Taxi non-cash payment surcharge review 2019

NBG Response to ESC Consultation Paper

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RESPONSE BY

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Executive Summary

The ESC's Taxi non-cash payment surcharge review 2019 stated objectives are:

1. To establish a methodology and approach, which will then be used to determine the maximum taxi non-cash payment surcharge.
2. In determining the maximum surcharge our objective is to promote efficiency and the long term interests of Victorian consumers while also allowing taxi payment processors to recover reasonable cost.

Establishing a Methodology to determine the maximum taxi non-cash payment surcharge:

The ESC faces a difficult task in this regard. It is being asked to determine a price intervention into a competitive market where there are multiple suppliers rather than where it traditionally operates, that is, a monopoly supplier not subject to competition.

Price Control mechanisms were effectively abandoned as a public policy mechanism in Australia following the Hilmer National Competition Policy Review in 1993. Since then Government policy, at both State and Commonwealth level, has been framed around a belief that Australia's growth was to be by way of a competitive market economy.

The implementation of Hilmer's reforms, focussing on competition and not on State intervention and price controls, is acknowledged as being a critical component for the unprecedented 26 years of economic growth enjoyed by Australia[1].

Accordingly the imposition of price control regulation in 2014 on multiple private firms operating in a competitive environment in the provision of non cash taxi surcharges flew in the face of 20 years of competition policy and was a retreat into a past era of Prices Commissioners and State intervention. It is the very antithesis of promoting a market economy. Further none of the preconditions required by the National Competition Policy for price setting to be used as a tool of economic policy were evident in this Taxi Payment Processing market in 2014 and that position remains unchanged today.

[1] As Hilmer found, price control mechanisms:
1. reduce incentives for investment and improved productivity,
2. involve substantial administrative and compliance costs, and
3. suggested that price control measures should be seen as a 'last resort' (p. 271).

Consistent with the move to a market based economy the Commonwealth Government abolished the Prices Surveillance Authority, merging into the ACCC, and focussed its prices work onto prices oversight and applying a consistent framework of Price Cap regulation on firms in industries for what were deemed to be monopoly assets not subject to competition. The Victorian Government pursued a similar policy framework with respect to utility assets.

So what are the methodological challenges the ESC faces in this review?

- Firstly it needs to use a methodology that involves evaluating the effects of price levels on earnings in the Taxi Payment Processor so investors in the firms providing the services receive a fair rate of return on their investment.
- Secondly, the methodology needs to deliver a rate of return adequate to attract capital and to ensure that a sufficient level of service is available for customers, including investment in new technology.
- Thirdly, will the price set be at a point that will encourage consumers to use the service. Making it a free good will maximise consumer uptake but the Taxi Payment Processor will terminate the service, conversely setting a price too high and consumers will abandon the service causing the Taxi Payment Processor to lower prices or terminate the service.
- Fourthly it needs to screen out mixed use supply from the processing so that costs and revenues of the Taxi Payment Processor are not mingled with "unregulated services" (e.g. App Booking, or Network, or Payment Instrument Services) as these will distort the analysis leading the ESC to over or undershoot in its determination.
- Finally it needs to identify the revenues and costs for an Efficient Producer in a competitive market where all producers operate and compete equally. In this case, the competitive market must be defined as taxi non cash payments.

NBG has detailed in our response to Question 3 how the 2012 Victorian Taxi Inquiry (VTII) comprehensively failed in identifying:

1. What constituted an Efficient Producer in the market.
2. What Reasonable Costs should be recovered.
3. What was a fair rate of return to investors and to attract investment by firms in new technology.

Balancing these criteria is key to both Benchmarking and Bottom Up cost assessments to provide ways of assessing the reasonable costs for an Efficient Producer.

Understanding the difference between a service fee and a surcharge is a key concept for the ESC Review.

This is key to understanding what Taxi Payment processing involves and being able to assess the supply chain and the resultant costs and revenues underpinning the product delivery. (i.e. what is the end user and other actors paying for or/and receiving). Having a clear perspective on the role of a Merchant Aggregator and that of a Merchant in Card Processing is key.

A Merchant applies a Surcharge to a card payment for the product it has sold to a consumer.

A Merchant Aggregator (AKA a Taxi Payment Processor) charges a Service Fee for a bundle of services it provides to both a consumer and a sub merchant (i.e. a driver/operator) in a multi sided market not a normal two sided market. Traditional competition analysis frameworks break down in multi sided markets.

Getting the nomenclature correct and the nature of the market correct is therefore important and not simply a piece of symbolic imagery. These concepts are set out in our response to Question 2.

The Victorian Taxi Industry Inquiry's (VTII) 2012 Recommendation on a Service Fee Cap was predicated on significant flaws.

Since 2014 both the Government and the public have relied on the findings contained in the VTII's Final 2012 Report to guide its policies and regulations relating to the processing of electronic payments in Taxis.

Government accepted the Recommendations of the VTII to impose a price cap of 5% on the service fee for non cash payments of taxi fares.

The recommendations of the VTII were premised on what it alleged was its detailed modelling of an Efficient Producer and the "0.65% of margin over identified costs" the Taxi Payment Processor should receive in the 5% Price Cap.

For the purposes of this submission we have revisited all of the VTII modelling and data. In addition to the VTII data, we have taken ESC's data from its Unbooked Commercial Passenger Vehicle Fare Review in 2018 and data from the RBA on consumer payment behaviour.

This has enabled NBG to develop both a detailed top down Waterfall Analysis and a bottom up Cost Analysis to construct an accurate perspective of the addressable market and identifiable costs and margins for an Efficient Producer.

From this we conclude that:

1. The VTII modelling actually cut the Taxi Payment Processor's 0.65% of margin over identifiable costs by 15% in order to meet its 5% target but this was never disclosed in its report.

2. The VTII should have recommended to Government that the Service Fee for taxi non-cash payment should have been reduced from 10% to 6.26%.

3. This is also supported by the benchmarking analysis we have detailed in response to Question 6.

4. Government clearly was misled by the VTII into believing that an efficient Taxi Payment Processor would be capable of earning the same margin under its 5% recommendation as it did in the previous 10% regime. This is dissembling behaviour by the report's authors at best.

NBG's detailed top down Waterfall Analysis and a bottom up Cost Analysis are set out in our response to Question 3 and conclude that the ESC should not use VTII's 5% surcharge price cap as a starting point for determining the "Reasonable Costs" for processing non cash payment instruments in Victorian Taxis in its 2019 review.

The ESC review affords the State with the opportunity to move the regulation of Card Payments in Taxis under the Reserve Bank of Australia and Australian Competition and Consumer Commission (RBA/ACCC) National Regulatory Framework.

The ESC's review of the existing arrangements and level of the "Taxi non-cash surcharge" provides the opportunity for the ESC, the Government, and the Industry Regulator (Commercial Passenger Victoria) to engage in a thorough rethink of not just the quantum of the surcharge but more broadly the appropriateness of maintaining industry specific regulatory arrangements for a small industry.

Since the Government, in response to the Victorian Taxi Industry Inquiry (VTII) enacted its legislation, the entire regulatory landscape with respect to Card Surcharging in Australia has moved on. NBG believes the case for removing the bespoke arrangements applied in Taxis is overwhelming and would deliver consumers a nationally consistent framework afforded by the RBA/ACCC.

We note that:

1. The market conditions that gave rise to the 2012 VTII recommendation (and the 2014 regulation of non cash surcharging that gave effect to the VTII's recommendations) no longer apply. The conditions precedent on Cabcharge products and the MPTP being available to other processors have been fulfilled.

2. A single RBA/ACCC regime can apply for Card payments in all Commercial Passenger Vehicles operating in Victoria; whether they be by Ridesharing

services (Uber), Hire Cars (Limousines), Pre-booked Taxi trips, or Unbooked taxi trips.

3. A far more effective RBA and ACCC enforcement regimes has been in operation since 1 September 2017. It is more than capable of providing the necessary protections for consumers and at the same time meet the requirements of Taxi Payment Processors as "Merchant Aggregators".
4. The RBA and ACCC enforcement already accommodates a Multi Sided Market supply chain that includes the role of Merchant Aggregator (AKA Taxi Payment Processor), Sub-merchants, and Cardholders.
5. The revised RBA/ACCC arrangements can cover all payment instruments used in Taxis and makes the merchant (aka the Taxi Payment Processor) accountable for their actions on a continuing basis. The RBA/ACCC model of regulation of card payments by merchants is based on three elements:
    a. Guidelines as to what is a reasonable cost to be recovered by a merchant including whether this is an ad valorem or a postage stamp.
    b. Makes the Merchant responsible for determining the level of the fee it charges and the manner in which it is applied.
    c. Contains a strong enforcement framework with considerable investigative resources and enforcement powers.
6. The RBA/ACCC National Regulatory Framework is a preferable regulatory framework to that of a price cap and a prices commissioner approach to regulation contained in the current Victorian legislation. It delivers a simple and low cost solution with market driven outcomes and it removes the regulatory burdens of a ESC reviews every two years.
7. The RBA has a clear Constitutional Power to act in this matter as it forms part of the Commonwealth Government's Banking powers so the State should abandon the field to the RBA/ACCC.

We have detailed why we have reached this view and how we believe Consumers and the CPV industry would benefit from this in our response to Questions 2, 5, and 9.

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Question 1 - Are there any additional stakeholders we should contact?

<u>Summary</u>

1. The ESC should initiate discussions with the RBA and ACCC on the removal of the ‘carve out’ of Taxis from the RBA/ACCC Card Surcharging provisions and identify the steps involved.
2. Additionally it should consult with Department of Transport on the administrative steps necessary to give effect to bringing all CPV trips within the common national regulatory framework for card payments.

Question 2 - Is there any part of the Supply Chain we appear to have misunderstood

Summary

There are three aspects of the Supply Chain the ESC needs to be cognizant of in its understanding of in its current review. These are:

1. The **position, role and services** of the Taxi Payment Processor (better described as the Merchant Aggregator)[2] in the supply chain. Taxi Payment Processing operates in a multi sided market not a traditional two sided market. This alters the pricing and costing structures. Multi sided markets demand different thinking in terms of competition theory by a Regulator.

2. **Understanding the difference between a service fee and a surcharge** is key to being able to assess the supply chain and the resultant costs and revenues underpinning the product delivery. (i.e. what is the end user and other actors paying for or/and receiving).

3. The **impact of different regulatory treatment** of Non Cash Surcharges in Booked and Unbooked Commercial Passenger Vehicle Market in Victoria.

2.1 The functions of the Taxi Payment Processor (Merchant Aggregator) in the supply chain - A Multi Sided Market NOT a Two Sided Market.

The ESC has set out its views of the supply chain at Figure A.3 (Page 21 of its Consultation Paper dated 11 Dec 2018). This interposes the Driver/Operator into the conventional 4 Party Payment Scheme analysis. This forces a two sided market analysis onto what is actually a multi-sided market.

The difficulty that conventional competition analysis faces is that its frameworks are all based around a two sided market but when the market becomes multi-sided they break down. Taxi Payment Processing (Merchant Aggregation) is actually a multi sided market which is what we have outlined in the revised Figure A3[3], our Figure 1. In this market the Taxi Payment Processing (Merchant Aggregation) interfaces with a group

[2] A Merchant Aggregator in the Card Payment Industry is a specialised form of a merchant services provider and typically handles payments transactions for a large number of small sub-merchants unable to obtain direct merchant facilities. Those sub-merchants do not have their own Merchant Identifier Number (MIN) but instead operate under the Merchant Aggregator's MIN. The Aggregator is the party sponsored by a bank or acquirer in the Card Payment Scheme. This allows merchant services to be offered in a very elegant and technically efficient manner. A Merchant Aggregator charges Service Fees for the services and risks it assumes in the card processing.
[3] Taxi Non-Cash Payment Surcharge Review 2019, Figure A.1:, Page 18

of sub-merchants (Drivers/Operator) and at the same time the Merchant Aggregator interacts with the Cardholder for the payment transaction processing as does the Driver/Operator in the delivery of the good. Similar multi sided markets have emerged in ticketing for events and hotel reservation/booking (more details in Question 7 & 8).

The Scheme Rules in Australia, (i.e. Visa and Mastercard) views the taxi Payment Processor as a Merchant Aggregator. In the USA such a party is described as an Independent Sales Organisation (ISO).

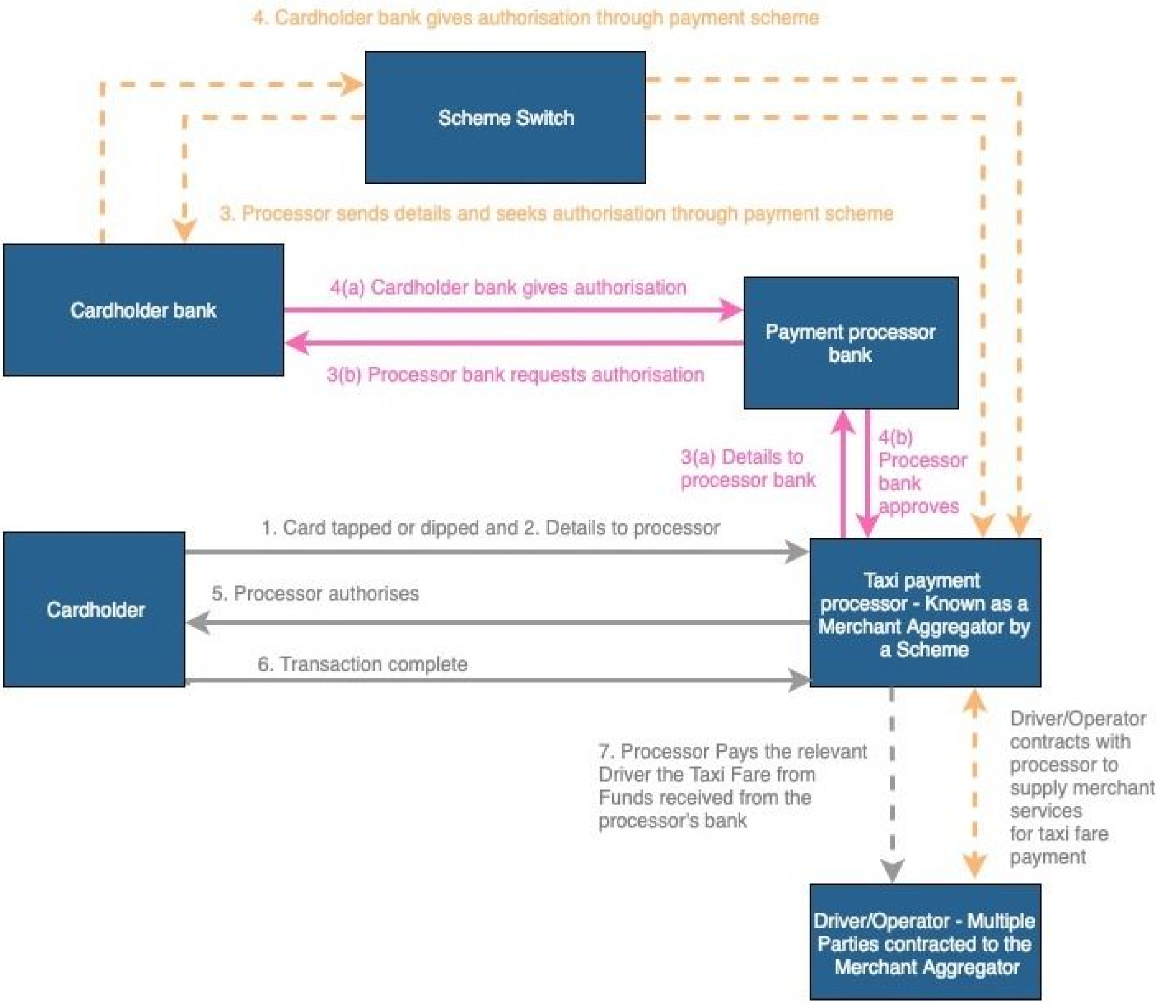
Because Merchant Aggregator arrangements are relatively rare in Australia compared to the USA and even the UK there is a popular misconception amongst consumers that the Taxi Driver/Operator is the Merchant which is not the case. The ESC's diagrammatic representation of the industry in Figure A.3[4] potentially perpetuates this misconception.

Accordingly getting the supply chain accurate is essential for the ESC not only to accurately determine the fee but also to communicate its decisions effectively to consumers.

Once the supply chain in Taxi Payment Processing is recognised as comprising a multi sided market then the pricing and costing structures are easier to understand and differentiate from the usual two sided market. We have examined the costing and pricing issues in greater detail in our response to Question 5 below in a discussion on the RBA's regime.

[4] Taxi Non-Cash Payment Surcharge Review 2019, Figure A.1:, Page 18

Figure 1 - Revised to reflect Taxi Payments Information Flow in a Four Party Scheme. The role of the Merchant Aggregator/Taxi Payment Processor



What are the Services Provided by the Merchant Aggregator (Taxi Payment Processor) to the Drivers and Operators and Cardholders?

The Merchant Aggregator (Taxi Payment Processor) role in the Supply Chain enables:

1. A Consumer to pay for a taxi fare with a non-cash instrument over a safe and efficient payment system reducing their need to carry cash.

2. Provides a driver/operator with access to a trade finance facility by providing immediate access to cash in their bank account from electronic transactions. This is priced at between 0% and 1.5% well below prevailing market rates of 20%[5] for small businesses and unavailable to micro enterprises like a taxi.

[5] This is the prevailing rate charged by Scottish Pacific, a leading non bank trade finance provider in Australia offering trade invoice facilities to SME businesses.

3. A Taxi driver/operator is able to increase their market appeal and hence their sales revenues by offering a non-cash payment facility as a mechanism to pay for a trip.
4. Taxi operators and drivers are able to work in a safer environment if they can accept electronic payments processing, particularly in lowering the risk of robbery or assault.
5. For Acquirers, Banks and Card issuers, all market facing risk in the provision of payment facilities in a high risk industry, the taxi industry, is assumed by the Taxi Payment Processor.
6. All regulatory compliance with the requirements of both State Regulators and the ATO is assumed by the Taxi Payment Processor which simplifies monitoring for authorities. This delivers an additional consumer benefit of limiting leakage into the Cash Economy.
7. The Taxi Payment Processor complies with the regulatory requirements relating to Anti Money Laundering and Counter Terrorism Financing Legislation, (Know Your Customer) and is subject to the Australian Tax Office electronic payment reporting requirements.

The impact of this is that:

- Specific Software needs to be developed by the Merchant Aggregator (Taxi payment Processor) that operates inside and alongside that of a regular EFTPOS system.
- Bank Issued EFTPOS terminals and systems fail to comply with this complex interplay of regulations
- There are minor variations between various States and Territories on the receipting requirements.

Summary

1. The regulatory and systems requirements are such that all Taxi Payment Processors have to invest in significant systems development and maintenance costs.
2. The Compliance and reporting costs to the Taxi Payment Processor are ongoing.
3. None of these costs are faced by merchants outside the taxi industry.

4. The cash economy risks faced by the State are reduced as electronic transactions are visible via the banking system to the Australian Tax Office.
5. The Merchant Aggregator (Taxi Payment Processor) is the market facing party and assumes all market risks from Cardholders and Drivers and Operators?

Why don't Taxi Drivers and Operators provide the EFTPOS Services?

- Drivers and Operators can be best described as an underbanked sector lacking access to sophisticated banking facilities.
- Card Issuers and Acquirers regard the taxi Industry as a high risk industry and impose significant risk premiums on the Merchant Service Fees for the industry.
- An individual Taxi Operator or Driver cannot meet the costs for systems development and regulatory requirements for an individual taxi.

Summary

1. Contracting with a Taxi Payment Processor as a Merchant Aggregator offers Drivers the least cost highest quality solution to meet their regulatory obligations in order for passengers to pay fares electronically.
2. The Taxi Payment Processor provides Drivers with a trade finance facility priced between 0% and 1.5% well below prevailing market rates of 20% faced by regular small businesses and unavailable to micro enterprises like a taxi.

2.2 Service Fee vs. Surcharge

Is it a Service Fee or is it a Surcharge? Getting the product described accurately is a key element of the Supply Chain.

This is not a matter of "one man's fish is another man's poisson" but rather there are some quite specific elements that are germane to the current analysis which distinguish a Service Fee from a Surcharge. These terms are not interchangeable but are distinctly different. The use of Surcharge to describe what is in operation in taxi payment processing by the Merchant Aggregator is misleading to consumers.

Table 1 - Service Fee vs. Surcharge

	What is a Service Fee	What is a Surcharge
Definition	A Service Fee is a type of fee collected to pay for services related to the primary product being purchased but which are additional to the primary product. Service Fees are levied when services beyond the physical good itself are provided as an extra service.	Surcharges are imposed to recover additional costs incurred by a merchant when the customer uses a card to pay for the service. Surcharges are applied outside the pricing of a product to provide a transparent pricing mechanism as to the cost of card acceptance
What is Delivered	Service Fees cover the costs of providing a range of services essential to the delivery of the primary product (in this case the ability to pay for a taxi fare with a card), including things like infrastructure costs and operating an internet site for cardholder receipt search and re-printing, operator and driver transaction dashboard to manage and reconcile transactions, fraud prevention, compliance with government regulations and anti money laundering protections, fees to third parties (e.g. card companies) hardware costs and maintenance; trade finance facilities. This is the services a Merchant Aggregator offers in a card scheme.	Surcharges avoid smearing the costs of a card acceptance across consumers who elect to pay cash. The Firm should not derive any surplus (profit) from the payment choice of a consumer but should be able to recover the Marginal Costs it incurs for offering non-cash payment facilities to consumers. The design of this regime is to leave the Firm without exposure to the payment choice behaviour of the Customer in their Cash versus Card decision.
Pricing	Since the Services being provided are both unrelated to the primary	The Price paid by the consumer as the surcharge

	good and the services delivered to end users different to the primary good, the Service fee needs to be set at a level that not only recovers the cost of accepting the card but also includes the recovery all of the costs incurred in delivering the service as well as a return on the operation of this business.	for the benefit of paying by card should be equal to the Marginal Cost faced by the Firm for Providing the service since it is not the product being supplied by the Firm.

Summary

1. A Service Fee is applied when the deliverable is a separate product with quite well defined characteristics not simple card acceptance. (We explore this further under our response to Question 5 on the RBA below)

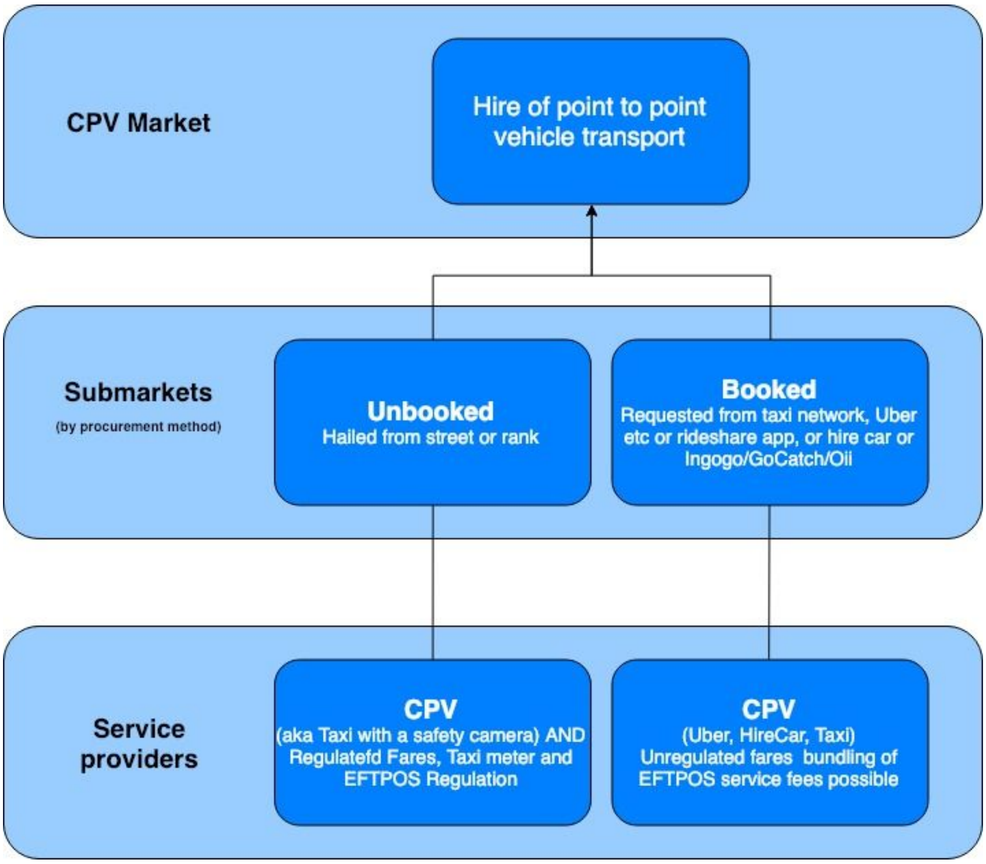
2. Service Fees are common in a number of industries. One of the most visible is in the ticketing (entertainment industry). What is delivered by ticketing processors for venues and promoters has many of the same characteristics of the services delivered by Taxi Payment Processors to the On Demand Point to Point transport industry. (We explore this further under our response to Question 7 & 8 on Benchmarking below)

3. A Merchant applies a Surcharge to a card payment for the product it has sold to a consumer. A Merchant Aggregator (AKA a Taxi Payment Processor) charges a Service Fee for a bundle of services it provides to both a consumer and a sub merchant (i.e. a driver/operator). Getting the nomenclature correct is therefore important and not simply a piece of symbolic imagery.

2.3 The impact of different regulatory treatment of Non Cash Surcharges in Booked and Unbooked Commercial Passenger Vehicle Market in Victoria.

In its 2018 Taxi Fare review the ESC sets out the supply chain for Commercial Passenger Vehicles in Victoria[6] and NBG has augmented it in Figure 2 as follows:

Figure 2 - Supply Chain for Commercial Passenger Vehicles in Victoria



This impact of the CPV supply chain analysis should inform the ESC's taxi non cash surcharging review because:

1. In the period since 2012 there has been a significant shift in the share of unbooked work of total taxi trips from 70% in 2012 to <50% in 2018.

2. The fares for booked CPV services (including those provided by taxis) are no longer subject to maximum fare regulation. This enables CPV providers with flexibility around how they set the level and structure of fares, **therefore a non cash surcharge can be bundled into the fare or a surcharge can be levied.** In some forms of CPV, specifically rideshare and hire cars, there is no regulated cap on the surcharge as they are subject to the RBA/ACCC regime. This muddies the supply chain as there is no "pure" payment processor for analysis.

[6] Fare Review for Unbooked Commercial Passenger Vehicle Services Consultation Paper, Figure A.2, Page 14

But it does provide a model as to how a market based surcharging regime under the RBA/ACCC provisions does effectively operate with with no detrimental effects for market participants and customers.

3. A CPV business that provides Taxi Payment Processing and a choice of Booked and Unbooked CPV services can therefore cross subsidise the costs of providing Taxi Payment Processing in Unbooked services from unregulated Booked services revenues.

4. Some providers of CPV Booked services are subject to RBA/ACCC card surcharge regulatory environment and some are subject to the Victorian specific non-cash surcharge regime. This is confusing for all participants and muddies any analysis by the ESC. It adds additional weight to NBG's view that the time is appropriate for the RBA/ACCC to be the single regulatory framework for payments for all Booked and Unbooked CPV trips in Victoria.

Arguably, based on this supply chain the ESC's review of Service fees should:

1. Only examine the costs and rate of return of a Taxi Payment Processor for Unbooked CPV services and

2. Allow the market to set the non-cash surcharge in Booked CPV services and rely on the RBA/ACCC regulatory regime to prevail in that market OR

3. Recommend that the State request the RBA/ACCC to remove the current carve out of Taxis and allow the market to set the non-cash surcharge for all CPV Payment Processors.

Summary

1. The ESC needs to recognise the correct role and functions that the Taxi Payment Processor (Merchant Aggregator) provides in the provision of services not only to passengers but also to drivers/operators.

2. These roles drive the costs that the Taxi Payment Processor (Merchant Aggregator) incurs in the provision of the services to the market.

3. The market structures for Commercial Passenger Vehicle Services and Taxi Payment Processing in 2019 is vastly different from that in 2012 when the VTII made its recommendation on the capping of the Non Cash Taxi Payment Processing Surcharge.

4. The reforms in CPV need to be incorporated by the ESC in its 2019 taxi non-cash surcharge review. It cannot rely on a static interpretation of the structure of the market based on the 2012 supply chain for this review.

5. The simplest and arguably the best outcome for both consumers and market participants will be for the State to request the RBA/ACCC to remove the current ‘carve out’ of Taxis and allow the market to set the taxi non-cash surcharge. NBG sets out the arguments supporting the action in our response to ESC Questions 5 and 9 below.

Question 3.0 What evidence is there that the current 5% maximum surcharge is lower than, higher than, or reflects the "reasonable cost" of accepting and processing non-cash payments

Summary

- NBG has undertaken a detailed top down Waterfall Analysis and a bottom up Cost Analysis and our review demonstrates that the Victorian Taxi Inquiry (VTII) comprehensively failed in its 2012 analysis in identifying:
    a. What constituted an Efficient Producer in the market.
    b. What Reasonable Costs should be recovered.
    c. What was a fair rate of return to investors and sufficient to attract investment by firms in new technology.
- NBG's Waterfall analysis demonstrates that:
    a. The VTII should have found that the efficient producer would process $22,000 per terminal per annum in non-cash payment of taxi fares, not $100,000 as it claimed.
    b. Adjusting the analysis to accommodate changes in the market by 2018 the Efficient Producer would process $24,000 per terminal per annum in non-cash payment of taxi fares
- NBG's analysis demonstrates that in 2012:
    a. The VTII modelling actually cut the Taxi Payment Processor's '0.65% of margin over identifiable costs' by 15% in order to meet its 5% target, despite stating that it had provided for a 0.65% margin over identifiable costs.
    b. Government clearly was misled by the VTII into believing that an efficient Taxi Payment Processor would be capable of earning the same margin under its 5% recommendation as it did in the previous 10% regime. This is dissembling behaviour by the report's authors at best.
    c. The VTII should have recommended to Government that the Service Fee for taxi non-cash payment should have been reduced from 10% to

6.26%. This is also supported by the benchmarking analysis we have detailed in response to Question 6.

- Implementation of the Government's Non-Cash Surcharging Legislation in 2014 by the Taxi Services Commission (TSC) treated GST as a cost to the Taxi Processor further reducing the Surcharge maximum to 4.54%. This treatment is at odds with the ATO's application of GST and needs to be reversed in the ESC's 2019 determination.

In 2012 the Final Report of the Victorian Taxi Industry Inquiry (VTII) made the following conclusion and recommendation:

> *"13.3 The 10 percent service fee levied on the processing of electronic payments should be brought under regulation and set at a level that better reflects the resource costs of providing the service. The inquiry recommends this fee be set at five per cent of transaction value as a maximum amount that can be charged, until subject to a further evaluation by the Essential Services Commission."*[7]

When this Recommendation was implemented by the Victorian Government in January 2014 it was in an amended form, so that the effective Surcharge was reduced to 4.54% not 5% as recommended by the VTII Report.

3.1 The Victorian Taxi Inquiry (VTII) Efficient Producer and Market Assumptions and Constraints

The VTII's analysis made a number of assumptions about the market that not only were wrong at the time but subsequent regulatory changes in the structure of the market mean that the the VTII's assumptions are more erroneous today than in 2012.

The VTII's Recommendation was predicated on these **assumptions** as part of its case underpinning its recommendation:

1. An "efficient Producer" operating in the Victorian market **processing $100,000 of non-cash payment of taxi fares on a single terminal**.
2. A costing analysis based on a bucket of costs which **assumed significant savings and efficiencies** which would be available for the Efficient Producer at a $100,000 of non-cash payment of Taxi Fares per terminal.

[7] Taxi Industry Inquiry, Customers First: Service, Safety, Choice, Final Report, September 2012, p. 217.

3. This Efficient Producer, with $100,000 of non-cash payment of Taxi Fares per terminal **would continue to generate a 0.65% of margin over identified costs**[8].

This is all set out at Page 215 of the VTII's Final Report and at Figure 5 on Page 215 and reproduced in this document in Figure 3.

Reviewing the decision of the VTII to recommend the 5% maximum service fee and the associated costing analysis that it claimed supported this recommendation based on an Efficient Producer with $100,000 of non-cash payment of Taxi Fares per terminal per annum, **it is clear that it was only possible for this Producer if a number of constraints are imposed on the market**.

The **constraints** are:

1. The Total Transaction Volume Constraint - Either the volume of taxi fares paid by card increased from 50% to 66% OR the size of the total taxi fare market in Victoria grew by 40%.

   There is nothing published by the VTII to support either assumption or a combination of the two to create an Efficient Producer processing $100,000 of non-cash payment of Taxi Fares per terminal per annum. The Cabcharge FY 2018 results presentation to the Australian Stock Exchange reports that the total fares it processed in Victoria in FY2018 was the same value as it processed in FY2014. Given Cabcharge's processor size in the market it suggests that fare revenues are flat and have not grown 40%.

   Further the ESC's 2018 Unbooked CPV Fare Review notes at Page 7 that "Average occupancy rates decreased from 29 per cent in 2014 to 27 per cent in 2016. This shows that taxi drivers were spending more time without a passenger in 2016 than in 2014". From this we conclude that the total taxi fare market did not grow by 40% as the VTII may have assumed.

   Since the taxi fare market didn't grow by 40% then movement from cash to card is the most likely way of increasing the total fares being processed by an efficient producer.

   In terms of the volume of taxi fares paid by card, we note that the VTII's report (see Page 214) states that 50% of fares are paid by Card. Separately we have reviewed the RBA's analysis of Card Payments published in July 2017. This suggests that in 2012/13 card share of transactions equivalent to the average Taxi fare was closer to 40% and by 2016 had risen to 61%.

2. The Payment Instrument Constraint - The terminal used by the Efficient Producer was processing ALL Card instruments not just Bank and Third party

[8] Taxi Industry Inquiry, Customers First: Service, Safety, Choice, Final Report, September 2012, p. 215.

cards. That is, it could process Cabcharge Payment Instruments which represents 39%[9] of cards share of payments processed.

3. The Single Terminal in a Taxi Constraint - There was only one terminal in a taxi, even though it was common for more than one terminal to be present.

3.2 NBG Waterfall Analysis of the VTII's assumptions and constraints

NBG has undertaken a waterfall analysis to replicate the VTII's statement that there can be an Efficient Producer with $100,000 of non-cash payment of Taxi Fares per terminal per annum and then test what happens as the constraints are released to more accurately reflect the market operating in Victoria not only in 2012 but in 2018.

The findings from the Waterfall Analysis are set out in the Table 2 below.

Four Scenarios are presented. In three scenarios (A, B,& C) we examined the impact of holding and/or releasing each constraint (assumptions) set out above. (i.e. Total Transaction Volume; Payment Instrument; Number of Terminals in a Taxi). In a fourth Scenario (D) we have updated the position to align with the market in 2017/18 using the ESC's own data from the 2018 Taxi Fare Review.

Scenarios A & B apply all constraints necessary to deliver the outcome for the VTII's $100,000 Efficient Producer. Only Cabcharge can process all EFTPOS transactions in Victoria.

Scenario C applies the data the VTII used or reported in other parts of its Final Report; and initially removes the Total Transaction Volume Constraint. It then progressively removes the remaining Constraints

Scenario D applies the ESC's 2018 CPV Fare Review data and RBA data[10] on the movement of cash to card on transactions values equating to average taxi fares and then progressively removes the Transaction Volume Constraints. This indicates that in 2012/2013 the volume of taxi fares paid by card was probably around 40% but by 2016 this has risen to 61%. We have applied 66% to reflect the continuing drift to card in the since 2016.

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[9] Taxi Industry Inquiry, Customers First: Service, Safety, Choice, Final Report, September 2012, p. 214. and Cabcharge Annual Results FY2013

[10] RBA Report on How Australians Pay https://www.rba.gov.au/publications/rdp/2017/pdf/rdp2017-04.pdf Page 6

Table 2 - NBG's Waterfall Analysis of the Victorian Taxi Non-Cash Payments Market

	VTII Analysis		VTII Corrected Analysis	2018 ESC Taxi Fare review	
	CABCHARGE TERMINAL ONLY		DUAL TERMINAL TAXI		
	Scenario A	Scenario B	Scenario C	Scenario D	Data Source
Market growth	40%	0%	0%	-7%	Draft ESC Unbooked CPV Fare Review June 2018, Page 7
EFTPOS SHARE OF FARES	50%	66%	50%	66%	TAXI INQUIRY PAGE 214 and RBA Survey of "How Australians Pay" July 2017 Page 6
TOTAL FARES	$840,000,000	$600,000,000	$600,000,000	$558,000,000	TAXI INQUIRY PAGE 214
EFTPOS FARES	$420,000,000	$396,000,000	$300,000,000	$368,280,000	TAXI INQUIRY PAGE 214
CAB CARDS SHARE OF PAYMENTS PROCESSED	39%	39%	39%	39%	TAXI INQUIRY PAGE 214 and CAB Annual Results FY13
Value of Cabcharge Product Processed	$163,800,000	$154,440,000	$117,000,000	$143,629,200	Applying CAB Card Market Share of 39%
ADDRESSABLE MARKET VIC	$256,200,000	$241,560,000	$183,000,000	$224,650,800	After Removing CAB Cards from Total Fares (AMEX, VISA, Master Etc)
NO OF TAXIS	4085	4085	4085	4625	TAXI INQUIRY PAGE 261 and Draft ESC Unbooked CPV Fare Review June 2018, Page 6
100% EFTPOS PER TAXI INCLUDING CAB PA	$102,815	$96,940	$73,439	$79,628	**Assumes driver processes all cards including Cabcharge product on the single terminal**
100% EFTPOS PER TAXI EXCLUDING CAB PA			**$44,798**	**$48,573**	**Assumes driver processes all non Cabcharge product on the single terminal**
50% EFTPOS PER TAXI EXCLUDING CAB PA			**$22,399**	**$24,287**	**THIS IS THE REAL EFFICIENT OPERATOR FIGURE FOR VIC**

NBG's conclusion from the Waterfall Analysis is that:

1. The VTII $100,000 Efficient Producer has to be Cabcharge and the terminal has to process 100% of ALL fares in Victoria and needs to process ALL instruments (i.e. including Cabcharge Cards). Clearly this does not in any way reflect the state of the Taxi Processing Market and can therefore be discarded as a starting point for any analysis.
2. The critical conclusion reached by the VTII, and used to underpin its recommendation that 5% was the appropriate surcharge, was flawed calling into question its costing analysis and it's taxi non cash surcharge cap recommendation.
3. When all constraints are released; an Efficient Producer in Victoria has a transaction fare value on a per terminal basis per annum that falls within the band $22,000 (Scenario C) to $24,000 (Scenario D). It is this revenue band that should underpin any Reasonable Cost analysis by the ESC in its current review.

3.3 The VTII's Identifiable Costing and Margin Analysis

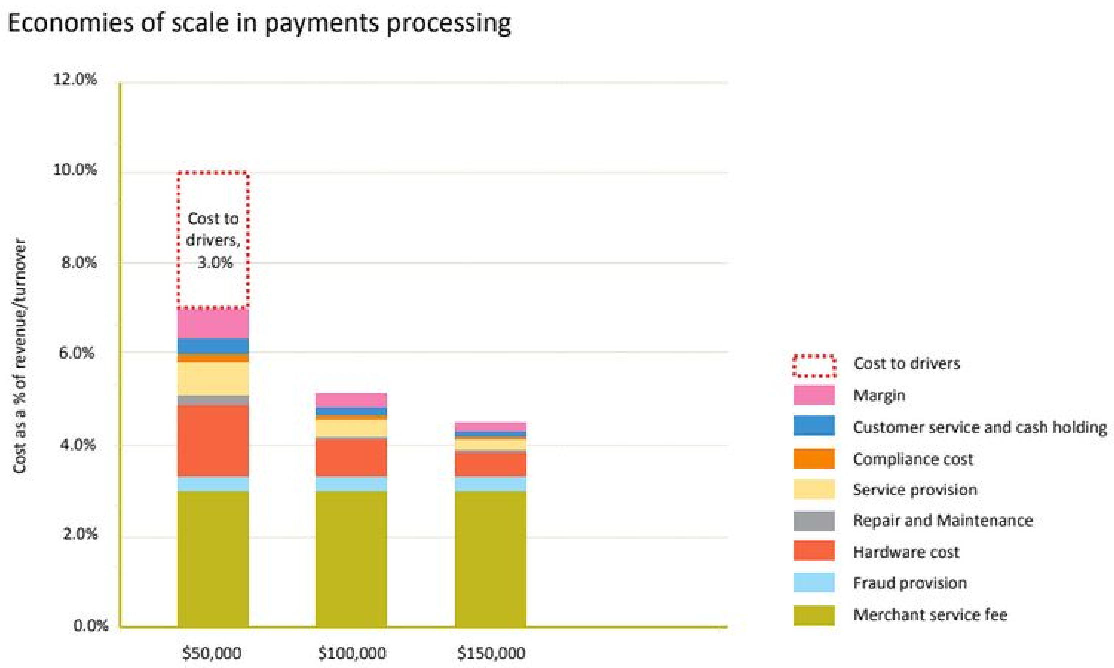
Once the VTII had identified what would be the turnover of an Efficient Producer ($100,000 p.a. per terminal) it then set out its analysis on the reasonable costs of this Efficient Producer with a 5% and 10% service fee regimes.

> *"The following figure (Figure 3) is based on data supplied in the anonymous submission and shows that a 10 per cent fee might recover costs for a terminal that is used to process $25,000 worth of transactions (the submission does not specify at what level of **(total)** turnover the percentages are calculated), but recovers well in excess of costs for a terminal that processes $150,000. **Without challenging the quantum of costs more broadly, it is clear that a lower surcharge could be consistent with cost recovery by an efficient operator who puts through around $100,000 in transactions (which includes a 0.65 per cent margin over identified costs).**"*[11]

To assist in the analysis of the VTII's costing at 5% service fee, we have detailed the figures we believe it used at both 10% and 5% service fees in Table 3 to highlight where it believed cost savings would result for an Efficient Producer that processes $100,000 per terminal per annum. We have included some comments as to our views on the veracity of these conclusions as well as their treatment of the 0.65% margin it claimed it was allowing.

[11] Taxi Industry Inquiry, Customers First: Service, Safety, Choice, Final Report, September 2012, p. 215.

Figure 3 - VTII's Illustration of costs of processing payments[12]



Source: Based on data supplied in anonymous submission E379 and TII analysis

[12] Taxi Industry Inquiry, Customers First: Service, Safety, Choice, Final Report, September 2012, Figure 5, p. 215.

Table 3 - The VTII's Costing Analysis of Identified Costs (See Page 215 of the VTII Final Report)

Service Fee (Surcharge)	10% Market	VTII's 5%	Change	NBG Comment	VTI Errors Corrected
Merchant service fee	3.00%	3.00%	0%		3.00%
Fraud prevention	0.29%	0.29%	0%		0.29%
Hardware cost	1.62%	0.73%	-55%	The cost of the hardware does not decline with turnover. It is fixed whether turnover is $0 or $100k. So assuming this is a saving is wrong	1.62%
Repair and Maintenance	0.18%	0.09%	-50%		0.09%
Service Provision	0.71%	0.35%	-51%		0.35%
Compliance cost	0.20%	0.08%	-60%	There will be some cost savings but the level is debatable as the compliance burden from the ATO and other agencies on the processor has increased	0.08%
Customer service and cash handling	0.35%	0.18%	-49%	Agreed	0.18%
Cost to Drivers	3.00%	0.00%	-100%	Agreed	0.00%
Sub Total of Identified Costs	**9.35%**	**4.72%**	**-50%**	**This is a ~50% reduction in identified costs**	**5.61%**
Margin the VTI stated it allowed over identified costs	0.65%	0.28%	-57%	The VTI actually cut the producer's margin by 57% in order to sustain a 5% surcharge despite stating that it would provide a 0.65% margin. This is dissembling behaviour on the part of a regulator at best.	0.65%
Total Surcharge (ex GST)	10.00%	5.00%	-50%	If the VTI's flaws are removed then the Surcharge should have been set at 6.26%	6.26%

From this costing analysis NBG concludes that:

1. The Hardware cost savings cannot be substantiated and should be removed.
2. The saving in compliance costs could be delivered even though the regulatory compliance regimes were increasing. In every other industry in Australia, as regulatory burdens increase then compliance costs increase. Why taxis would be different is unclear.
3. A major "Cost Saving" the VTII used to support its claim that a 5% service fee was reasonable was created by cutting the margin of the Taxi Payment Processor by 57%. This cut was NOT declared in its report. In fact the VTII stated that it was allowing a 0.65% "margin over identified costs" in the 5% regime.[13]
4. The Service Fee should have been set at 6.26% (plus GST) to set the margin at the correct level and reinstate the hardware costs but this would have required the VTII to walk away from its public commitments in its May 2012 Draft report which were made absent of any modelling or industry analysis.
5. It is therefore a Service Fee of 6.26% plus GST that the ESC should use as a the reference point against which its 2019 review should be assessed, NOT 5%.

3.4 The Taxi Services Commission's 2014 Implementation of the Non Cash Surcharge compounded the impact of the flaws in the 2012 VTII analysis.

The errors contained in the VTII's 2012 analysis and report to reduce the service fee to 5% were further compounded in 2014 by the manner in which the Taxi Services Commission (TSC) implemented the non cash payment surcharge legislation. This cut the **Service Fee to 4.54%, a 55% NOT 50% reduction**.

Prior to the enactment of the VTII reforms, the Service Fee was 10% plus GST as required by the ATO. BUT in January 2014 the TSC, by administrative fiat, formed a view that the Service Fee as legislated, was GST inc. This interpretation is at odds with the Australian Taxation Office's (ATO) view on Service Fees (GSTR 2014/2)[14]applied to EFTPOS transactions. The ATO's view is that the GST should be added to an EFTPOS Service Fee like any taxable supply.

The TSC administrative decision was undertaken without consultation. It was in conflict with the VTII's recommendations, and the Explanatory Memorandum that accompanied the Bill on introduction to Parliament covering the Service Fee.

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[13] Taxi Industry Inquiry, Customers First: Service, Safety, Choice, Final Report, September 2012, p. 215.
[14] https://www.ato.gov.au/law/view/document?src=hs&pit=99991231235958&arc=false&start=11&pageSize=1

The TSC has treated GST as a cost to the Taxi Payment Processor (Merchant Aggregator) which is at odds to the construction of consumption tax on the supply of a good or service. A consumption tax is levied on the Consumer of a Good or Service. The ATO is quite definitive as to which financial services do NOT include GST. Taxi Payment Processing services fees or surcharge are not included in this list, although a Cabcharge Payment Instrument is covered.

NBG's view on the treatment of GST is that:

1. The TSC treated GST as a Cost to the Taxi Payment Processor (Merchant Aggregator). Consequently the maximum surcharge in operation is 4.54% NOT 5% well below the "reasonable cost" of accepting and processing taxi non-cash payments.

2. The ESC needs to determine the Service Fee level going forward ex GST or alternatively allow GST as a cost of the Taxi Payment Processor (Merchant Aggregator).

3. It would be preferable if the ESC followed the provisions of A NEW TAX SYSTEM (GOODS AND SERVICES TAX) ACT 1999 and the associated Rulings and Determinations to be applied as they are in every other industry.

Question 4 - What sources of information should we consult when assessing reasonable costs?

Summary

1. Cost data from existing suppliers but only for the services of being a Merchant Aggregator. Thus suppliers with bundled products and services need to have revenues and costs unbundled to identify the position of a "pure play" Taxi Payment Processor (Merchant Aggregator).

2. Benchmarks not only from the On Demand Point to Point Transportation industry but also from other industries with services that have similar characteristics (e.g. Ticketing Service Providers in Entertainment industry) and which charge end users service fees for the services they provide.

3. The Victorian Taxi Industry Report's finding that an acceptable margin (profit) for an efficient Taxi Payment Processor "*is a 0.65 per cent margin over identified costs*"[15] in the Service Fee.

[15] Taxi Industry Inquiry, Customers First: Service, Safety, Choice, Final Report, September 2012, p. 215.

Question 5 - Are the costs of acceptance included in the RBA's merchant surcharging standard reflective of processing non-cash payments for taxis? If not, which costs should be included or excluded?

Summary

The RBA/ACCC model of regulation of card payments which:

1. Avoids the pitfalls of Price Cap pricing in a competitive market with multiple suppliers and thus is fit for purpose delivering market driven outcomes which promote competition and innovation.
2. Provides Guidelines as to what is a reasonable cost to be recovered either by way of ad valorem or a postage stamp pricing methodologies.
3. It allows Exogenous Variables (e.g. a prescribed technology refresh) to be recovered without the need to resort "Price Resets".
4. Incorporates a supply chain that includes the role of Merchant Aggregator (AKA Taxi Payment Processor), Sub-merchants, and Cardholders.
5. Makes a Merchant Aggregator responsible for determining the level of the service fee it charges and the manner in which it is applied.
6. Contains a strong enforcement framework with considerable investigative resources and enforcement powers for the ACCC covering Card surcharging [16].
7. Treats GST as a Cardholder (consumer) cost not a Merchant Aggregator (supplier) cost so aligns with the the provisions of A NEW TAX SYSTEM (GOODS AND SERVICES TAX) ACT 1999 (Cth).
8. Can assume responsibility for all Commercial Passenger Vehicle card payments (i.e. rideshare, hire cars and taxis). without any diminution of consumer welfare. (See Response to Question 9)

This is a preferable regulatory framework to that of a price cap and a prices commissioner approach to regulation contained in the Victorian legislation.

[16] See RBA Discussion Paper on the efficacy of enforcement in a market based solution https://www.rba.gov.au/publications/bulletin/2018/dec/pdf/payment-surcharges-economics-regulation-and-enforcement.pdf

We address three issues in response to the ESC's question. These are:

1. The premise underpinning the RBA's surcharging guidance enable the RBA to include the Taxi Non Cash payment surcharging.

2. The need to price the impact of exogenous variables incurred by Taxi Payment Processors (Merchant Aggregators) over which it has no control. E.g. The need to undertake a technology refresh imposed by third parties as occurred with the closure of the 2G network and which will occur ultimately with the closure of the 3G network.

3. The treatment of GST in taxi non-cash payment service fees needs to be rectified to align its treatment with the RBA.

The RBA (Payment Systems Board) is the Payment Scheme regulator for Australia. It can regulate all major payment schemes and rules including all major cards used in Victorian Taxis including non Bank Cards.

5.1 Premise 1 - behind the RBA's Determination on Surcharging - The Role of the Merchant Aggregator:

Because the RBA's Determination on Surcharging is founded on its management of the Payment System as part of the Banking functions in Australia, its objective is delivering efficient outcomes in not only the Card Schemes (i.e. Visa and Mastercard) but also other Cards (e.g. AMEX) or payment mechanisms (e.g. PayPal or some Loyalty Schemes). Further it has a power to "designate" payment mechanisms so that they fall within its ambit. (e.g. So if a transport card like an Opal or Myki morphs into a card with wider payment capabilities it could designate those cards).

Because it starts from the perspective of regulating the rules of a Payment System, the supply chain it encompasses is flexible and includes not only one in which the Cardholder and the Merchant have a direct relationship but also one where the Cardholder and a sub-merchant together interact with a Merchant Aggregator as occurs in Taxis. These arrangements are envisaged under the Scheme Rules as well as the Merchant Arrangements of Non Bank Cards.

This Merchant Aggregator is a specialised form of a merchant services provider and typically handles payments transactions for a large number of small sub-merchants unable to obtain direct merchant facilities. Those sub-merchants do not have their own Merchant Identifier Number (MIN) but instead operate under the Merchant Aggregator's MIN. The Merchant Aggregator is the party sponsored by a bank or acquirer in the Card Payment Scheme. This allows merchant services to be offered in a very elegant and technically efficient manner. A Merchant Aggregator charges Service Fees for the services and assumes the risk in the card processing.

NBG has presented its analysis of the Taxi Payment industry Supply Chain at (Question 2).

The RBA has acknowledged and accepted NBG's view of the Supply Chain in Taxis in all of its reviews of surcharging. Namely that the Taxi Driver/Operator is NOT offering the card payment facility but operates via a Merchant Aggregator (the Taxi Payment Processor) as contained in the Scheme Rules.

Accordingly the RBA's framework can accommodate Taxi Payment Processors (Merchant Aggregator) without amendment.

5.2 Premise 2 behind the RBA's Determination on Surcharging - Pricing at different points in the Supply Chain:

Merchant and the Cardholder Direct Relationship - Pricing

In the RBA surcharging regulatory regime, where the Merchant and the Cardholder have a direct relationship, the underlying principle driving pricing of card acceptance is that an efficient Merchant should price all costs for goods sold into the sale price save for the Marginal Cost of providing the Non-Cash Payment facility.

Therefore the Firm should not derive any surplus (profit) from the payment choice of a consumer. Accordingly when the Merchant and the Cardholder have a direct relationship the RBA guidelines require the Merchant to price the cost of acceptance at the Marginal Cost of accepting the Card payment.

The design of this regime is to:

- Leave the Firm without exposure to the payment choice behaviour of the Customer in their Cash versus Card decision.
- At the consumer level it removes the "free rider" problem for those choosing to pay by cash and delivers transparency on pricing for those electing to pay by Card.
- Deliver clear price signals to Consumers and leave it to Merchants as to how they deliver them.

Since 1 September 2017 the RBA's pricing and card surcharging functions have been bolstered with specific consumer protection enforcement powers for the ACCC covering Card surcharging in general.

5.3 Cardholder and a sub-merchant together interact that with Merchant Aggregator - How is Pricing dealt with in the RBA Surcharging guidelines

In this case the Merchant Aggregator has two options where its pricing can be applied:

1. The Merchant Aggregator recovers the cost of its service from the Sub-Merchant who in turn can elect to recover the cost as a pass through from the Customer or absorb them in their pricing. Because the Marginal Cost to the Sub-Merchant is the price it is paying to the Merchant Aggregator the Consumer is in exactly the same position as the Direct Relationship described below. This occurs in unregulated Booked Commercial Passenger Vehicle services including Ridesharing Services (e.g. Uber) and Taxis with a negotiated fare.

2. The Merchant Aggregator recovers the cost of its service from the Consumer. This occurs in both Unregulated and Regulated Commercial Passenger Vehicle fares. Some of these transactions are covered by the RBA (rideshare and hire cars) and some of them by the Victorian Legislation (taxis) depending on the type of vehicle chosen.

In both pricing scenarios above:

- The Merchant Aggregator's product is the payment and ancillary services it provides to the Sub-merchant and Cardholder; AND
- The Merchant Aggregator is not delivering the good/service the consumer is acquiring with the Card but rather the Sub-Merchant is providing the good/service.

The RBA's "Surcharging Guidelines" enable the Merchant Aggregator to recover not only its reasonable costs but also recover a return on its capital for producing its services. It is also able to recover the impact of exogenous variables such as a technology refresh.

NBG's conclusions are that the RBA's Surcharging Guidelines are designed:

1. To deliver market driven outcomes in the provision of Merchant Aggregator services and Sub-Merchants can seek the most efficient outcome.
2. To avoid a Price Cap Regulators regime unlike that that applies in Victorian Taxis[17].

[17] Resorting to price caps is required only in industries characterised by a "natural monopoly" or near monopoly as is the case in utility assets where to have multiple suppliers are inefficient (e.g. Transmission, Port, or water assets). That was never the case in taxi payments processing. The Victorian Government's Non Cash Surcharging legislation is a good example of regulatory overkill with minimal at best regulatory impact analysis when a market based solution was what was required.

3. To be a fit for purpose form of regulation and is capable of covering payments in Taxis as it does for all other forms of Commercial Vehicle in Victoria (rideshare and hire cars).

5.4 The RBA Guidelines would enable the treatment of Exogenous Variables as they impact on a Taxi Payment Processor

Costs of exogenous influences, like changes in the cost of the MSF, macroeconomic policy fluctuations (varying the level of GST), or legislative intervention that is unrelated to the regulated industry all affect the Taxi Payment Processor's profitability. The Taxi Payment Processor is unable to recover these costs under the current State regulatory structure BUT which it could recover under the RBA surcharging arrangements.

The best recent example of the impact of an exogenous variable was the decision to shut down the 2G network so the spectrum could be reassigned by Government. The 2G network had been the critical backbone for data communications for Taxi Payment Processors. The shutdown of this network required Taxi Payment Processors to replace their entire 2G EFTPOS terminal fleet with 3G compliant terminals. The prescriptive nature of the regulations in Victoria meant that there was no mechanism for resetting the non cash surcharge to compensate for the change.

In contrast the RBA surcharging standards would allow for the impact of the necessary technology refresh from such decisions to be recovered.

Accordingly the ESC should now allow for the costs of the upgrade from 2G to 3G that took place in the period between 2014 and 2018 in its current review. Further it should consider how the next generation network upgrade will be funded once the rollout of 5G is underway and 3G network is decommissioned by telcos; and provide for that in its determination.

5.5 The Treatment of GST in the existing Victorian arrangements is wrong given the design of the the consumption taxation regime in Australia.

The RBA does NOT include GST in its analysis of surcharging. The RBA allows GST as a pass through tax on consumers NOT a cost to be borne by the Taxi Payment Processor (Merchant Aggregator) as the TSC decision has made it.

The ESC therefore should:

- Determine the Non Cash Surcharge Ex GST

- Allow the provisions of A NEW TAX SYSTEM (GOODS AND SERVICES TAX ACT 1999 (Cth) and the associated Rulings and Determinations to operate.

Question 6 - What are the advantages and disadvantages of using bottom up cost assessments for the reasonable cost of accepting and processing non-cash payments?

<u>Summary</u>

The the methodological challenge confronting the ESC involve balancing the following:

- It needs to use a methodology that involves evaluating the effects of price levels on earnings in the Taxi Payment Processor so investors in the firms providing the services receive a fair rate of return on their investment.
- The methodology needs to deliver a rate of return adequate to attract capital and to ensure that a sufficient level of service is available for customers, including investment in new technology.
- Will the price set be at a point that will encourage consumers to use the service. Making it a free good will maximise consumer uptake but the Taxi Payment Processor will terminate the service, conversely setting a price too high and consumers will abandon the service causing the Taxi Payment Processor to lower prices or terminate the service.
- It needs to screen out mixed use supply from the processing so that costs and revenues of the Taxi Payment Processor are not mingled with "unregulated services" (e.g. App Booking, or Network, or Payment Instrument Services) as these will distort the analysis leading the ESC to over or undershoot in its determination.
- It needs to identify the revenues and costs for an Efficient Producer in a competitive market where all producers operate and compete equally. In this case, the competitive market must be defined as taxi non cash payments excluding Cabcharge products.

Balancing these criteria is key and both Benchmarking and Bottom Up cost assessments to provide ways of assessing the reasonable costs for an Efficient Producer.

Bottom up cost assessment provides the regulator with a good surrogate for a building block analysis in a rate of return environment.

The difficulties it faces are assessing what is the cost base of an Efficient Producer.

These difficulties include:

1. The need to identify the cost base of a "pure play" producer of the regulated service and not the cost base of one with a mix of regulated and unregulated revenues and costs which distort what is an Efficient Producer. These unregulated and additional services can be used to rebalance any loss in revenues from a general price cap on regulated services.

2. The ESC's own paper flags that a number of suppliers offer a range of unregulated services alongside their Taxi Payment Processing service (e.g. issue their own payment instruments, offer account services, booking and dispatch services, taxi plate leasing, cash handling services).

   The methodology adopted by the ESC needs to rigorously screen out the unregulated revenues and the cross subsidising opportunities that can arise.

3. Unlike a price cap utility industry where it is easy to screen out the unregulated asset base from the regulated base; it is more difficult in this industry where you have multiple suppliers in the same market. **Accordingly looking at a supplier without unregulated income or services is key to any bottom up assessment.**

4. The Regulator needs to avoid trying to pick and choose the costs of different producers to determine its fee. For example, it may be that an Efficient Producer has higher Merchant Service Fees (MSF) because its transaction volumes are lower than those faced by an Inefficient Producer with higher transaction volumes. So if the regulator assumes the lower MSF is the industry norm and applies them across the industry, the Efficient Producer is penalised and the Inefficient Producer is unaffected. As the Victorian Taxi Inquiry (VTII) demonstrated, the MSF fixed costs dominate the cost basket in this industry.

5. It requires the ESC to engender trust in the regulated industry and at the same time avoid regulatory capture. Some behavioural studies of regulators and industry participants suggest that trust is problematic and this skews a regulator's decision making towards consumers and against the regulated industry[18]. Whilst making popular decisions is easy, they often lead to suboptimal outcomes as was the case in the VTII report.

[18] In 2017 Chris Engel and Klaus Heine reported on a series of laboratory experiments they undertook to test the behaviour of Regulators and a regulated industry in a dynamically changing environment. Their study simulated the behaviour of Regulators and identified the behavioural characteristics demonstrated an the unconscious consumer preference influences in decision making which mitigated against trust by the regulated industry in the decision process of the regulator.

Engel, C. & Heine, K. Public Choice (2017) 173: 217. https://doi.org/10.1007/s11127-017-0473-5

Questions 7 & 8 - The advantages and disadvantages of using benchmarks methods to assess the reasonable cost of accepting and processing non-cash payments?

Summary

1. Excluding the outliers, the Benchmark pricing indicates that and Ad Valorem fee of 6% plus GST (6.6% GST INC) is the industry standard necessary to provide a rate of return for the Taxi Payment Processor (Merchant Aggregator) on their assets, promote innovation, and generate price signals for new entrants.

2. If the Victorian Taxi Inquiry had honestly analysed the position in the Taxi Payment Processing industry it would have determined that the fee applicable in Victoria should have been 6.26% plus GST. Accordingly an Ad Valorem fee of 6% plus GST delivers a "efficient producer" outcome.

3. Alternatively, the ESC should allow Payment Processors to elect to switch to a Postage Stamp pricing model as is applied by payment processors operating in Victoria in other industries with similar characteristics to taxi payment processing.

4. Postage Stamp pricing is easier for a consumer to understand prior to making a payment choice decision (cash v card) as they see the actual cost of the choice and can factor that in to the price.

Benchmarking enables comparisons at the top level not only in this industry but other industries and geographies. It also enables the regulator to consider alternative approaches to pricing for the service. E.g. postage stamp pricing compared with ad valorem as applied in taxis in Victoria. Finally it is a way of comparing the current fee structure against that being applied in both regulated and unregulated regimes.

So Benchmarking is not some simple task of looking within the On Demand Point to Point Transportation Industry. It enables an examination of services similar to those being provided by Taxi Payment Processor (Merchant Aggregator) in several industries. NBG has identified that they operate in Retail, and Entertainment.

The entertainment industry is instructive because the role of the ticketing agency has many things in common with a Taxi Payment Processor (Merchant Aggregator). For example *Ticketmaster Terms and Conditions* spell out the nature of the services it provides for the fees it charges at Clause 19.3[19]:

> *"The price shown for tickets on a Site includes GST and, where applicable, per ticket fees but excludes fees that are calculated on a per transaction basis. Per transaction fees are added to the final total of your order. The fees calculated on a per transaction basis are handling fees and delivery fees. Handling fees cover the costs of providing ticketing services, including things like infrastructure costs and operating an internet site. Handling fees vary depending on the event and are agreed between the relevant Event Partner and Ticketmaster. The delivery fee depends on which delivery option/s are available and selected by you at checkout. Delivery options that normally attract delivery fees include Express Mail, Registered Post, International Airmail and International Express. The delivery options that attract delivery fees for an event and the applicable fee for each option, are displayed on the 'Find Tickets' page for the event on the Site".*

As another benchmark in the retail industry we note that Afterpay offers merchants a payment facility similar to a Taxi Payment Processor (Merchant Aggregator). The 2018 ASIC study of the 'Buy Now Pay Later' industry has identified how the largest service provider, Afterpay, derives 75% of its revenues. It charges a mixture of a postage stamp and ad valorem fee and is included in our analysis (see Table 4) since it is a useful benchmark of a similar service but where the fee is paid for by the retail merchant and not the customer.

The following Table 4 sets out:

1. Type of Service Fee – Is it an Ad Valorem or Postage Stamp or a Combination of both?
2. Party responsible for payment of the Service Fee (Customer/Passenger or Merchant/Driver)
3. Does it recover the MSF and are additional services provided?
4. Is it regulated or determined by the Market?
5. Is the Service Fee subject to GST/VAT and how is it applied?

[19] https://www.ticketmaster.com.au/h/purchase.html

__Table 4 - Benchmarking__

Country	Industry	Type Service of Fee	Party Responsible to pay the fee	Additional Services Provided	Recover greater than the MSF	Service Fee Regulated or Market Based	GST/VAT Added or Included
VIC	Taxis	Ad Valorem	Passenger	YES	YES	Regulated at 5% (**4.54%** ex GST)	GST Included
NZ	Taxis	Postage Stamp	Passenger	YES	YES	Market **$2.00** per Transaction	VAT added to fee
USA	Taxis (Boston)	Ad Valorem	Driver	YES	YES	Regulated at a **6%** Cap	N/A
Singapore	Taxis (Paid by Debit and Credit Card)	Ad Valorem	Passenger	YES	YES	Market at **10%**	GST Added
	Taxi (Paid in App by AliPay)	Ad Valorem	Passenger	YES	YES	Market at **5%**	GST Added
Australia	Retail Afterpay	Postage Stamp + Ad Valorem	Merchant	YES	YES	Market **6%** of purchase value plus $0.30 per transaction	GST Added to Fee
Australia	Entertainment Ticketek (Aust Open 2019)	Postage Stamp	Customer	YES	YES	Market **$5.90**	GST Included in Fee
Australia	Entertainment Ticketek (Melb Comedy Festival 2019)	Postage Stamp	Customer	YES	YES	Market **$11.70** per Transaction	GST Included in Fee
Australia	Entertainment Melb Comedy 2019 Festival 14 Venues and Booking Services excluding Tickettek and Ticketmaster	Postage Stamp	Customer	YES	YES	Market Fee ranges from $1.00 to $7.15 per Transaction. Av Fee **$3.51** per show across 14 Venues and Booking services. Fees of $1.50 per	GST Included in Fee

						show are common on a ticket price of $30.00 equates to a surcharge of **5%**	
Australia	Entertainment Arts Centre Ticketmaster (Melb Comedy Festival 2019)	Postage Stamp	Customer	YES	YES	Market at **$8.50** per transaction	GST Added
Australia	Entertainment Cinemas (Village)	Postage Stamp	Customer	YES	YES	Market **$3.25** per Transaction	GST Included in Fee
UK BEFORE EU Directive	Hackney Cabs TFL	Ad Valorem	Passenger	YES	YES	Regulated to a max of **12.5%**	VAT Added to Fee
	Hackney Cabs Edinburgh	Ad Valorem	Passenger	YES	YES	Regulated at **6%**	VAT Added to Fee
UK AFTER EU Directive	Hackney Cabs	Ad Valorem	Driver	YES	YES	Market at **6%**	VAT added

Conclusions from Benchmarking:

1. Victoria's taxi service fee at 4.54% Excluding GST is the lowest ad valorem fee in place in the On-Demand Taxi Industry from our benchmark survey of Taxis in Australia and overseas.
2. The Victorian Ad Valorem taxi service fee is below the fees charged in the retail industry for comparable services where the service fee is paid by the merchant to the payment processor. (See Afterpay)
3. The Victorian Taxi Inquiry analysis to support its recommendation contained manifest errors and assumptions (See Question 3).
4. The current 4.54% is well below market determined fees for similar services in the retail and entertainment industries in Victoria.
5. In the Entertainment industry Postage Stamp Fees are commonly $3.25 to $3.50 GST INC in Victoria.
6. Postage Stamp pricing in Taxis should be considered as an alternative to Ad Valorem pricing as occurs in the Entertainment industry

7. Postage Stamp pricing is simple for the passenger to comprehend and they can see the actual cost impact of the service fee prior to making a payment choice decision of Cash V Card[20].

8. Postage Stamp pricing eliminates any "drip pricing"[21] or price shock claims that can flow from Ad Valorem pricing.

[20] On 23 October 2018 the New York Court of Appeal allowed the introduction of Surcharges by Retailers in New York State in a case brought by a group of Retailers against the New York State Attorney General. Expressions Hair Design (and Others) v Schneiderman 2018 NY Slip Op 07037 decided on October 23, 2018 the Court of Appeals Fahey, J. (Earlier the USA Supreme Court in a 5 Judge decision confirmed a decision to allow Surcharging and sent the Case Back to the New York Court of Appeal for final determination). Part of the decision by the New York Court of Appeal was that Postage Stamp pricing should be used as opposed to Ad Valorem as it signaled clearly to the consumer the cost being applied for paying by card. Using an Ad Valorem was viewed as too complicated for a consumer to calculate at the time of purchase.

[21] https://www.accc.gov.au/consumers/online-shopping/drip-pricing

Question 9 - What other methods could we use to assess the reasonable cost of accepting and processing non-cash payments?

Summary

1. NBG believes that the market conditions that gave rise to the 2012 VTII recommendation (and the 2014 regulation of non cash surcharging that gave effect to the VTII's recommendations) no longer apply. The conditions precedent on both Cabcharge products and the MPTP being available to other processors have been fulfilled.
2. A far more effective RBA and ACCC enforcement regime has been in operation since 1 September 2017. It is more than capable of providing the necessary protections for consumers and at the same time effectively regulate the Taxi Payment Processors (Merchant Aggregators)[22].
3. The revised RBA/ACCC arrangements can cover all payment instruments used in Taxis
4. The ESC should as part of its determination recommend that the Victorian Government ask the RBA to remove the 'carve out' of Taxis from its determination on surcharging.
5. This would align the regulatory frameworks for all payment processors for all CPV providers in both booked and unbooked CPV trips in the State (i.e. rideshare, hire cars and taxis). It would also align the regulatory framework with that faced by all merchants in Australia.

When the Victorian Taxi Inquiry undertook its review and when the Victorian Government introduced the legislation relating to prescribing the Non Cash Payment Surcharges in taxis, the national regulatory and enforcement regime was not conducive to delivering the desired policy outcome for taxis. That is, to deliver lower surcharges (services fees) on non-cash payments in taxis.

Since that time the regulatory and policy environment has moved on but Victorian Taxi Payment Surcharging regulation has remained static.

[22] In Dec 2018 the RBA published an analysis of the Efficacy of the RBA/ACCC Regulatory regime. https://www.rba.gov.au/publications/bulletin/2018/dec/pdf/payment-surcharges-economics-regulation-and-enforcement.pdf

The History and where we are today:

1. The 2012 Victorian Taxi Inquiry recommended on Page 217 of its Report the "removal of service regulation applying to the processing of regulation of electronic payments for taxi fares when competition is more effective in this area". Since 29 June 2015 all of the conditions precedent that the VTII required for removal of its recommended price cap of 5% on Service Fees in Taxis are now in place[23].

2. In 2016 the RBA published its findings of a review of Surcharging. Taxis were exempted by the RBA from its Surcharging determination even though the banking powers of the Commonwealth under the Constitution would have enabled the RBA's determination to cover the field.

3. The reason advanced at the time was that the enforcement powers of the RBA were insufficient to ensure compliance within the industry.

4. Subsequently as part of the Commonwealth Government's response to the Murray Inquiry into the Financial System's recommendations on surcharging, the Commonwealth Government moved to bring the enforcement of Card surcharging within the ambit of the Australian Competition and Consumer commission (ACCC) and thus delivered real penalties and enforcement provisions on merchants that recovered more than their reasonable costs.

5. Since 1 September 2017 all businesses in Australia are covered by the provisions of the Competition and Consumer Act with respect to surcharging which include rideshare and hire cars except for Taxis.

The way ahead is for a simple and low cost solution with a market driven outcome:

NBG believes that since the market conditions that gave rise to the 2012 VTII recommendation (and the 2014 regulation of non cash surcharging that gave effect to the VTII's recommendations) no longer apply; coupled with the far more effective RBA and ACCC enforcement regimes in operation since 1 September 2017, the ESC should as part of its determination recommend:

[23] https://www.accc.gov.au/media-release/accc-accepts-undertaking-from-cabcharge-to-allow-competitors-to-process-its-cards-0 Further as the ESC notes on Page 22 of its Consultation Paper the MPTP is also now open to competition and a new supplier has entered the market. This was another market reform condition precedent that the VTII set to the to the removal of price controls on Service Fees for card processing.

The Victorian Government ask the RBA to remove the 'carve out' of Taxis from its determination on surcharging.

This:

- Would bring Taxis, and all of the cards used in Taxis, within the ambit of the ACCC's enforcement regime and would provide a consistent approach to regulation across all parts of the On Demand Point to Point transport industry.
- It would allow efficient market outcomes to emerge.
- Would be simpler and more efficient for consumers, and the industry by removing an unnecessary regulatory and compliance layer.
- Can be fixed by a letter from the Victorian Minister to the RBA seeking the removal of the 'Carve Out' of taxis from its determination and does NOT require any specific legislation.

A simple low cost solution which opens the way for technical innovation, new products, and new entrants freed from the shackles of artificial price cap regulation redolent of a command economy.

Questions 10 & 11 & 12 - What are the consequences of having a single maximum surcharge or many maxima?

Summary

1. Single Service Fee is simple to understand and operate with 14 different MSFs operating in cards processed in Taxis.
2. Having a fee that is simple and easy for the passenger and the driver to comprehend is essential in the taxi industry.
3. The preponderance of 'Tap and Go' transactions in taxis today, and the workflow of a 'Tap and Go' transaction, where the card is presented at the end of a transaction on a terminal, means that it is NOT possible to deliver pricing based on card type. The consumer will not know the service fee before the 'Tap and Go' step in the workflow.

1. At various times the question of applying varying fees to accommodate a mix of MSF has been canvassed and rejected by successive reviews.
2. The ESC needs to be aware that today there are 14 different MSFs that can be applied across all cards that can be presented in taxi payment processing plus on some there is an option for dynamic currency conversion at the time of processing.
3. In the days of Swipe and Dip processing it was possible for a EFTPOS terminal to identify before processing a transaction the card type being presented to then determine the correct MSF. The advent of 'Tap and Go' means it is NOT possible to ascertain the card type and apply an MSF applicable to that card type before processing. Thus the acquirer and the Taxi Payment Processor can only identify the card type and MSF after the 'Tap' of the card and the passenger has left the taxi (i.e. whilst it may have some elegance from an economic perspective, the technology available in the payment system does not allow for it to be offered).
4. As an aside, we would flag that the sticker stuck on the dash or window identifying relevant service fees for 14 different card types would be impractical in a taxi.

5. At an operational level NBG can envisage difficulties and complaints arising inside a taxi late at night as a driver explains that the fee on the card presented is higher or lower than another card the passenger has used.
6. Moving the nomenclature to being a ‘Service Fee’ would make it simpler for Consumers to understand the services delivered and benefits they receive.