jet2 LTD
Kelkoo.com (UK) LTD
Lastminute.com LTD
LD Lines
Lloyds Banking Group
Monarch Airlines
Office of Rail Regulator
Opodo LTD
P&O Ferries LTD
Passenger Shipping Association
Rail Europe LTD
Royal Bank of Scotland PLC
Ryanair Holdings PLC
SAS Scandinavian Airlines
SeaFrance LTD
Silverrail Technologies
Skyscanner LTD
Stagecoach Group PLC
Stena Line LTD
The Trainline LTD
Thomas Cook Group PLC
Trailfinders LTD
Travelbag LTD
Travelsupermarket.com LTD
TUI Travel PLC
Turkish Airlines PLC
Virgin Atlantic Airways LTD
Which?

B USE OF SURCHARGES IN THE UK

Surcharging across the economy

B.1 The evidence provided in the Which? super-complaint indicates that surcharging outside travel markets is fairly limited. Surcharging in the non-travel sectors mentioned in the super-complaint is sporadic, with not all relevant retailers surcharging and those that do often do not surcharge debit cards.

B.2 Other evidence also indicates that surcharging is not widespread outside travel markets and has not grown strongly in recent years. In 2007, the OFT conducted a survey⁴⁸ of 1052 businesses across the UK that accept card payments, including retailers, wholesalers and public sector bodies. The survey included businesses in the travel sector. It found that:

- Overall only 19 per cent of businesses that accepted card payments surcharged at least one card type. 81 per cent of businesses applied no surcharges at all.
- Fourteen per cent of businesses applied surcharges to credit cards, nine per cent to charge cards, and six per cent to debit cards. Across all card types, around a quarter of businesses that surcharged only did so on transactions below a certain level.
- Credit card surcharges ranged from less than one per cent of transaction value to over three per cent, with roughly equal numbers of businesses setting surcharges at each level. Around a tenth required a flat fee (usually between 50 pence and £1.30).
- Debit card surcharges tended to be lower if charged as a proportion of transaction value, with more businesses charging a flat fee (usually between 10 pence and £1.00).

⁴⁸ Conducted as part of a Competition Act investigation into the charges that credit card networks levy on retailers.

- Businesses gave various reasons for not surcharging. For example, 18 per cent saw surcharges as unfair, 17 per cent saw them as bad customer service, 16 per cent were afraid to lose custom, whilst 14 per cent had simply never thought about surcharging.

B.3 Comparing the results of this survey to data in the super-complaint we find:

- the markets referred to in the super-complaint cover a similar, but not significantly wider, range of markets as was seen in the 2007 study
- the average level of surcharges – for example, generally not exceeding 3 per cent for credit cards, and lower or often waived for debit cards – does not seem to have changed significantly.

B.4 The British Retail Consortium (BRC) told the OFT that their members largely reject payment surcharging. They believe their members consider surcharging to be:

- impractical – as competition within the retail sector would put any retailer who imposed a payment surcharge at a competitive disadvantage, and
- unworkable – as it may be difficult for retailers to distinguish card types at the point of sale in store. BRC note that there are currently over 270 levels of interchange fee in the UK and complex hardware, software and staff training would be required to implement an accurate surcharging mechanism and process at the point of sale.

Surcharging in the passenger transport market

B.5 The Which? super-complaint identified just over 30 firms in the passenger transport market. The OFT has corroborated the data provided by Which? in light of recent changes in some firms' surcharges. Tables B.1- B.3 summarise the surcharges of these firms. The firms identified provide a good cross section of the practices used in each sector, but should not be treated as an exhaustive list of suppliers.

Table B.1 Surcharging⁴⁹ of firms in the airlines sector

Trader	Credit card surcharge	Debit card surcharge	Other
Air Berlin	€10 per passenger (Mastercard), €17 per passenger (other credit cards)	€10 per passenger	
British Airways	£4.50 per passenger	£0	Paypal £4.50, All other cards £0
BMI Baby	£4.50 per journey (min £6.50)	£3 per journey (min £4)	VISA electron £0
Easyjet	£8 plus 2.5% per transaction (min £12.95)	£8 per transaction	VISA electron £0
Flybe	£5 per journey (min £6.50)	£4.50 per journey (min £5.50)	VISA electron £0
Iberia	£4.50 per passenger	£0	All other cards £0

⁴⁹ This table relates to charges which the OFT consider to be payment surcharges. This includes any charges which vary depending on the payment mechanism the consumer chooses to use and/or which are only added to the total price the consumer has to pay once they select which payment mechanism they are going to use.

Jet2	7% per transaction (min £4.99)	3.5% per transaction (min £4.99)	Paypal 5% (min £4.99) VISA electron & Solo £0
Monarch ⁵⁰	£10 per transaction	£0	VISA electron £0
Thomas Cook	£4 per journey	£3 per journey	VISA electron & Pre-paid MasterCard £0
TUI Group Airlines (Thomson)	2.5% per transaction	£2.95 per transaction	VISA electron £0
Ryanair	£6 per journey	£6 per journey	Pre-paid MasterCard £0
Virgin Atlantic	1.5% per transaction	£0	All other cards £0

Source: OFT analysis of websites April-May 2011. List not exhaustive.

⁵⁰ Surcharges for Monarch have been updated following changes to their charging structure introduced on 1 June 2011.

Table B.2 Surcharging of firms in the ferry sector

Trader	Credit card surcharge	Debit card surcharge	Other
Brittany Ferries	£5 per transaction	£0	All other cards £0
Condor Ferries	£0	£0	All other cards £0
DFDS Seaways	2.5% per transaction (Min £4, Max £25)	£0	All other cards £0
IOM Steam Packet	£3 per transaction	£0	All other cards £0
Irish Ferries	£5 per transaction	£5 per transaction	Visa Electron £0
LD Lines/Transmanche	2% per transaction	£0	All other cards £0
Norfolkline Irish Sea Ferries	£4.50 (Visa), £6 (AMEX), £4 (MC) per transaction	£1 per transaction	Visa Electron £0
P&O Ferries	£4 per transaction	£0	All other cards £0
Stena Line	£5 per transaction	£0	All other cards £0

Source: OFT analysis of websites April-May 2011. List not exhaustive.

Table B.3 Surcharging of rail ticket re-sellers

Trader	Credit card surcharge	Debit card surcharge	Other
Britain Express (powered by Rail Easy)	4.5% per transaction	£0.75 per transaction	No Free Mechanism
Eurostar	£4 per transaction	£0	All other cards £0
Megatrain/Megabus	£0	£0	All other cards £0
My Train Ticket	2.25% per transaction	£0	All other cards £0
Qjump	£3.50 per transaction	£0	All other cards £0
Quno	£2.50 per transaction	£0.50 per transaction	No Free Mechanism
Rail Easy	4.5% per transaction	£0.75 per transaction	No Free Mechanism
Rail Europe	2.5% per transaction	£0	All other cards £0
Rail Saver (powered by Rail Easy)	4.5% per transaction	£0.75 per transaction	No Free Mechanism
Red Spotted Hanky	£0	£0	All other cards £0
The Trainline	£3.50 per transaction	£0	All other cards £0

Source: OFT analysis of websites April-May 2011. List not exhaustive.

C COST ASSESSMENT

- C.1 Retailers incur different costs of accepting cash, cards and other payment mechanisms. In this Annexe we identify what costs retailers may incur, and provide estimates of retailers' costs based on the information received from retailers and banks as part of the super-complaint.
- C.2 We note that the OFT is investigating, under the Competition Act 1998, the multilateral interchange fees (MIFs) charged by MasterCard and VISA to banks each time a card transaction is processed at a merchants outlet.⁵¹ The European Commission recently found that MasterCard's MIF arrangements contravene competition rules and MasterCard has subsequently appealed this decision. The UK Government has intervened in support of the Commission and it is expected that the judgement of the General Court will inform the OFT's ongoing investigation.

The cost of accepting card payments

- C.3 Retailers' external costs of accepting card payments are generally paid to acquirers (often banks) operating within payment card networks.⁵² Some retailers use payment services intermediaries alongside or instead of traditional acquirers. Retailers may also incur their own costs in connection with processing card payments.

⁵¹ See: www.offt.gov.uk/OFTwork/competition-act-and-cartels/ca98-current/interchange-fees/

⁵² Six major acquirers, including the largest high-street banks, acquire transactions within the VISA and MasterCard networks. Charge card networks like American Express and Diner's Club tend to deal with retailers directly, acting as their own acquirers. Extensive detail on the structure of payment card networks is available on the OFT's website in connection with Competition Act cases against some card networks. See: www.offt.gov.uk/OFTwork/competition-act-and-cartels/ca98-current/interchange-fees/

Fees to acquirer banks

- C.4 Fees paid to acquirers are often the largest, and for some retailers are the only, costs of accepting payment cards. They include:
- merchant service charges (MSCs) paid for processing each transaction. For credit cards, MSCs are usually a percentage of transaction value, whilst for debit cards they are usually a flat fee and significantly lower for all but the smallest transactions
 - other per-transaction fees. Some acquirers charge separate fees for services that others cover in MSCs. The most common separate fees are for charge-backs: returning funds to a consumer when a transaction is reversed, for example when goods are returned, and
 - overhead (often monthly) fees, such as fees for terminals or chip-and-pin devices.
- C.5 MSCs are usually the largest component of fees that retailers pay to acquirers. When a consumer makes a purchase from a retailer and the transaction is processed, the retailer pays an MSC in part to cover its acquirer's costs of requesting and processing funds from the consumer's card issuer. However, MSCs also tend to include a range of other costs that acquirers pass on to retailers.
- C.6 In general, around 70 per cent of the MSC is made up of the multilateral interchange fee (MIF) that the acquirer pays to the card issuer. MIFs cover issuers' costs including costs of providing payment guarantees and, for credit cards, may cover some costs of providing other benefits to cardholders.⁵³

⁵³ Through MIFs issuers pass on to acquirers and thence retailers some of the broader costs of running card networks. In return, retailers receive benefits including payment security, avoidance of any need to check consumers' creditworthiness and increased demand from consumers who favour cards.

C.7 Costs of accepting cards payment methods can vary widely between retailers, as larger retailers often have greater negotiating power with the card networks.

Fees to intermediaries

C.8 Payment services intermediaries⁵⁴ assist some retailers in accepting secure payments online or in other 'cardholder not present' situations such as through call centres or mail order. Intermediaries may charge for:

- providing equipment and services needed to accept online and other distance payments, such as payment functionality for retailers' websites,
- providing fraud detection and management services (in which some intermediaries specialise), or
- providing some or all of the merchant services usually provided by acquirers, up to full transaction processing. In these cases the intermediary typically deals with an acquirer but acts as a point of contact for retailers, charging a mark-up on the acquirer's relevant fees.

C.9 Some intermediaries that process transactions for retailers require retailers to put up cash deposits in readiness to refund cancelled purchases. A retailer may receive interest but could still forego higher savings rates or investment returns.

⁵⁴ Including Retail Decisions, Netbanx, Nochex, Paypoint.net, Payxpert and Sage Pay. Some acquirers also provide payment services such as functionality for retailers' websites or fraud management. Examples include Elavon and RBS-Worldpay. PayPal also helps some retailers accept cards and provides merchant accounts, as well as handling payments through the PayPal system.

Retailers' own costs

C.10 Retailers' own costs of processing card payments vary significantly. All elements needed to accept card payments can be provided by acquirers or payment service intermediaries and are often included in their fees. However, some retailers prefer to self-source, for example when acquirers offer less comprehensive services or when the retailer can manage its payment website more cheaply than an intermediary might. Retailers' own costs may therefore include:

- buying and maintaining point-of-sale equipment like chip-and-pin devices
- fraud monitoring and maintaining compliance with Payment Card Industry Data Security Standards (PCI DSS) to help prevent fraud, required by all the major card networks
- developing and running infrastructure to handle card payments, such as payment functionality for websites or call centres, and
- staff training.

C.11 Retailers' own costs are more varied than acquirers' or intermediaries' fees. Some retailers face no direct costs because all elements above are included in fees. When retailers do incur their own costs those may not be separable from general overheads of staying in business. For example, there may not be a significant extra marginal cost from adding payment functionality to a website which is necessary for being in business.

C.12 We note that retailers' costs of accepting cash include the costs of security and often, compared to card payments, greater time spent processing transactions at tills.

Which?'s estimates of retailers' costs

C.13 In the super-complaint Which? provides estimates of the lowest, average and highest fees that retailers may be charged by acquirers for processing card transactions, reproduced below:

Table C.1 Which?'s estimates of acquirers' fees

Card type	Lowest	Highest	Average
Debit card	£0.08	£0.16	£0.11
Credit card	0.88%	1.8%	1.34%

Source: Which? super-complaint 30 March 2011

C.14 These estimates are built up from data on multilateral interchange fees (MIFs) published by VISA and MasterCard. As mentioned above, MIFs can be around 70 per cent of MSCs. Which?'s estimate of lowest fees assumes a typical medium-sized retailer and, in particular, that MIFs may decrease in line with recent reductions in Europe, and with them MSCs. Which?'s estimates of average and high total fees include assumptions about other costs beyond MSCs (like charges for renting chip-and-pin devices) and assume smaller retailers may fail to obtain the cheapest rates on total fees from acquirers.

Data on retailers' costs

C.15 The OFT has obtained data directly from acquirers on fees for processing card transactions. We also requested information from the passenger transport providers mentioned in the super-complaint on their total costs of accepting card payments, including information on intermediaries' fees and providers' own costs. Since providers' responses varied in format and comprehensiveness the estimates of processing costs provided below are indicative.

Fees to acquirer banks

C.16 From acquirers, we obtained data on fees charged to all retailers and to the travel sector in particular.⁵⁵ We also received information on a range

⁵⁵ For some acquirers, average MSCs in travel markets are higher than averages elsewhere. But the highest MSCs can be found in other markets (up to six per cent). Average MSCs to travel providers may be relatively high to cover the insurance liabilities of card issuers, passed on to acquirers in MIFs and then to retailers in MSCs, since credit card legislation requires issuers to

of factors that cause fees to vary. For example, MSCs are often higher for online and other 'cardholder not present' transactions than for face-to-face transactions. MSCs may also vary according by retailer size, reflecting the greater bargaining power of larger retailers.

C.17 Table C.2 below shows, in summary and anonymised form, acquirers' fees to travel providers including airlines for processing online transactions. We have omitted data where there were overriding confidentiality concerns.⁵⁶

Table C.2 Acquirers' fees to retailers in the travel sector for processing card transactions

Charge	Minimum	Maximum	Average ⁵⁷
Merchant service charges			
Debit cards and prepay	£0.01	£1.50	£0.30
Credit cards	0.12%	4.70%	1.80%
Charge cards	-	-	-
Other per-transaction fees			
Charge-backs	£0	£15	Applicable MSC ⁵⁸
Periodic (usually monthly) fees			
Terminal rental (chip-and-pin, for example) per terminal per month	£20	£25	£20
General service fees	£0	£ hundreds	£0 for larger retailers

cover risks to purchases made by credit card. Travel purchases can be high-value and subject to disruption.

⁵⁶ We have omitted fees for charge cards because commercial confidentiality may be breached by showing even summary anonymised data, since there are only two main networks.

⁵⁷ Average MSCs are the (un-weighted) means of averages provided by acquirers. Acquirers' other fees are more variable in structure. Averages are OFT estimates

⁵⁸ The MSC charged to process the original transaction.

Source: Responses to OFT information request (April- May 2011)

- C.18 It is important to note that this table does not capture certain sources of variation in acquirers' fees. Merchant service charges can be blended, that is, offered at uniform rates across different card types and networks. Unblended rates can vary over time for the same retailer, for example if an acquirer offers premiums and discounts contingent on volumes of card payments, volumes of business in other areas or activity by the retailer to promote the card network.
- C.19 Nonetheless, the table provides a good indication of travel providers' average variable costs. It can be seen that the estimates for processing card payments provided to the OFT by the acquiring banks are somewhat greater than the estimates provided by Which?, although minimum MSCs are lower than Which?'s estimates.

Fees to intermediaries

- C.20 Intermediaries' fees are more varied than acquirers'. Some retailers pay for inclusive off-the-shelf services where the intermediary handles all aspects of online payments through its website. The smallest retailers (taking only a few hundred payments per month) can pay low monthly overheads for comprehensive services, avoiding dealing with acquirers directly or paying any per-transaction fees. Larger retailers usually pay confidential negotiated rates for anything from fraud management up to full web hosting and transaction processing. The travel providers mentioned in the super-complaint mostly have traditional acquirer relationships but some incur extra overheads from using intermediaries.
- C.21 From information provided to us, we have estimated that typical additional costs of using an intermediary for a provider with a traditional acquirer relationship include:
- charges to maintain online payment functionality (particularly for smaller providers), and
 - charges for fraud prevention and monitoring.

C.22 The sum of such overhead costs appeared to equate to no more than 20 pence per transaction for any travel provider.⁵⁹

Retailers' own costs

C.23 Retailers' own costs of processing payments, as mentioned above, are highly varied, and some travel providers reported no additional costs of card processing. This is unsurprising given the range of services offered by acquirers and intermediaries, leaving few remaining elements for some providers to cover independently. Other providers reported costs, for example relating to website development and management time, that may at least in part belong to general overheads or one-time investments rather than to ongoing direct costs of accepting card payments. Without greater access to confidential business information it is difficult to estimate relevant per-transaction costs.

Total costs

C.24 Table C.3 below illustrates travel providers' typical costs of processing common-sized transactions. It applies the average MSCs for each card type and typical charge-back costs.⁶⁰ Though overheads charged by acquirers may be irrelevant to online transactions (for example terminal rental) and general service fees may be zero for some acquirers, we have assumed an average overhead of a penny per transaction, given the high number of transactions processed on average each month, to capture the costs borne by some retailers. We assumed monthly intermediaries' fees to be 10 pence per transaction (half of the maximum in returns to us, given the proportion who reported zero intermediary costs). We also

⁵⁹ Based on returns of varying formats and comprehensiveness. A small number of retailers using intermediaries for full payment processing also reported costs of putting up cash deposits to refund cancelled purchases.

⁶⁰ For charge-backs a fraction was added to the total per-transaction fee to reflect the probability of application. We assumed that five per cent of transactions are reversed and incur a charge-back fee, so added a probability-weighted (0.05 x applicable MSC) to MSCs.

allowed 10 pence per transaction for providers' own costs, which may be an overestimate on average since some travel providers process tens of thousands of transactions per month.

Table C.3 Illustrative costs of processing card transactions

Card type	Transaction size			
	£50	£100	£250	£500
Credit card	£1.16 (2.3%)	£2.10 (2.1%)	£4.94 (2.0%)	£9.66 (1.9%)
Charge card	£1.52 (3.0%)	£2.84 (2.8%)	£6.77 (2.7%)	£13.34 (2.7%)
Debit card	£0.53 (1.1%)	£0.53 (0.5%)	£0.53 (0.2%)	£0.53 (0.1%)

Source: OFT analysis

- C.25 It is important to emphasise that this table may underestimate some travel providers' costs, despite making relatively generous assumptions about providers' own direct costs. The table is based on average fees for any card network so does not reflect the higher MSCs likely to be paid by some smaller providers. We have also omitted occasional costs quoted by some providers but not others, such as costs due to failures by acquirers, card networks or intermediaries.
- C.26 The overall estimates of travel providers' costs of processing card payments appear to be higher than those provided by Which? in the super-complaint. However we would require more detailed data from a greater number of retailers in order to reach a more accurate estimate of actual costs.

D CARDHOLDING AND USAGE IN THE UK

D.1 In 2009, debit, credit, charge and prepaid cards were used to make more than eight billion purchases worth £396 billion in the UK.⁶¹ Nearly 93 per cent of UK adults held at least one plastic card (not including store cards):

- 86 per cent of adults held at least one debit card
- 62 per cent held at least one credit or charge card, and
- five to eight per cent are estimated to have held at least one prepaid card (with less than five per cent owning a Pre-paid MasterCard or Pre-paid VISA).⁶²

D.2 Debit and credit cards are almost entirely branded VISA or MasterCard. Charge cards are branded by those networks, American Express, Diner's Club and some smaller networks. Prepaid cards are issued within the major networks and by a number of individual banks and building societies.

D.3 The full picture of cardholding and usage is complex, but some basic facts are relevant to a consumer's likelihood of encountering a payment card surcharge.

⁶¹ The latest comprehensive data available is from the UK Cards Association (*UK Plastic Cards 2010*) and run to the end of 2009. Data for 2010 will be available later in 2011.

⁶² Data on prepaid cards is less complete than for other card types. There were 2.5 million active prepaid cards issued by members of the UK Cards Association (including VISA and MasterCard) at the end of 2009. Since some cards are not reloadable and their balances will have declined to minimal amounts, the number of useable cards was less. Thus a maximum of five per cent of the UK adult population of 50 million may have held a prepaid card issued by a UK Cards member (with no multiple cardholding and if all cards remained usable). Several major issuers of prepaid cards are not members of UK Cards, including Broadcastle Bank, APS, Raphaels and the Newcastle Building Society. Including prepaid cards issued by them, the UK Cards Association estimates there to be up to four million issued.

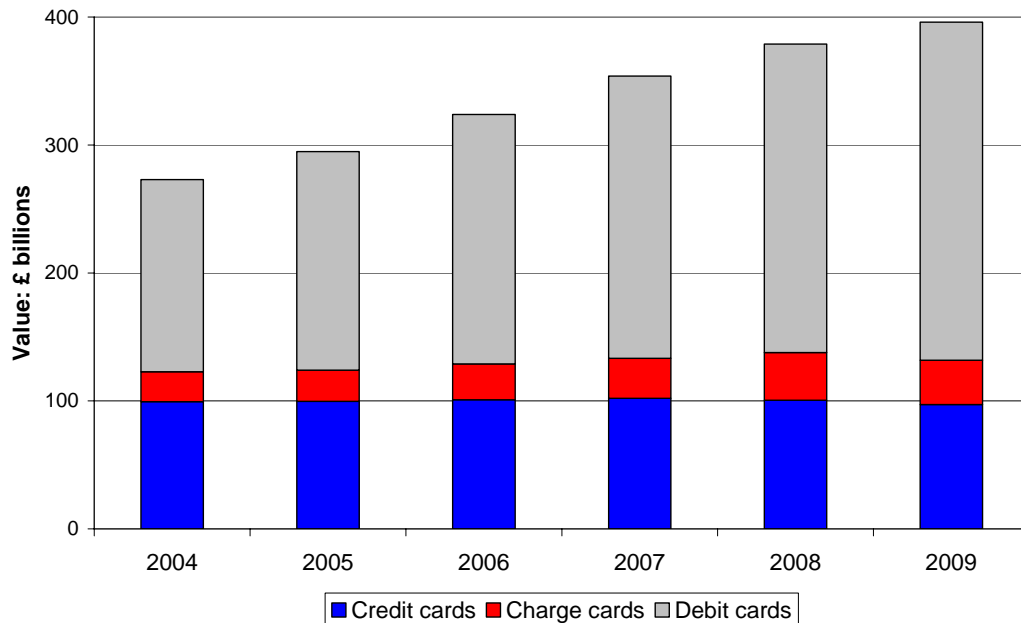
D.4 Overall, debit cards are used for more purchases than (more widely surcharged) credit or charge cards, with prepaid cards remaining niche:

- In 2009, debit cards were used for 67 per cent of all purchases by value within the UK (excluding cash withdrawals). Credit and charge cards were used for nearly 33 per cent. Prepaid cards were used for less than one per cent.
- By number of UK purchases, debit cards were used for 75 per cent, credit cards for 25 per cent and prepaid cards for less than one per cent.

D.5 As shown in Chart D.1 below, debit card usage has grown strongly whilst use of credit and charge cards has remained mostly flat. The chart omits prepaid cards for which little time series data is available, although evidence suggests ownership and usage was lower pre-2009.⁶³

⁶³ Based on data and notes from *UK Plastic Cards 2010* and discussions with the UK Cards Association. For example, total UK purchases using prepaid cards issued by UK Cards Association members were valued at £600 million in 2009 (0.16 per cent of total card purchases by value) and less than half that in 2008.

Chart D.1: All UK card purchases by card type



Source: UK Cards Association

D.6 Credit cards are used more often online, where surcharging (in general and particularly for credit cards) is more common:

- In 2009, credit and charge cards were used for 52 per cent of UK online card purchases by value. Debit cards were used for 48 per cent.
- Credit cards remain popular online for the reassurance they provide. However, debit cards are used increasingly often, with online use growing at 40 per cent a year on average over the five years to 2009.
- There is little data on the use of prepaid cards online, but even total purchases by prepaid cards would realistically represent no more than two per cent of all UK online card purchases.
- Online payment methods other than cards remain niche for purchases from retailers. PayPal is accepted by nearly 400 online

retailers (of which some surcharge for its use) but is used significantly less often for shopping than cards.⁶⁴

D.7 Another indicator of an individual's likelihood of having to pay a surcharge is the extent to which consumers hold multiple cards, allowing them to substitute for non-surcharged cards (for example to avoid a credit card surcharge by electing to pay by debit card). Consumers holding only one card type have no option to substitute. At the end of 2009:

- 32 per cent held only one or more debit cards and no other card types.
- One per cent held only credit or charge cards.

⁶⁴ PayPal acceptance figures are from PayPal's website. PayPal is used more widely between consumers or between businesses.