Testimony of Professor Todd Zywicki Presented to

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Subcommittee on Consumer Protection, Product Safety, and Data Security

"Protecting Consumers from Junk Fees"

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Chairman Hickenlooper, Ranking Member Blackburn, and Members of the Committee:

I am Todd Zywicki and it is a pleasure to appear before you today to testify on the topic of "Protecting Consumers from Junk Fees." I am George Mason University Foundation Professor at Antonin Scalia Law School and Research Fellow of the Law & Economics Center. From 2020-2021 I served as the Chair of the CFPB's Taskforce on Consumer Financial Law and from 2003-2004 I served as the Director of the Office of Policy Planning at the Federal Trade Commission. I am also co-author of *Consumer Credit and the American Economy* (Oxford 2014) and have written and spoken extensively on issues of consumer protection generally and consumer financial protection specifically. I appear voluntarily today in my personal capacity and do not speak on behalf or represent any other party.

I share the frustration that many consumers hold today regarding the proliferation of seemingly ubiquitous add-on fees that we experience constantly, from surcharges for using our credit cards at a merchant, to hotel "resort fees," and others. And earlier this year I experienced exactly this frustration when I checked into a hotel on vacation and was assessed a mandatory $30 a day "resort fee" that was only disclosed in fine print on the last screen of a multi-page checkout process at an Internet hotel booking website. Buying a ticket to concert *has* in fact become a tedious process of searching for a concert or sports ticket and then having to spend 10 minutes clicking through multiple pages before you can discover the real price and decide whether to go to the show.

So I also say, "Enough."

But it is also important to stress that not all of these fees are "junk" fees. Many of these multi-part pricing schemes are economically efficient, in that they better match consumers with the product terms and attributes they value. Others are appropriate as means to protect some consumers from being forced to subsidize others' choices or the higher costs that some consumers impose relative to others. For example, requiring upper-income jet-setters to pay foreign currency transaction fees hardly seems unfair to those who don't travel abroad and presumably nobody has an issue with requiring payment of "add on" fees for additional toppings on a pizza. Requiring every vacation resort to be all-inclusive would force those who don't drink alcohol to subsidize those who do. While some use of multi-part pricing today is likely welfare-reducing, multi-part pricing has become more frequent is because paying for the services you actually use over the long run can be more fair and efficient for other consumers, even if foreign travelers, partiers, and those who pay late on their credit cards might disagree.

As Howard Beales and I wrote recently:

> The term "junk fees" defies easy definition. But it is imperative to distinguish 'junk fees' that are designed to extract rents and consumer surplus from consumers from efficient behavior-based fees. Welfare-reducing "junk" fees are most likely to emerge only under a relatively narrow set of market conditions — particularly those markets with few repeat customers where consumers are less likely to learn of the hidden fees, where consumers are effectively locked-in and unable to avoid paying the fee when it is imposed, or where such fees may be atypical and thus consumers are not alert to them.[1]

"Junk Fees" are Theoretically Possible But Likely Arise in Only Limited Contexts

[1] Howard Beales and Todd Zywicki, *Junkyard Dogs: The Law and Economics of "Junk" Fees*, COMPETITION POLICY INTERNATIONAL (Apr. 28, 2023), *available in* https://www.competitionpolicyinternational.com/junkyard-dogs-the-law-and-economics-of-junk-fees/.

One example of what might be classified as a "junk fee" is the growing practice of merchants imposing credit card "surcharge" fees on consumer retail transactions.[2] Rarely, if ever, are consumers informed up-front of the presence of a surcharge—I was recently on business travel at an out-of-town conference and after lunch was presented with the bill—which I happened to notice that a surcharge would be applied if I chose to pay with a credit card. Notably, businesses are guaranteed the right under federal law to offer cash discounts to consumers, but this one chose to impose a surcharge that I did not discover until after the meal. Such situations—non-repeat customers visiting a tourist area, not carrying a large amount of cash, and eating a moderately expensive sit-down restaurant—present prime opportunities for the potential for exploitative "junk fees."[3] Hotel "resort fees," which are typically imposed by hotels in similar contexts—namely, tourist areas with minimal repeat business—provide a similar example.

Fees such as credit card surcharges or hotel "resort fees," in which the various elements of the price are not revealed until later in the transaction but which the consumer cannot reasonably avoid (such as a mandatory surcharge when paying with a credit card), are often referred to as "drip pricing." Concert and sports tickets provide a variation on the theme. While most consumers today are aware that transaction and ticketing fees will be assessed on a ticket purchase, typically it is difficult or impossible to discover the size of those fees until one has invested a substantial degree of time picking seats and clicking through multiple screens to finally discover the "real" price.

[2] *See* Todd J. Zywicki, Geoffrey A. Manne, and Kristian Stout, *Behavioral Economics Goes to Court: The Fundamental Flaws in the Behavioral Law & Economics Arguments Against No-Surcharge Laws*, 82 Missouri L. Rev. 769 (2017).

[3] Ironically, the CFPB and self-identified consumer advocates not only have never criticized abusive credit card surcharging practices by merchants, they have actually *supported* the right of merchants to impose such fees.

Moreover, these fees typically are mandatory and effectively unavoidable. A strong case can be made that fees of this sort should be disclosed as part of the price of the ticket, much like airlines are required to disclose all applicable taxes and fees as part of their quoted up-front price.

Although mandatory "resort fees" illustrate the theoretical potential for market failure, this example remains the exception to the general rule that markets tend to deliver consumers the collection of services and prices they desire. Only approximately 6-7 percent of U.S. hotels charge such fees and those that do are mainly limited to resort hotels in certain markets, such as Orlando or Las Vegas, just as the theory predicts.[4] Moreover, those hotels that do charge "resort fees" often do claim to offer more amenities than those that do not and of those hotels that charge resort fees, those with more amenities appear to charge higher fees than those with more Spartan offerings.[5] Thus, even in a case such as resort fees, although a case might be made for requiring better pricing disclosure of these fees up-front to facilitate consumer shopping, it is questionable whether they should be entirely dismissed as nothing more than "junk fees."

In Most Instances Market Competition Delivers the Collection of Prices and Services that Consumers Desire

In contrast to these rare contexts in which market failure is possible, in most situations competitive markets tend to produce pricing terms that better align the

[4] *See* John O'Neill and Donna Quadri-Felitti, *Resort Fees and Service Fees in the U.S. Hotel Industry: Context and Concepts Related to Partitioned Pricing*, 2 ICHRIE RESEARCH REPORTS (2017). A more recent survey estimates the figure at about 6% of hotels, predominantly in tourist destinations. *See* Sally French and Sam Kemmis, *How to Avoid Hotel Resort Fees (and Which Brands are the Worst)*, NERDWALLET.COM (Mar. 1, 2023), *available in* https://www.nerdwallet.com/article/travel/hotel-resort-fees#:~:text=According%20to%20the%20American%20Hotel,you%20can%20find%20some%20gems.
[5] *See* French and Kemmis, *supra*.

incidence of payment for certain services with the cost of providing those services, such as charging more for additional pizza toppings or for first-class airline seats. Regulatory interference with prices in this context can lead to less efficient pricing, higher overall costs for consumers, and unfair and regressive subsidization and redistribution of costs among consumers.

For example, consider the CFPB's recent proposal to impose an effective $8 price control on credit card late fees.[6] Prior economic research has demonstrated that size of late fees is correlated with consumer risk and that when late fees are regulated, consumers overall are forced to pay higher interest rates to compensate for chargeoffs.[7] A recent study has also demonstrated that when the size of late fees is reduced, the frequency of late payment increases.[8] Moreover, these findings are generalizable—limits on the pricing of behavior-based and risk-based pricing fees have been demonstrated to lead to offsetting adjustments in other costs, such as higher interest rates and higher prices for other fees (such as cash advance fees and penalty interest rates). In addition, limiting the ability to price risk efficiently leads to a reduction in credit accessibility and the size of credit lines, particularly for lower income and higher risk borrowers.[9] It is not clear why forcing those who pay their credit card bills on time, especially lower-income Americans, to subsidize those who pay late is considered to be a "pro-consumer" policy.

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[6] *See* Todd Zywicki, *A Close Look at the Consumer Financial Protection Bureau's Credit Card Late Fees Proposal*, CONSUMER FINANCE MONITOR PODCAST (Mar. 9, 2023), *available in* https://www.ballardspahr.com/insights/blogs/2023/03/podcast-the-consumer-financial-protection-bureaus-credit-card-late-fees-proposal-guest-todd-zywicki.

[7] Nadia Massoud, Anthony Saunders, and Barry Scholnick, *the Cost of Being Late? The Case of Credit Card Penalty Fees*, 7 J. OF FIN. STABILITY 49 (2011).

[8] Daniel Grodzicki, *et al.*, *Consumer Demand for Credit Card Services*, 63(3) J. OF FIN. SERVS. RES. 273 (June 2023).

[9] *See* CONSUMER FINANCIAL PROTECTION BUREAU, 1 TASKFORCE ON CONSUMER FINANCIAL PROTECTION LAW REPORT 596-604 (2021) (summarizing studies); *See* Thomas A. Durkin, Gregory Elliehausen, & Todd J. Zywicki, *An Assessment of Behavioral Law and Economics Contentions and What We Know Empirically About Credit Card Use by Consumers*, 22 Sup. Ct. Econ. Rev. 1 (2014) (same).

Inefficient regulation of bank overdraft protection services also raise the danger of curtailing access to this service and forcing those who do not overdraft to pay for those who do.[10] To date, the CFPB has been relatively restrained in its regulation of overdraft pricing and access. And several banks have adopted changes to their overdraft services. But economic analysis has shown that when access to overdraft protection is curtailed by regulation or the permissible among of overdraft fees is regulated, consumers are more likely to bounce checks (and incur NSF fees) and have attempted payments declined. A study by Dlugosz, Melzer, and Morgan found that when price controls on the permissible size of overdraft fees were relaxed following preemption, the minimum balance necessary to be eligible for interest checking declined by 28%-40% (approximately $376-$538), and checking account ownership by low-income households rose by 4 percentage points (which corresponds to a 10% increase in the probability that a low-income household would have a bank account).[11] Low-income households were also more likely to persist in account ownership and less likely to have their accounts closed. By contrast, they found that lifting these restrictions had no affect on bank account ownership by higher-income consumers, implying that the price controls adversely affected primarily lower-income households. It has also been suggested the restrictions on access to overdraft protection led to a reduction in access to free checking. Moreover, because overdraft protection and payday loans are viewed as relatively close substitute products by consumers, reducing access to overdraft protection can be expected to lead to an increase in the use of payday lending by consumers.

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[10] *See* Testimony of Todd Zywicki, "The End of Overdraft Fees? Examining the Movement to Eliminate the Fees Costing Consumers Billions," Testimony Presented to The House of Representatives Committee on Financial Services Subcommittee on Consumer Protection and Financial Institutions (Mar. 31, 2022).
[11] Jennifer L. Dlugosz, Brian T. Melzer, and Donald P. Morgan, *Who Pays the Price? Overdraft Fee Ceilings and the Unbanked,* working paper (Apr. 15, 2021).

Experience with the Durbin Amendment to Dodd-Frank, which imposed price controls on debit card interchange fees has similarly had the effect of leading to higher required monthly minimum balances to be eligible for free checking, reduced access to free checking (especially among lower-income consumers who were unable to meet the steep increases in minimum balance requirements that followed in the wake of the Durbin Amendment's imposition), higher monthly maintenance and other fees for those no longer eligible for free checking, and elimination of rewards on debit cards.[12] According to one estimate, some 1 million low-income consumers might have lost access to bank accounts as a result of the cost increases that resulted from imposition of the Durbin Amendment as part of Dodd-Frank. Even more ironic in light of the topic of today's hearing, the imposition of the Durbin Amendment actually *produced* a change in the majority of bank accounts from a simple free-checking model to a new model with multiple price points and greater pricing complexity. It would be difficult to conjure a more telling example of the incoherence associated with some prior efforts to regulate the pricing of consumer services.

In Some Instances, Multi-Part Pricing is the Result of Government Regulations that Interfere with the Ability of Sellers to Offer Simpler Prices Even if Desired by Consumers

In still other situations, the presence of multi-part pricing might reflect government regulations that mandate or encourage the fragmentation of costs into multiple parts even where doing so reduces consumer welfare. For example, the endless list of fees you face when you buy a home (such as appraisal, credit risk, flood insurance,

[12] *See* 1 CFPB TASKFORCE REPORT at 585-596 (summarizing studies).

and other fees) results from interpretations of RESPA that effectively prohibits lenders or other third-parties from offering a bundled suite of those services for one guaranteed price.[13] The Federal Trade Commission's Motor Vehicle Dealers NPRM seems to follow the RESPA approach of imposing a convoluted multi-stage price revelation structure for consumer auto transactions and new limits on the sale of add-on products that is likely to simply make the process of buying a car more complicated and time-consuming with no demonstrable benefit to consumers.[14]

Another example of regulation-induced multi-part pricing is the use of a variety of fees by airlines, such as baggage fees, ticket change fees, paying for food and snacks, etc. One explanation for the growing propensity and size of these fees is that airline tickets are subject to a hefty 7.5% excise tax on each ticket (in addition to other ticketing and travel taxes and fees), whereas these partitioned fees are not.[15] Moreover, because bundling the cost of these services into the overall cost of the trip will increase ticket costs, this will also increase the amount of taxes consumers have to pay, which can be avoided by purchasing untaxed services instead.[16]

As noted above, the elimination of simple free checking for bank accounts and the spread of a variety of new fees, especially for lower-income consumers, in the past decade is primarily the result of the operation of the Durbin Amendment, Dodd-Frank

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[13] *See* Howard Beales and Todd Zywicki, *Junk Fees or Junk Policy?*, THEHILL.COM (Mar. 21, 2022), *available in* https://thehill.com/blogs/congress-blog/politics/599085-junk-fees-or-junk-policy/; *see also* CONSUMER FINANCIAL PROTECTION BUREAU, 2 TASKFORCE ON CONSUMER FINANCIAL PROTECTION LAW REPORT 16-17 (2021).
[14] Federal Trade Commission, Notice of Proposed Rulemaking, *Motor Vehicle Dealers Trade Regulation Rule*, 87 F.R. 42012, 16 CFR 463 (July 13, 2022).
[15] *See* Davide Scotti and Martin Dresner, *The Impact of Baggage Fees on Passenger Demand on US Air Routes*, 41 TRANSPORT POL'Y 4 (2015).
[16] *Id.*

generally, and restrictions imposed by the Federal Reserve on the operation of bank overdraft programs.

The Efficient Pricing Scheme for Consumers will Vary By Market and Will Change Over Time And Regulators Should be Cautious About Arresting this Evolution

But more to the point, is there anyone who ever travels on a plane today who is unaware that most airlines today charge for baggage or doesn't know that "Bags Fly Free" on Southwest Airlines? Or that unlike other airlines, there are no change or other "junk" fees on Southwest? According to one report, when Southwest chose not to follow the other airlines and impose new fees, the company opted to forego approximately $500 million per year in new revenues. But that was offset by the fact that Southwest increased its market share by two percentage points, increased passenger loads by 10%, and brought in an additional *$2 billion* per year in incremental revenues.[17] On the other hand, Southwest fares are also slightly higher *ceteris paribus* than those that charge for baggage and other fees.[18]

As the airline industry example illustrates, it is also quite common to see a blend of different strategies in certain markets. For example, some hotels offer all-inclusive experiences and others engage in partitioned pricing. A family of six going to Disney for a week is obviously going to prefer a different set of fees and services than a business person flying to New York for an overnight business meeting. High-end hotels often charge for services such as parking and breakfast that many budget hotels include in their

[17] David Whelan, *All Grown Up*, FORBES (Jun. 29, 2011), available at http://www.forbes.com/forbes/2011/0718/features-southwest-airlines-gary-kelly-midway-grown-up.html; *see also* Manne and Zywicki, *supra* note.
[18] *See* Scotti and Dresner, *supra* note.

price. It is hard to argue that the reason why the Ritz-Carlton or Four Seasons charges for services that Motel 6 does not is because those who stay at luxury hotels are less sophisticated or attentive than consumers who opt for budget hotels that offer free parking and breakfast.

Moreover, the optimal pricing scheme for any product or service tends to evolve over time. For example, cable television traditionally offered a large package of dozens of channels of programming in a limited number of "package" offerings and prices. Over time consumers balked at being asked to pay for a large number of channels they did not watch, notably expensive sports programming. So in response to consumer demand, program offerings have become unbundled, as a variety of specialty streaming channels have emerged that offers a smaller and more targeted set of viewing options at a lower price than the traditional multi-channel cable package. Others have continued to stick with the cable companies' bundled channel offerings.

Other markets have evolved in the opposite direction. For example, when cell phones were first introduced, pricing was very complex, with separate prices for incoming calls, outgoing calls, text messages, different data plans, and the like. "Competitive pressure to attract consumers who found such plans confusing, along with changes in technology, led to the much simpler pricing plans that prevail today."[19] General-purpose prepaid cards have followed a similar evolutionary trajectory from more complex a la carte pricing and per transaction fees to greater pricing simplicity and convenience in response to consumer demand and without regulatory prompt.[20]

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[19] Beales and Zywicki, *Junkyard Dogs*, *supra*.
[20] *See* Todd J. Zywicki, *The Economics and Regulation of Network Branded Prepaid Cards*, 65 FLA. L. REV. 1477 (2013).

More fundamental, determining whether regulatory intervention might be justified requires making a threshold determination as to whether there is a market failure in any given context and whether there is some feasible government response that can improve the situation once all intended and unintended consequences are considered. Attaching the conclusory, pejorative term "junk fees" to these various different fees not only obscures the analytical differences between these different types of fees but if implemented recklessly will actually harm consumers and the economy. In particular, where these fees do serve the purpose of aligning consumer costs with pricing (such as use, higher costs, or risk-based pricing), interfering with their efficient operation will force those costs to be subsidized by other consumers. Imposing price controls on credit card late fees or other terms and conditions, for example, likely will lead to higher interest rates and reduced credit access for most consumers (as well as an increase in the number of late payments), but particularly lower-income and higher risk consumers who pay their bills on time. It is hard to see how this predictable result is beneficial to consumers overall.

Conclusion

As Beales and I concluded in our recent article:

> The notion of junk fees is a fine piece of rhetoric, but useless as an analytical tool. Both the structure of pricing, and the level of prices, should be determined by competition in the marketplace. As we observe, the result is detailed fee structures for some products and services, and bundled pricing for others. But marketplace competition over pricing structures is far more likely to satisfy consumer preferences than an inevitably overbroad set of regulatory requirements.[21]

[21] Beales and Zywicki, *Junkyard Dogs*, *supra*.

As the examples given above indicate, consumer pricing is often a complex, dynamic process that undoubtedly can sometimes suggest a need for regulation. But even then, it is necessary to accurately identify the nature of the market failure and the efficacy of the proposed response.[22]

Thank you for your time and the opportunity to appear before you today and I am happy to take any questions you may have.

[22] For example, Beales and I note that the FTC's example of fees for automotive add-ons for arguably worthless products such as nitrogen-filled tires provides an example. But in that example the problem is in the claim that filling one's tires with nitrogen does something useful for consumers rather than the fact that the additional fee is charged separately rather than it being included in a higher up-front cost for all consumers. *See* Beales and Zywicki, *Junkyard Dogs*, *supra*.