Competition Tribunal Tribunal de la Concurrence

PUBLIC VERSION

Reference: *The Commissioner of Competition v. Visa Canada Corporation and MasterCard International Incorporated,* 2013 Comp. Trib. 10
File No.: CT-2010-10
Registry Document No.: 0337

IN THE MATTER of the *Competition Act*, R.S.C. 1985, c. C-34, as amended;

AND IN THE MATTER of an application by the Commissioner of Competition pursuant to section 76 of the *Competition Act*;

AND IN THE MATTER OF certain agreements or arrangements implemented or enforced by Visa Canada Corporation and MasterCard International Incorporated.

B E T W E E N:

The Commissioner of Competition
(applicant)

and

Visa Canada Corporation
MasterCard International Incorporated
(respondents)

and

The Toronto-Dominion Bank
The Canadian Bankers Association
(intervenors)

Dates of hearing: 20120508 to 20120510, 20120514 to 20120517, 20120522 to 20120525, 20120528 to 20120601, 20120604 to 20120607, 20120618 to 20120621
Before: Phelan J. (presiding), Dr. W. Askanas and Mr. K. Montgomery
Date of Reasons and Order: July 23, 2013
Reasons and Order signed by: Mr. Justice M. Phelan, Dr. W. Askanas and Mr. K. Montgomery

REASONS FOR ORDER AND ORDER DISMISSING THE COMMISSIONER'S APPLICATION

I. INTRODUCTION

[1] The Commissioner of Competition has brought an application in which she is seeking an Order from the Tribunal prohibiting Visa Canada Corporation and MasterCard International Incorporated from implementing or enforcing rules which prohibit merchants who accept Visa and MasterCard credit cards from declining to accept particular Visa or MasterCard credit cards, applying a surcharge for those customers paying with credit cards, or engaging in other forms of discrimination. The Commissioner asserts that each of the Respondents has engaged in price maintenance and has brought the application in accordance with section 76 of the *Competition Act*, R.S.C. 1985, c. C-34.

II. THE PARTIES AND INTERVENORS

[2] The Commissioner of Competition has filed this application in accordance with her mandate of enforcing and administering the *Competition Act* (see: s. 7 of the *Competition Act*).

[3] The Respondent Visa Canada Corporation is an unlimited liability company formed by amalgamation under the laws of Nova Scotia, with offices in Toronto. It is a wholly-owned subsidiary of Visa Inc., a Delaware corporation.

[4] The Respondent MasterCard International Incorporated ("MasterCard") is headquartered in the United States. MasterCard Canada, Inc., is a subsidiary of MasterCard.

[5] The Canadian Bankers Association (the "Bankers Association") and the Toronto-Dominion Bank (the "TD Bank") were granted leave to intervene in these proceedings in accordance with subsection 9(3) of the *Competition Tribunal Act*, R.S.C. 1985, c. 19 (2nd Supp.).

[6] The Bankers Association is a national organization which represents the Canadian banking industry. Its members consist of 51 domestic chartered banks, foreign bank subsidiaries, and foreign bank branches operating in Canada. The TD Bank is a Schedule I bank incorporated under the *Bank Act*, S.C. 1991, c. 46, and is one of the largest banks in Canada.

[7] The Bankers Association and the TD Bank have supported the position taken by the Respondents in these proceedings.

III. THE BACKGROUND FACTS

[8] Before examining the rules that have been challenged in this application, it is important to sketch the background against which the application is brought.

A. CREDIT CARD NETWORK AND ITS PARTICIPANTS

[9] While Visa and MasterCard credit card networks are commonly referred to as "four party" networks, it was agreed that they require in fact the participation of five players: (i) cardholders; (ii) issuers; (iii) merchants; (iv) acquirers and (v) credit card networks.

(1) Cardholders and Issuers

[10] Neither Visa nor MasterCard issue credit cards. For the purposes of this decision, the expression "credit card" refers to the general purpose credit card that is accepted as a form of payment at many unrelated merchant locations across a wide geographic area.

[11] Credit cards are issued by financial institutions, known as "Issuers", such as the TD Bank, and the *Bank Act* permits them to do so (see: s. 409(2)(*d*) of the *Bank Act*).

[12] Visa and MasterCard enter into agreements with Issuers authorizing them to enter into agreements with cardholders in Canada for the use of credit cards bearing the Visa or MasterCard brand.

[13] Issuers market and issue credit cards to cardholders and manage the relationship with the cardholders, including the provision of credit, interest rate, the monthly fees (if any), the cardholder benefits (e.g. the funding of rewards), the foreign exchange markup rate and monthly statements.

[14] Both Visa and MasterCard have a long list of requirements and rules with which each Issuer must comply in order to be able to issue the credit card product. They can set minimum reward requirements in relation to each credit card product. For example, Visa has four categories of consumer credit cards that Issuers may offer to cardholders: Classic, Gold, Platinum and Infinite. Each category has its own set of minimum reward requirements which the Issuer must respect (e.g. at the Visa Classic level, Issuers are required to provide cardholders with a basic selection of customer support services, whereas at the Infinite level, Issuers must provide a significantly increased level of services, including dedicated telephone lines and improved service standards, concierge service and emergency medical evacuation. Issuers can, however, provide enhanced benefits, such as reward points and welcome bonus rewards.

[15] A business or consumer to whom a credit card has been issued is known as a Cardholder.

(2) Credit Card Networks

[16] Visa operates the electronic payment system network by which transactions involving payment with a Visa payment card, including credit, debit or prepaid cards, are authorized and paid as between Cardholders' and merchants' financial institutions. As the network operator, Visa establishes rules to ensure the efficient and secure operation of its network. Visa also engages in other activities such as the marketing and promotion program to support the Visa brand and insists in product, platform and processing enhancements to improve the quality and security of the network.

[17] MasterCard operates its own network by which MasterCard credit card transactions are authorized and paid. It also establishes rules to ensure the efficient and secure operation of its network and is also engaged in the marketing and promotion of the MasterCard brand.

[18] The operations of both Visa and MasterCard are sufficiently similar that any differences are immaterial to this proceeding.

(3) Merchants and Acquirers

[19] Sellers of goods and services are known as "Merchants" in the credit card network world. The Merchants are the primary day-to-day commercial interface with the Cardholder. Merchants wishing to accept a credit card as a form of payment enter into an agreement with an "Acquirer", an entity that provides Merchants with services enabling them to accept Visa and MasterCard branded credit cards for payment. They provide, *inter alia*, the technology and hardware to accept credit card payments. Moneris, Chase Paymentech, and Global Payments are all Acquirers.

[20] The services provided by Acquirers in Canada vary from Acquirer to Acquirer and a Merchant is free to select the Acquirer and the services of which they would like to take advantage. For example, at the hearing, the Tribunal heard evidence regarding the services the TD Bank provides as an Acquirer.

[21] The TD Bank, through its TD Merchant Services, provides acquiring services to Merchants. Mr. van Duynhoven, the President of TD Merchant Services, explained that the TD Bank maintains its own network which is supported by an extensive infrastructure and which directly interfaces with over a dozen different payment card networks, including Visa, MasterCard, American Express, Interac and Discover, as well as supporting numerous payment systems and technologies that support private label, gift and loyalty cards.

[22] The services provided by Acquirers will be examined in more detail in paragraphs 147 to 152 of this decision.

B. CREDIT CARD TRANSACTION AND FEES

[23] A typical credit card transaction involves the participation of all five participants. The important steps of a transaction can be summarized as follows:

Authorization

1. After the Cardholder has provided his credit card for the purchase, the Merchant, using the point-of-sale technology supplied by the Acquirer, seeks authorization from the Acquirer for the transaction. The authorization request flows from the Merchant's point-of-sale device to the Acquirer's network.
2. The Acquirer will identify the applicable payment network for the pending transaction and then "routes" the authorization request to that network. For example, the Acquirer will identify that particular card as a Visa card and then route the transaction to the Visa network.
3. Visa and MasterCard, through their electronic networks, forward the authorization request to the applicable Issuer in order to obtain authorization.

4. The Issuer determines whether to authorize or decline the transaction and communicates that determination through the Visa or MasterCard network and ultimately traverses the Acquirer's network.

Clearing

5. Upon receipt of an authorization or decline, the Acquirer communicates the message to the Merchant through the point-of sale technology. The transaction is then "cleared".
6. The Cardholder is then charged with the cost of the transaction.

Settlement

7. An Acquirer, such as TD Merchant Services, receives typically at the end of each business day, a batch of all the cleared transactions via the Merchant's payment terminal from the Merchant. The Acquirer will settle all of the Merchant's customer payment network transactions, including Visa and MasterCard transactions, and deposits into the Merchant's account the total value of the transactions, less any reserves held for security/risk purposes. Acquirers in Canada typically pay their Merchants 100% of their transaction values on a daily basis.
8. Typically, the Acquirer charges the Merchant for its service fees at the end of the month.

[24] The Issuer must pay Visa and MasterCard a network fee (the "Issuer Network Fees") for each transaction.

[25] The Acquirer, in accordance with its agreements with Visa and MasterCard, must pay Visa and MasterCard a network fee (the "Acquirer Network Fees"), which is set as a percentage of the transaction.

[26] In addition to the "Acquirer Network Fees", Acquirers also pay fees known as "Interchange Fees" for each transaction. Visa and MasterCard each set default Interchange Fees applicable to credit cards involving their own brands of credit cards. However, they do not receive any revenue from the Interchange Fees, these fees are provided to the Issuers. The Interchange Fees are also set as a percentage of the value of the transaction and depend, for example, on the type of credit card used and the Merchant's business status.

[27] In Canada, default Interchange Fees are rarely, if ever, departed from by individual financial institutions although such departure is legally possible.

[28] As a result, the Acquirer for each transaction has to pay an Acquirer Network Fee and an Interchange Fee.

[29] Acquirers will generally speaking simply pass on the Interchange Fees and the Acquirer Network Fees to the Merchants. In additions to these fees, an Acquirer also charges another fee for the services that they provide to the Merchants (the "Acquirer Services Fees"). As a result, it is said that the fees paid by the Merchants, known as the "Merchant Discount Fees" or "Card Acceptance Fees", consist of three components:

(1) the Interchange Fees;
(2) the Acquirer Network Fees; and
(3) the Acquirer Services Fees

[30] The Interchange Fees constitute the largest component of the Card Acceptance Fees (for the purposes of this decision, we[1] shall use "Card Acceptance Fees" to refer to the total fees paid by Merchants to Acquirers).

[31] Prices charged by Acquirers for the services they provide to Merchants are negotiated between the two parties and are incorporated in a written agreement. Pricing for acquiring services can vary widely but the two predominant pricing models in Canada are known as "blended pricing" and "interchange plus pricing".

[32] Blended pricing consists of an Acquirer charging Merchants a Card Acceptance Fee for each credit card brand in the form of a single percentage fee. This blended rate includes the Interchange Fee, the Network Fees and the Acquirer Services Fees. Some Acquirers may even have the same Card Acceptance Fees for different credit cards. Blended pricing is the most common pricing model in Canada and is the prevalent method of merchant pricing for medium and smaller sized Merchants.

[33] In interchange plus pricing, the Acquirer passes through to the Merchant the actual ad valorem Interchange Fee and quotes the Merchant unbundled fees such as the Network Fees and the Acquirer Service Fees. While generally not as widespread as the blended pricing model, interchange plus pricing is common for very large Merchants (in terms of dollar sales). According to Mr. van Duynhoven, interchange plus pricing is applied to approximately **[CONFIDENTIAL]** of the TD Bank's merchant customer locations. Given the size of Merchant customers who are on interchange plus pricing, this type of pricing arrangement represents approximately **[CONFIDENTIAL]** of the TD Bank's total Visa and MasterCard transaction volume.

[34] Mr. Jordan Cohen of Global Payments Canada also stated that approximately **[CONFIDENTIAL]** of the purchase volume that GPC processes would be on an interchange plus pricing methodology. Mr. van Duynhoven also indicated that interchange plus pricing had become more prevalent in recent years as Merchants seek greater transparency as regards to actual interchange rates.

C. THE CONTESTED RULES

- *No-Surcharge Rule*

Visa

[35] The Visa International Operating Regulations (the “Visa Regulations”) set out the conditions that Issuers and Acquirers, participating in the Visa network system, must meet. They include the so-called “No-Surcharge Rule”, which has existed for over 30 years:

> “Visa merchants agree to accept Visa cards for payment of goods or services without charging any amount over the advertised price as a condition of Visa card acceptance, unless local law requires that merchants be permitted to engage in such practice.”

[36] The Visa Regulations require that, as a term of their own contracts with Merchants, Acquirers must require Merchants to comply with the No-Surcharge Rule.

MasterCard

[37] MasterCard’s No-Surcharge Rule is found in section 5.11 of its Operating Rules, entitled “Prohibited Practices”, and the Operating Rules provide that an Acquirer must ensure that none of its Merchants engage in any of the prohibited practices listed in section 5.11. Section 5.11 provides as follows:

> A Merchant must not directly or indirectly require any Cardholder to pay a surcharge or any part of any Merchant discount or any contemporaneous finance charge in connection with a Transaction.
> […]
> For purposes of this Rule:
> 1. A surcharge is any fee charged in connection with a Transaction that is not charged if another payment method is used.
> 2. The Merchant discount fee is any fee a Merchant pays to an Acquirer so that the Acquirer will acquire the Transactions of the Merchant.

- *The Honour All Cards Rule*

Visa

[38] The Visa Regulations also provide that Merchants are prohibited from refusing to accept a valid Visa credit card (the “Honour All Cards Rule”):

> Honor All Cards Properly Presented

> Honoring All Visa Cards
>
> Visa merchants may not refuse to accept a Visa product that is properly presented for payment, for example, on the basis that the card is foreign-issued, or co-branded with a competitor's mark.

[39] Acquirers are required by agreement with Visa to ensure that Merchants comply with the Honour All Cards Rule.

[40] The Honour All Cards Rule has existed since the creation of Visa in 1976.

MasterCard

[41] Rule 5.8.1 of MasterCard's Operating Rules sets out its Honour All Cards Rule:

> "A Merchant must honor all valid Cards without discrimination when properly presented for payment. A Merchant must maintain a policy that does not discriminate among customers seeking to make purchases with a Card. A Merchant that does not deal with the public at large (for example, a private club) is considered to comply with this rule if it honors all valid and properly presented Cards of Cardholders that have purchasing privileges with the Merchant."

[42] Under the Operating Rules, each Acquirer must ensure that each Merchant complies with the Honour All Cards Rule.

- *The No-Discrimination Rule*

MasterCard

[43] Section 5.11 of MasterCard's Operating Rules also prohibits Merchants from discriminating amongst MasterCard's credit cards (the "No-Discrimination Rule"):

> "5.11.1 Discrimination
>
> A Merchant must not engage in any acceptance practice that discriminates against or discourages the use of a Card in favor of any other acceptance brand."

[44] Again, Acquirers must under contract terms ensure that no Merchant engages in such a practice.

[45] The Visa Regulations do not contain a No-Discrimination Rule.

[46] The No-Discrimination Rule, the Honour All Cards Rule and the No-Surcharge Rule shall be referred to as the "Merchant Rules". The operation of these Merchant Rules is the matter which the Commissioner seeks to prohibit.

D. BACKGROUND IN CANADA AND ELSEWHERE

(1) Canada

[47] On March 19, 2008, Visa became a publicly traded corporation. Prior to that, it functioned as a joint venture between thousands of independent financial institutions across the world.

[48] In the spring 2008, Visa introduced a new premium credit card, the Visa Infinite, which had higher Interchange Fees than the other Visa credit cards. Evidence adduced at the hearing establishes that in March 2008, TD launched its first Visa Infinite card. The Infinite Card was structured to offer various rewards and benefits to Cardholders in order to attract "high income" and "high spend" Cardholders. Chris Hewitt, the Associate Vice President of Direct Marketing at the TD Bank, explained that the TD Bank set this early launch date in order to attract as many Cardholders as possible before competitor Issuers launched their own Visa Infinite cards.

[49] Visa also moved from 2 formulae for calculating default interchange rates to 21 formulae. Some of the new rates were based on the applicable Merchant's industry segment, some were based on the nature of the underlying transaction, and some were based on the Merchant's total annual sales volume. For some transactions, the rate went up, while for others, the rate went down.

[50] In April 2008, MasterCard began assessing additional fees on all MasterCard credit transactions and, in July 2008, introduced the "MasterCard High Spend Program" with higher Interchange Fees than the standard MasterCard credit card. In November 2008, MasterCard launched a premium credit card with Interchange Fees much higher than those associated with a standard MasterCard credit card.

[51] In the fall of 2008, MasterCard also made significant changes to its Interchange Fees. The number of formulae for calculating default Interchange Fees went from 2 to 11.

[52] This series of events in 2008, generally hidden from Merchants in advance of implementation, became the lightning rod for opposition not only to the increases in fees to be paid by Merchants, but also opposition to the whole Merchant Rules system. Developments in other countries, to which reference will be made, also had significant influence on the debate about the efficacy, fairness and legality of the Merchant Rules.

[53] In the fall of 2008, the Retail Council of Canada and a coalition known as the Stop Sticking it To Us Coalition, a group of 29 Canadian member organizations and backed by over 200,000 businesses, engaged in various activities regarding the increase in Card Acceptance Fees.

[54] In November 2008, the Competition Bureau ended its preferences for non-duality (the principle that an Issuer could only issue cards of one credit card network), thereby allowing Issuers to issue both Visa and MasterCard credit cards to consumers and Acquirers to acquire transactions for multiple credit card networks. This decision was largely based on the transitions of Visa and MasterCard from member-owned associations to publicly held corporations that were not controlled by their Issuers or Acquirers.

[55] The Stop Sticking it To Us Coalition testified before the Standing Senate Committee on Banking, Trade and Commerce in the spring of 2009, which had been mandated with the task of reporting on the credit and debit card systems in Canada and their relative rates and fees, in particular for businesses and consumers. Amongst the recommendations made by the Committee in its Report of June 2009, was the creation of an "oversight board" that would establish a code of conduct for payment systems participants, and the recommendation that the federal government take "appropriate action to permit surcharging and/or discounting by merchants" and prohibit any honour-all-cards rules. (See Senate, Standing Senate Committee on Banking, Trade and Commerce, *Transparency, Balance and Choice: Canada's Credit Card and Debit Card Systems* (June 2009)). The Senate Committee's recommendations did not, however, echo those made by the Coalition when the latter recommended that the Federal Government regulate Interchange Fees based on costs and, in that regard, use the Australian regulatory experience.

[56] In the summer of 2009, the House of Commons Standing Committee on Industry, Science and Technology and the Committee on Finance commenced a study on credit card Interchange Fees and the debit payment system in Canada. Around the same time, the Canadian Federation of Independent Businesses ("CFIB") proposed a Code of Conduct to address its concerns about rising Interchange Fees. In its Code, it made 10 recommendations, including the rights of Merchants to refuse cards and to surcharge or discount. The Code of Conduct was to be adopted by credit card companies, processors and banks, together with federal oversight. CFIB stated that it would encourage the government to intervene if the credit card companies and banks were unwilling to negotiate a workable Code of Conduct for the industry on a voluntary basis.

[57] On November 19, 2009, the Federal Minister of Finance released for public consultation a Draft Code of Conduct for the Credit and Debit Card Industry. Stakeholders were invited to provide their views on the proposed document. The voluntary Code of Conduct for the Credit and Debit Card Industry in Canada (the "Code of Conduct") was released in April, 2010, and after some minor revisions were made, it was adopted by the payment card networks, the major credit and debit card issuers and payment processors, and came into force in August 2010.

[58] The extent to which this Code of Conduct may be classified as "voluntary" is very much in doubt. The evidence establishes that the credit card industry was to accept either this Code or face possibly even more stringent regulation. The Code has all the hallmarks of a regulation.

[59] Brian Weiner, the Head of Strategy and Interchange at Visa Canada Corporation, testified that he had attended various meetings with the Department of Finance on behalf of Visa and that those meetings had included discussions regarding surcharging, discounting and the Honour All

Cards Rule. The Department of Finance had also met with other stakeholders such as Issuers, Acquirers, Merchants and consumers to develop the Code.

[60] The Financial Consumer Agency of Canada monitors the Code of Conduct (see: *Financial Consumer Agency of Canada Act*, S.C. 2001, c. 9, at para. 3(3)(*c*)).

[61] The Code of Conduct provides for greater transparency and disclosure by payment card networks and Acquirers to Merchants by, for example, requiring payment card networks to make applicable interchange rates easily available on their websites. Under section 5 of the Code of Conduct, payment card network rules must ensure that Merchants can provide discounts for different methods of payment and also differential discounts among different payment card networks. Further, the payment card network rules will ensure that a Merchant can choose to accept only credit or debit payments from a payment card network without having to accept both.

[62] On July 12, 2010, the *Payment Card Networks Act*, S.C. 2010, c. 12, received Royal Assent and section 6, which is not yet in force, provides that the Governor in Council, on the recommendation of the Minister of Finance, may make regulations respecting payment card networks.

[63] On June 18, 2010, the Minister of Finance also launched the Task Force for the Payments System Review (the "Task Force") which received the mandate of reviewing the payments system. In its discussion paper, "The Way We Pay – Transforming the Canadian Payments System", the Task Force discussed the possibility of increasing fairness in credit and debit card networks and noted the fact that the Commissioner had brought a section 76 application before the Competition Tribunal.

[64] The Minister unfortunately made statements directly related to the matters before the Tribunal during the final days of the Tribunal's hearing between the close of evidence and the opening of final argument. The Respondents and the Bankers Association used these statements in final argument.

[65] As an independent quasi-judicial/judicial tribunal, the Tribunal as a matter of law is not bound by these statements nor can it be influenced by them. Those statements, presumably not intended to impact this process, were unhelpful but more importantly irrelevant to the Tribunal's decision. The comments were noted but played no part in the Tribunal's decision making process.

(2) Other Jurisdictions

[66] The Tribunal heard evidence about the regimes and results in other systems which is helpful in considering the "but for world" in terms of what has or will happen to the competitive environment if the Merchant Rules were not in place and if the Commissioner were successful in this application.

[67] The Tribunal has had to be careful in assessing the experience of other jurisdictions in part because no witness from any of the other jurisdiction's regulatory authorities gave evidence here. The evidence of the various reports and experience was largely third hand from persons who had a particular viewpoint. While admissible as evidence in this Tribunal, that evidence and the lessons which can or should be drawn does not have the same weight as if the Tribunal had had the benefit of direct evidence.

[68] However, the evidence did underscore the need for effective regulation in this field.

Australia

[69] In 2001, the Reserve Bank of Australia ("RBA") began a lengthy reform project regarding the payments system in Australia. The original motivation for the reform stems from the findings and recommendations of the Financial Systems Inquiry ("Inquiry") released in 1997 which found that while earlier deregulation had improved competition and efficiency in Australia's payments system, further gains were possible.

[70] In accordance with the recommendations of the Inquiry, a Payments System Board ("Board") within the RBA was established in 1998. At that time, the government also provided the RBA with specific powers to regulate the payments system in order to implement the Board's policies. The most relevant powers in the context of the card payment reforms are those set out in the Payment Systems (Regulation) Act 1998 (Cth.) ("PSRA"). The PSRA, among other things, provides the RBA with the authority to designate a payment system for regulation, to create regulatory standards for a designated payment system, and to ensure that actors within a designated payment system comply with regulatory standards.

[71] In April of 2001, the MasterCard and Visa credit card networks were designated by the RBA as payment systems or "schemes" under the PSRA. The designation came following a March 2000 investigation by the Australian Competition and Consumer Commission ("ACCC") which concluded that the collective setting of interchange fees by the credit card networks was in breach of the price-fixing provisions of the Trade Practices Act 1974 (Cth.). Following discussions with the banks, the ACCC asked the RBA to consider using its powers to address the issue of interchange fees. Accordingly, Visa and MasterCard were designated as payment systems and lengthy consultations in respect of possible reforms ensued. On August 27, 2002, the RBA released its reforms of the credit card payment systems. The reforms, among other things, regulated interchange fees and prohibited the no-surcharge rule.

[72] The Setting of Wholesale ("Interchange") Fees Standard ("Interchange Standard"), which came into effect on July 1, 2003, regulated the default interchange fees set by Visa and MasterCard. The Interchange Standard required that an objective, transparent and cost-based benchmark be used to determine a weighted cap on the level of interchange fees applicable to Visa and MasterCard credit card transactions. Under the Interchange Standard, the weighted average interchange fee applicable to such transactions was 0.55%. A revised standard effective November 1, 2006 reduced the interchange fee benchmark to 0.50%. The 0.50% benchmark still applies today.

[73] While Visa and MasterCard have both been designated as payment systems under the PSRA, American Express and Diners Club have not and are thus not subject to the Interchange Standard.

[74] The RBA imposed a standard requiring the removal of the no-surcharge rules in the MasterCard and Visa credit card networks effective January 1, 2003. The standard provided that "[n]either the rules of the Scheme nor any participant in the Scheme shall prohibit a merchant from charging a credit cardholder any fee or surcharge for a credit card transaction". Again, American Express and Diners Club are not subject to this regulation but they have provided the RBA with written undertakings that they will not prohibit merchants from surcharging.

[75] In mid-2011, the RBA decided to conduct a public consultation on potential modifications to the standard relating to surcharging. The RBA had been concerned about excessive surcharging and an increased tendency for surcharges to be "blended" across card networks (cards from different schemes are surcharged at the same rate despite significant differences in acceptance costs).

[76] Excessive surcharging became an increasing problem. While the Commissioner disputes some of the excessive surcharging evidence, we are persuaded that it became a problem in Australia and the extent of it was encapsulated by Karen Leggett of the National Bank of Canada:

> The RBA's *Payments System Board Annual Report* for 2011 notes that the average fee paid by merchants to acquirers for accepting MasterCard and Visa credit card transactions in 2010/2011 was 0.81% of the value of transactions. However, many Australian merchants.surcharged more, and sometime much more, than their costs of accepting credit cards. For example, Australian taxi operators regularly impose a 10% surcharge on credit card payments

[77] The RBA ultimately determined that it will modify the standard to allow Visa and MasterCard to limit surcharges to an amount reasonably related to the cost of acceptance.

New Zealand

[78] The New Zealand Commerce Commission ("Commission") began an investigation into interchange fees and surcharging in 2003. In November 2006, the Commission filed a civil claim under the Commerce Act 1986 (N.Z.), 1989/5 against Visa International, MasterCard Incorporated and others seeking an order to, *inter alia*, prohibit Visa and MasterCard from enforcing their no-surcharge rule and honour all cards rule in New Zealand.

[79] In August of 2009, the Commission settled its litigation with Visa and MasterCard. Under the terms of the settlement, Visa and MasterCard agreed not to (1) enforce any rule which prohibits or prevents surcharging by merchants in respect of New Zealand acquired transactions or (2) require or encourage acquirers to include any provision to that effect in any merchant agreement, or take steps to enforce any such provision in an existing merchant agreement. Nothing in the settlement prevents Visa and MasterCard from implementing or enforcing rules that oblige merchants to clearly disclose surcharges and that ensure that the surcharges bear a reasonable relationship to the cost of acceptance.

The United Kingdom

[80] After receiving a recommendation from the Mergers and Monopolies Commission ("MMC") that MasterCard and Visa not be allowed to prohibit surcharging, in February of 1991, Parliament passed "The Credit Card (Price) Discrimination Order" which made it unlawful for any person to make or carry out an agreement relating to credit cards to the extent that it imposes or requires the imposition of a "no discrimination" or "no surcharge" rule. Thus surcharging on credit cards has been permitted in the United Kingdom since 1991.

[81] In March of 2011, "Which?", a not-for profit consumer organization, filed a super complaint with the Office of Fair Trading regarding surcharging practices in the travel industry and improper disclosure of surcharges. The Office of Fair Trading responded to the complaint in June of 2011 and recommended that merchants seek to improve the transparency and overall presentation of payment surcharges in the transport sectors. The United Kingdom government subsequently stated that it would introduce legislation to prohibit surcharging that was beyond the reasonable cost of card acceptance.

European Community

[82] In order to address merchant concerns as expressed by the European Commission ("EC") in the context of the EU investigation of multilateral interchange fees, MasterCard decided to remove its no-surcharge rule in the European Economic Area effective January 1, 2005. MasterCard modified its rule to provide that if a surcharge is applied, it must be clearly indicated to the cardholder at the point of sale and it must bear a reasonable relationship to the merchant's cost of accepting cards as a method of payment.

[83] Thereafter, the EC continued its investigation of MasterCard relating to interchange fees and in December of 2007 decided that MasterCard's multilateral interchange fees for cross-border payment card transactions with MasterCard and Maestro branded debit and consumer credit cards in the European Economic Area violated EC Treaty rules on restrictive business practices. The EC's decision against MasterCard was affirmed on May 24, 2012.

[84] The EC examined Visa's no-surcharge rule, honour all cards rule and interchange fees and in 2002, granted Visa a limited exemption to allow it to maintain its rules. As part of the resolution, Visa agreed to reduce its interchange fees. In 2007, the exemption expired at which point the EC commenced proceedings against Visa. Those proceedings included an investigation of the no-surcharge rule, the honour all cards rule and the setting of interchange fees. An agreement was reached in respect of the honour all cards rule in debit transactions. However, the EC's investigation in respect of the rules and interchange fees for credit transactions appears to be ongoing.

United States

[85] On October 4, 2010, the United States Department of Justice ("DOJ") filed a civil antitrust lawsuit against Visa, MasterCard and American Express challenging certain of the defendants' rules, policies and practices that impede merchants from providing discounts or benefits to promote the use of a competing card that costs the merchant less to accept. At the same time, the DOJ announced that it had reached a settlement with Visa and MasterCard and filed a proposed final judgment. The final judgment was approved on July 20, 2011. As part of the settlement, Visa and MasterCard agreed not to adopt, maintain or enforce any rule or agreement which would prevent merchants from offering consumer discounts or rewards based on card type, expressing their preference for or promoting a particular card type and providing information about card costs.

[86] The prohibition on surcharging was not challenged in the complaint filed by the DOJ. In the final judgment, the DOJ reserved its right to investigate and bring actions to prevent or restrain violations of antitrust laws concerning any rule of Visa or MasterCard.

[87] Visa, MasterCard and other defendants including certain financial institutions were involved in class proceedings before the U.S. District Court for the Eastern District of New York. The proceedings began in May 2005 after approximately 55 complaints, all but 10 of which were styled as class actions, were filed in U.S. federal district courts on behalf of merchants. The cases alleged, *inter alia*, that Visa's and MasterCard's setting of interchange fees and their no-surcharge rule violated antitrust laws.

[88] On July 13, 2012, Visa and MasterCard entered into a Memorandum of Understanding in respect of a settlement in these proceedings. The settlement terms include a cash payment, a reduction in interchange fees for several months and reforms to the Visa and MasterCard rules including the no-surcharge rule. Surcharges, subject to certain conditions such as disclosure and a cap, will be allowed.

[89] It is instructive that in all of the jurisdictions to which the Tribunal was referred, no proceedings or regulatory actions were based on "price maintenance". Frequently the proceedings or actions were based on price fixing, or collusion or conspiracy – but not price maintenance.

IV. <u>THE APPLICATION</u>

[90] On December 15, 2010, the Commissioner filed an application under section 76 of the *Competition Act*, the new price maintenance provision, challenging the Merchant Rules. The application alleges that the agreements entered into by Visa and MasterCard with Acquirers, which require Acquirers to impose the Merchant Rules on Merchants, influence upward or discourage the reduction of the Card Acceptance Fees. The Commissioner submits that without these rules, Merchants would have the ability to constrain Card Acceptance Fees, by imposing a surcharge or by encouraging their customers to use lower-cost methods of payments.

V. EVIDENCE

[91] Thirty-one individuals testified at the hearing, including eleven experts. They are as follows:

A. The Lay Witnesses

(1) The Commissioner of Competition

[92] Ten lay witnesses appeared on behalf of the Commissioner. Eight of the ten witnesses worked for Canadian Merchants – with one exception those Merchants were from large corporations:

1. Mario de Armas - Senior Director of International Payments with Wal-Mart Stores, Inc.
2. Tim Broughton - Co-Owner of the Restaurant "C'est What?"
3. Craig Daigle - Senior Director, Treasury and Risk Management, Shoppers Drug Mart
4. Pierre Houle – Treasurer at Air Canada
5. Candice Li - Vice President, Treasurer, WestJet Airlines, Ltd.
6. Charles Symons - Tax and Treasury Manager, IKEA
7. Michael Shirley - Vice President Finance and Controller, Best Buy Canada Ltd.
8. Paul Jewer - Chief Financial Officer, Sobeys Inc.

[93] Douglas Swansson, who is head of Payment Services at Coles Supermarkets Pty Ltd., one of Australia's largest retailers, also testified. The Tribunal also heard from Marion van Impe, the Director of Student Accounts & Treasury at the University of Saskatchewan.

(2) The Respondents

[94] Visa called William Sheedy, Group President of Americas of Visa Inc., Elizabeth Buse, Group President, Asia-Pacific, Central Europe, Middle East and Africa, with Visa Inc., and Brian Weiner, Head of Strategy and Interchange at Visa Canada Corporation.

[95] Kevin Stanton, President of MasterCard Advisors, and Betty K. Devita, President of MasterCard Canada Inc. testified on behalf of the Respondent MasterCard. MasterCard also called Jordan Cohen, the President of Global Payments Canada, a merchant Acquirer and processor in Canada, as a witness.

(3) The Intervenors

[96] The TD Bank introduced the evidence of Jeff van Duynhoven, President of TD Merchant Services, and Chris Hewitt, Associate Vice President, Direct Marketing at the TD Bank.

[97] Karen Leggett, Executive Vice-President, Marketing, National Bank of Canada, and Robert Livingston, President of Capital One Bank, testified on behalf of the Bankers Association.

B. The Expert Witnesses

(1) The Commissioner of Competition

[98] Dennis Carlton was tendered, and accepted by the Respondents, as an expert in the areas of industrial organization and antitrust economics as applied to payments systems.

[99] Ralph Winter was qualified as an expert to provide testimony and opinion evidence in the area of economics and Canadian competition policy.

[100] Alan Frankel testified as an expert witness qualified to give opinion evidence in the areas of antitrust economics and the economics of payment systems.

[101] Mike McCormack who works as the Managing Director of Palma Advisors, a Florida-based consultancy specializing in the payments transaction industry, was qualified as an expert to give opinion evidence with respect to the payment card transaction industry and the acquiring industry.

[102] Michael Kemp provided opinion evidence on survey evidence, including survey methods and the principles governing the design and management of survey research.

(2) The Respondents

[103] Kenneth Elzinga was qualified as an expert witness to give opinion evidence in the areas of industrial organization and antitrust economics, generally, and as applied to payment systems.

[104] Jeffrey Church gave opinion evidence as an expert in the field of competition policy and economics.

[105] Michael S. Mulvey appeared as an expert witness in the field of consumer research and consumer behaviour. Benoît Gauthier was qualified as an expert witness to give opinion evidence in respect of survey research and design.

[106] Peter Dunn was qualified to give expert evidence with respect to the payments industry and payment systems.

(3) The Intervenors

[107] Balaji Jairam was qualified to give opinion evidence as an expert in payment systems and the payments industry in Canada.

VI. THE RELEVANT LEGISLATION

[108] Section 76 reads as follows:

76. (1) On application by the Commissioner or a person granted leave under section 103.1, the Tribunal may make an order under subsection (2) if the Tribunal finds that	76. (1) Sur demande du commissaire ou de toute personne à qui il a accordé la permission de présenter une demande en vertu de l'article 103.1, le Tribunal peut rendre l'ordonnance visée au paragraphe (2) s'il conclut, à la fois :
(a) a person referred to in subsection (3) directly or indirectly	a) que la personne visée au paragraphe (3), directement ou indirectement :
(i) by agreement, threat, promise or any like means, has influenced upward, or has discouraged the reduction of, the price at which the person's customer or any other person to whom the product comes for resale supplies or offers to supply or advertises a product within Canada, or	(i) soit, par entente, menace, promesse ou quelque autre moyen semblable, a fait monter ou empêché qu'on ne réduise le prix auquel son client ou toute personne qui le reçoit pour le revendre fournit ou offre de fournir un produit ou fait de la publicité au sujet d'un produit au Canada,
(ii) has refused to supply a product to or has otherwise discriminated against any person or class of persons engaged in business in Canada because of the low pricing policy of that other person or class of persons; and	(ii) soit a refusé de fournir un produit à une personne ou catégorie de personnes exploitant une entreprise au Canada, ou a pris quelque autre mesure discriminatoire à son endroit, en raison de son régime de bas prix;
(b) the conduct has had, is having or is likely to have an adverse effect on competition in a market.	b) que le comportement a eu, a ou aura vraisemblablement pour effet de nuire à la concurrence dans un marché.
(2) The Tribunal may make an order prohibiting the person referred to in subsection (3) from continuing to engage in the conduct referred to in paragraph (1)(a) or requiring them to accept another person as a customer within a specified time on usual trade terms.	(2) Le Tribunal peut, par ordonnance, interdire à la personne visée au paragraphe (3) de continuer de se livrer au comportement visé à l'alinéa (1)a) ou exiger qu'elle accepte une autre personne comme client dans un délai déterminé aux conditions de commerce normales.
(3) An order may be made under subsection (2) against a person who	(3) Peut être visée par l'ordonnance prévue au paragraphe (2) la personne qui, selon le cas :
(a) is engaged in the business of producing or supplying a product;	a) exploite une entreprise de production ou de fourniture d'un produit;

(b) extends credit by way of credit cards or is otherwise engaged in a business that relates to credit cards; or

(c) has the exclusive rights and privileges conferred by a patent, trade-mark, copyright, registered industrial design or registered integrated circuit topography.

b) offre du crédit au moyen de cartes de crédit ou, d'une façon générale, exploite une entreprise dans le domaine des cartes de crédit;

c) détient les droits et privilèges exclusifs que confèrent un brevet, une marque de commerce, un droit d'auteur, un dessin industriel enregistré ou une topographie de circuit intégré enregistrée.

[109] The parties disagree on the interpretation to be given to section 76. The Respondents submit that in order for section 76 to apply, the applicant must establish the resale of a product. The Commissioner disagrees.

A. The Interpretation and Application of Section 76

(1) The Requirement of a Resale?

[110] It is well established that the principles of statutory interpretation require that the words of the legislation be read "in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament" (see E. A. Driedger, *Construction of Statutes* (2nd ed. 1983), at p. 87, as cited in *Rizzo & Rizzo Shoes Ltd. (Re)*, [1998] 1 S.C.R. 27, at para. 21).

[111] Further, it is presumed that the legislature does not speak in vain and that every word found in a statute is supposed to have a meaning and a function (see: Ruth Sullivan, *Sullivan on the Construction of Statutes*, 5th ed (Markham: LexisNexis Canada, 2008) at p. 210).

[112] Headings should be distinguished from marginal notes. Headings may be used as intrinsic aids but the weight to be given to headings in a statute will depend on a number of factors including the degree of difficulty by reason of ambiguity or obscurity in construing the section (see *Law Society of Upper Canada v. Skapinker*, [1984] 1 S.C.R. 357; *R. v. Lohnes*, [1992] 1 S.C.R. 167) contrary to the Commissioner's submissions. Marginal notes are inserted for convenience of reference only and do not form part of the enactment (see: s. 14 of the *Interpretation Act*, R.S.C. 1985, c. I-21).

[113] Counsel for the Commissioner argues that Parliament intended to set out two distinct prohibitions in paragraph 76(1)(*a*)(*i*) and that while both prohibitions require a vertical relationship, only one of the two prohibitions requires a resale. The first prohibition refers to the person's customer and does not require a resale whereas the second prohibition does require a resale because it relates to a person to whom the product comes for resale:

> The first prohibition provided for in s. 76(1)(a) is against influencing upward or

> discouraging the reduction of "the price at which the person's customer . . . supplies or offers to supply **a product** within Canada". [emphasis added] The second prohibition interdicts the influencing upward or discouraging the reduction of "the price at which any other person to whom **the product** comes for resale supplies or offers to supply **a product** within Canada".
>
> […]
>
> The first half of subsection 76(1)(a)(i) does not require that a product be resold. Rather, it requires that the person whose prices are being influenced upward or discouraged be a "customer". A plain reading of section 76 shows that it is applicable to agreements that influence upwards the price at which a person's <u>customer</u> sells ***a*** product. […] What is prohibited is the influencing upward or discouragement of the reduction by a supplier of the price at which *any* product is supplied or offered for supply by a customer within Canada.
> […]
> With respect to the second half of the provision (after the "or"), it is clear that a reseller need not be selling the very same product or set of services that the reseller obtains from its supplier in order for section 76 to apply. The second half of subsection 76(1)(a)(i) explicitly refers to conduct that influences upwards or discourages the reduction of the price that "any other person to whom <u>the</u> product comes for resale supplies or offers to supply or advertises <u>a</u> product within Canada" [emphasis added], as opposed to "<u>the</u> product", "<u>that</u> product" or "<u>the</u> same product" as that supplied by the supplier. Had Parliament intended to require that a reseller must be selling precisely the same product or set of services – no more and no less – than are supplied by the supplier in order for section 76 to apply, it would have said so using explicit limiting language.
>
> [Closing Submissions of the Commissioner of Competition, at pp. 142-144]

[114] Counsel for the Commissioner submits that the above interpretation is supported by the use of the heading "Price Maintenance" (instead of "Resale Price Maintenance") and the relevant legislative history. It is further argued that succumbing to the Respondents' interpretation would render paragraph 76(3)(*b*), which provides that an order can be made against a person who is engaged in the credit card business, devoid of any meaning and would lead to absurd consequences.

[115] The Tribunal has carefully considered the Commissioner's submissions, but finds that a resale is required under section 76 of the *Competition Act*. The resale of a product does not require that the product be identical. However, the Tribunal concludes, as is illustrated by the caselaw referred to by the parties, that in many instances, the product will be identical or substantially similar on the important characteristics of the product.

[116] An ordinary reading of paragraph 76 (1)(a)(*i*) leads the Tribunal to conclude that the word "resale" applies to both "customer" and "other person" given the presence of the word "other" . The presence of the phrase "or any other person to whom the product comes for resale", suggests that the product has also come for resale to the person's customer. The words "to whom the product comes for resale" modifies both the "customer" and the "other person" rather than creating two types of persons caught under the provision – any customer who obtains the product even for their own use and other persons who intend to resell the product.

[117] We note that a reference to any "other" person ("autre personne") is absent in the French version of the paragraph. None of the parties drew the Tribunal's attention to this issue. However, our interpretation of the English provision, which narrows the application of the provision, can be supported by a reading of the French version and is also supported by the legislative history of the price maintenance provision.

[118] From 1951 until 1976, the *Combines Investigation Act* contained a criminal prohibition of resale price maintenance. Canada was amongst the first countries to enact such a prohibition in 1951 and the enactment followed the Report of the MacQuarrie Committee which had found that the prescription and the enforcement of minimum resale prices must be viewed as "manifestations of a restrictive or monopolistic practice which does not promote general welfare" (see: Committee to Study Combines Legislation, *Interim Report on Resale Price Maintenance* (Ottawa: Queen's Printer, 1951) and R.D. Anderson and S.D. Khosla, "Recent Developments in the Competition Policy Treatment of Resale Price Maintenance", Canadian Competition Policy Record, vol. 6, no. 4, December 1985, 1 at 6.).

[119] In 1976, the provision was broadened to also apply to horizontal price maintenance. The word "resale" was removed from the price maintenance section. A provision was also added to provide that the section would apply to persons engaged in businesses relating to credit cards. Section 38 of the *Combines Investigation Act* read as follows:

38. (1) No person who is engaged in the business of producing or supplying a product, or who extends credit by way of credit cards or is otherwise engaged in a business that relates to credit cards, or who has the exclusive rights and privileges conferred by a patent, trade mark, copyright or registered industrial design shall, directly or indirectly,	38(1) Quiconque exploite une entreprise de production ou de fourniture d'un produit, offre du crédit, au moyen de cartes de crédit ou, d'une façon générale, exploite une entreprise dans le domaine des cartes de crédit, ou détient les droits et privilèges exclusif que confère un brevet, une marque de commerce, un droit d'auteur ou un dessin industriel enregistré ne doit pas, directement, ou indirectement,
(a) by agreement, threat, promise or any like means, attempt to influence upward, or to discourage the reduction of, the price at which any other person engaged in business in Canada supplies or offers to supply a product within Canada; or	a) par entente, menace, promesse ou quelque autre moyen semblable, tenter de faire monter ou d'empêcher qu'on ne réduise le prix auquel une autre personne exploitant une entreprise au Canada fournit ou offre de fournir un produit ou fait de publicité au sujet d'un produit au Canada; ni
(b) refuse to supply a product to or otherwise discriminate against any other person engaged	b) refuser de fournir un produit à une autre personne exploitant une entreprise au Canada,

in business in Canada because of the low pricing policy of that other person.

ou établir quelque autre distinction à l'encontre de celle-ci, en raison du régime de bas prix de celle-ci.

[…]

[emphasis added]

[nos soulignements]

[120] The then Bureau of Competition Policy of Consumer and Corporate Affairs Canada described the amendments as follows:

> The amendments have further extended the scope of the provision by deleting the definition of "dealer" and expanding the application of the prohibitions in this section not only to a person engaged in the business of producing or supplying a product (previously defined as a "dealer") but also to a person extending credit by means of credit cards and to holders of intellectual property rights. Since the Act no longer refers to a dealer requiring resale at a specified price, the prohibition applies equally to any person attempting to influence upward a selling price of a product irrespective of whether that person is the supplier of the product. It might apply, for example, to a situation where one supplier of a product sought by agreement to influence upward the price at which his competitor supplied the same or similar products. It is also anticipated that this amendment will effectively curtail the practices engaged in by a firm providing credit card services for retailers of preventing a retailer from giving a discount for cash. This provision will, therefore, be of benefit not only to retailers but also to consumers.
>
> [emphasis added]
>
> (Canada, Department of Consumer and Corporate Affairs (Bureau of Competition Policy), *Stage 1- Competition Policy Background Papers* (Ottawa: Consumer and Corporate Affairs, 1976) at 55.)

[121] The criminal prohibition therefore not only caught resale price maintenance, but also horizontal price maintenance. In 1986, the provision became section 61 of the *Competition Act*.

[122] From the early 1980s until 2008, various studies were commissioned. Often the authors would question whether resale price maintenance should be criminalized (see e.g. *Report of the Royal Commission on the Economic Union and Development Prospects for Canada* (Ottawa: Supply and Services Canada, 1985) at p. 224). In 1999, the Commissioner of Competition engaged Professors VanDuzer and Paquet to conduct an independent study of the provisions of the *Competition Act* dealing with anticompetitive pricing and their enforcement by the Competition Bureau. The Professors concluded that vertical price maintenance should be subject to civil review and should not be a criminal offence. They found that the *per se* prohibition of vertical resale price maintenance was inconsistent with economic analysis.

[123] The Standing Committee on Industry, Science and Technology made similar recommendations in its 2002 Report "A Plan to Modernize Canada's Competition Regime":

> That the Government of Canada repeal the price maintenance provision (section 61) of the *Competition Act*. In order to distinguish between those practices that are anticompetitive and those that are competitively benign or pro-competitive, that the Government of Canada amend the *Competition Act* so that: (1) price maintenance practices among competitors (i.e., horizontal price maintenance), whether manufacturers or distributors, be added to the conspiracy provision (section 45); and (2) price maintenance agreements between a manufacturer and its distributors (i.e., vertical price maintenance) be reviewed under the abuse of dominant position provision (section 79).
>
> (see: House of Commons, Standing Committee on Industry, Science and Technology, *A Plan to Modernize Canada's Competition Regime*, April 2002)

[124] The Competition Policy Review Panel, in its final report "Compete to Win" issued in June 2008, also recommended that the price maintenance provision be decriminalized:

> The resale price maintenance provisions of the *Competition Act*, broadly speaking, address pricing issues that can arise between suppliers and resellers of a product, but do so as a criminal offence under the legislation. This is an area of Canadian competition law that is more restrictive than comparable US law. Other provisions of the *Competition Act*, such as those relating to refusal to deal and exclusive dealing, address competition issues between suppliers and resellers as civil matters. The Panel believes that resale price maintenance should also be treated as a civil matter.
>
> …
>
> The Panel recommends that:
>
> 14. The Minister of Industry should introduce amendments to the Competition Act as follows:
>
> […]
>
> (e) repeal the existing resale price maintenance provisions and replace them with a new civil provision to address this practice when it has an anti-competitive effect. This new provision should be subject to the private access rights before the Competition Tribunal;
>
> (see: Canada, Competition Policy Review Panel, *Compete to Win* (Ottawa: Industry Canada, 2008)

[125] The reference to the US law in the above report referred to the fact that in 2007, the Supreme Court of the United States had rejected the *per se* illegality of resale price maintenance in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 127 S. Ct.

[126] Less than one year after the release of the Panel's report, the *Budget Implementation Act*, S.C. 2009, c. 2, received Royal Assent and made important amendments to the *Competition Act*. The Act repealed the criminal price maintenance provision and added a new price maintenance provision, at section 76, to Part VIII of the *Competition Act* ("Matters Reviewable by the Tribunal"). The repealed provision and the new provision are set out in the table below – the changes have been underlined:

61. No person who is engaged in the business of producing or supplying a product, […] shall, directly or indirectly, (a) by agreement, threat, promise or any like means, attempt to influence upward, or to discourage the reduction of, the price at which any other person engaged in business in Canada supplies or offers to supply or advertises a product within Canada; or	**76.** (1) On application by the Commissioner or a person granted leave under section 103.1, the Tribunal may make an order under subsection (2) if the Tribunal finds that (a) a person referred to in subsection (3) directly or indirectly (i) by agreement, threat, promise or any like means, has influenced upward, or has discouraged the reduction of, the price at which the person's customer or any other person to whom the product comes for resale supplies or offers to supply or advertises a product within Canada, or […] (b) the conduct has had, is having or is likely to have an adverse effect on competition in a market.
61. (1) Quiconque exploite une entreprise de production ou de fourniture d'un produit […] ne peut, directement ou indirectement : a) par entente, menace, promesse ou quelque autre moyen semblable, tenter de faire monter ou d'empêcher qu'on ne réduise le prix auquel une autre personne exploitant une entreprise au Canada fournit ou offre de fournir un produit ou fait de la publicité au	**76**. (1) Sur demande du commissaire ou de toute personne à qui il a accordé la permission de présenter une demande en vertu de l'article 103.1, le Tribunal peut rendre l'ordonnance visée au paragraphe (2) s'il conclut, à la fois : a) que la personne visée au paragraphe (3), directement ou indirectement :

sujet d’un produit au Canada	(i) <u>soit</u>, par entente, menace, promesse ou quelque autre moyen semblable, <u>a fait</u> monter ou <u>empêché</u> qu’on ne réduise le prix auquel <u>son client ou toute personne qui le reçoit pour le revendre</u> fournit ou offre de fournir un produit ou fait de la publicité au sujet d’un produit au Canada, […] b) <u>que le comportement a eu, a ou aura vraisemblablement pour effet de nuire à la concurrence dans un marché</u>.

[127] The Tribunal concludes that Parliament’s intent was to return to resale price maintenance. Support for this interpretation is also found in documents released at that time.

[128] The Competition Bureau, at the time, described section 76 as “designed to provide resellers of products with the freedom to set their own prices and to provide suppliers with the ability to compete through low-pricing policies.” (see: *A Guide to Amendments to the Competition Act*, Competition Bureau (April 22, 2009)).

[129] The two-prong prohibition interpretation advanced by the Commissioner is not supported by any documents or studies released around the time the amendments were made to the *Competition Act* or before that time. On the contrary, the documents and papers introduced at the hearing show that Parliament intended to return to the traditional focus of the resale price maintenance.

[130] The ill which Parliament sought to address is adverse effects in the price of products for resale not the control of adverse effects of price *per se*. If that had been the intent, then the words “for resale” would be entirely redundant.

[131] Counsel for the Commissioner emphasised that the heading of the provision refers to “Price Maintenance”. However, as stated above, the weight to be given to headings in a statute will depend on a number of factors.

[132] The Commissioner’s submission that refusing to agree with her interpretation would lead to absurd consequences because it would mean that the provision, in this case, would not apply to businesses involved in the credit card business, should also be rejected. Those businesses are subject to section 76, as directed under paragraph 76(3)(*b*). However, this does not entail that in all cases, an order shall be issued – this will depend on the particular facts of a case.

[133] Further, the Commissioner has provided no justification why Parliament intended to subject customers and persons other than customers to different criteria.

[134] The Tribunal therefore finds that section 76 requires a resale of a product. The resale of a product does not require that the product be identical. However, in many instances, the product should be identical or substantially similar on the important characteristics of the product. Dr. Church expressed the view that the product being resold should be in the same product market as the product supplied and the Respondents reiterated that view. A conclusion on this point is not necessary to decide the case before us.

[135] The Commissioner's interpretation leads to a result which, while not absurd as she suggests for other interpretations, are far more intrusive than would be reasonable. The Commissioner's interpretation would mean that Canada has embarked on a form of price control where any increase in a price – an increased input – would be subject to section 76 consideration.

[136] If Parliament had intended to extend the reach of section 76 so far beyond what had been the traditional area of competition policy and law, clear language would be required.

[137] The Commissioner's concern appears to be more directed to abuse of dominance by the two credit card companies. This was acknowledged by Dr. Carlton in responses to questions from the Tribunal:

> **JUSTICE PHELAN**: Taking that, you had a discussion about franchises and using the franchise example where a franchisor imposes restrictions on a franchisee, and that may be, in fact, more costly. Is the problem that we're talking about really a problem of dominance by Visa and MasterCard in the market?
>
> **DR. CARLTON**: I think it is, because if Visa and MasterCard weren't dominant, they couldn't impose these types of conditions. That is the whole point of why, you know, you ask: Are there so many alternatives that, you know, someone could just say, I'm not interested in you, Visa?
>
> […]
>
> **JUSTICE PHELAN**: Without taking you into legal definitions, from an economic perspective, would you describe what is happening here as an abuse of the dominant position that Visa and MasterCard have?
>
> **DR. CARLTON**: Yes, you could certainly describe it that way.

[138] That concern may be related to the interpretation that abuse of dominance requires the practice of anti-competitive acts, in accordance with paragraph 79(1)(*b*), and the purpose of an anti-competitive act must be an intended predatory, exclusionary or disciplinary negative effect on a *competitor*, as held by the Federal Court of Appeal in *Commissioner of Competition v. Canada Pipe Company Ltd.*, 2006 FCA 233, leave to appeal to SCC refused, 31637 (May 10, 2007).

[139] However, any gap in the provisions governing abuse of dominance does not justify an overreaching interpretation of section 76.

VII. ANALYSIS: THE ELEMENTS OF SECTION 76 AND THE ISSUES TO BE DETERMINED

A. Paragraph 76(1)(*a*)

[140] The central issue in this case is: "Has the Commissioner established that each of the Respondents, directly or indirectly, by agreement, threat, promise or any like means, has influenced upward, or has discouraged the reduction of, the price at which the person's customer or any other person to whom the product comes for resale supplies or offers to supply or advertises a product within Canada?"

(1) Requirement of a resale

[141] The Commissioner submits that Visa and MasterCard do supply "Credit Card Network Services" to be resold by Acquirers to Merchants and those services have been described as follows:

> Visa and MasterCard provide Acquirers with direct access to their respective networks so as to permit Acquirers to supply merchants with the services required in order to allow merchants to accept credit card payments, including "authorization", "clearing" and "settlement" services (collectively referred to by the Commissioner as "Credit Card Network Services").
>
> Broadly speaking, "authorization", "clearing" and "settlement" refer to the basic steps in a credit card transaction that involve authorizing the credit card transaction, collecting the value of the transactions from the cardholder's bank, and reimbursing the merchant for the transaction conducted using a Visa or MasterCard-branded credit card.

[142] The Commissioner submits that the services are the "main, primary and critical input supplied to Acquirers". In that regard, the Commissioner relies on the evidence before the Tribunal with respect to the small proportion of value-added by Acquirers as reflected in the component of Card Acceptance Fees typically allocated for Acquirer services. The Commissioner alleges that the Acquirers purchase what she defines as Credit Card Network Services from the Respondents and resell them to Merchants.

[143] The Respondents submit that Acquirers sell Merchants the ability to accept Visa, MasterCard and other payment cards for payment and that they do not resell authorization, clearance and settlement services to Merchants. In that regard, they turn to and rely on the evidence adduced by the Intervenor, the TD Bank.

[144] At the hearing, the Tribunal heard evidence from Jeff van Duynhoven, President of TD Merchant Services, TD's acquiring business. The Tribunal also heard from Jordan Cohen, the President of Global Payments Canada, another Canadian Acquirer.

[145] The Commissioner also called Mike McCormack of the United States who was qualified to give opinion evidence on the payment card transaction industry and the acquiring industry.

[146] These witnesses gave slightly varying descriptions of the industry and of the nature of the services provided by the various participants. Where there is a conflict, the Tribunal prefers the evidence supportive of the Respondents' position. In particular, the Tribunal found Mr. van Duynhoven of TD Bank to have current, direct and Canadian experience and knowledge. The Tribunal found that the Respondents' witnesses on this issue better withstood cross-examination and were more cogent and consistent.

[147] The Tribunal has carefully reviewed the evidence adduced regarding the products sold by Visa and MasterCard and those sold by Acquirers. It finds that the products sold by the Respondents to Acquirers can be described as "Credit Card Network Services" and those sold by Acquirers to Merchants can be described as "Credit Card Acceptance Services". These services are different and Acquirers do not resell either Visa or MasterCard Credit Card Network Services.

[148] Visa and MasterCard operate their respective networks by which MasterCard or Visa card transactions are authorized and paid. They supply authorization, clearance and settlement of transactions services to Acquirers over their respective network ("Credit Card Network Services"). Acquirers, on the other hand, provide to Merchants services that enable them to accept credit cards ("Credit Card Acceptance Services"), which services are different than those of Visa and MasterCard.

[149] The role of an Acquirer was clearly explained by Mr. van Duynhoven who stated as follows :

> Instead, as discussed elsewhere in this Witness Statement, Canadian Acquirers provide a bundle of services, including, but not limited to: leasing and selling point-of-sale equipment, such as countertop terminals, wireless terminals and internet-based technology; providing guaranteed payment and credit services, including the assumption of risk of fraud and "chargeback" inherent therein; ongoing training, service and support of equipment and sales staff, including the maintenance of call centres and technical personnel; and development of loyalty and specialty programs for Merchant Customers.

[150] The Tribunal found Mr. van Duynhoven, who worked in the Canadian payments industry for approximately 20 years, to be a knowledgeable witness and his evidence was cogent. He explained that Acquirers build and operate proprietary networks of their own and deploy point-of-sale technology to Merchants in order to enable transactions:

> **JUSTICE PHELAN**: So you have described that you have your own network --
> **MR. VAN DUYNHOVEN**: Correct.
> **JUSTICE PHELAN**: -- for these things, in the sense that it connects up to the Visa or MasterCard network?
> **MR. VAN DUYNHOVEN**: Right. And a number of other networks, as well.

> **JUSTICE PHELAN**: And a number of others. And that is essentially the same structure for your competitors. They have their own networks that connect in a similar fashion?
> **MR. VAN DUYNHOVEN**: Yes. One of the chief functions that an acquirer does is trying to simplify the process for a merchant. So rather than having a Visa point-of-sale device on the merchant's counter for the checkout, a MasterCard one, one for American Express, one for Interac, et cetera, et cetera, we provide all of that functionality to the merchant and connect to a variety of different networks. So the merchant doesn't have to worry about how all of that works, from a technological standpoint.

[151] These networks facilitate connections between Merchants, payment card networks such as Visa and MasterCard and the Issuers around the globe who ultimately provide authorization for individual transactions. Merchants do not connect or interface with the Visa and MasterCard networks. Clearing and settlement between Issuers and Acquirers and between Acquirers and Merchants are separate activities. Acquirers communicate with Issuers over the Respondents' networks. Merchants communicate only with their respective Acquirers.

[152] M. van Duynhoven also explained that as an Acquirer, TD remains financially responsible for the transactions it acquires. This means that the TD Bank remains responsible for any transaction that results in a "charge-back" from the Issuer and that it undertakes "accounts receivable risk" in that it has "floated" for its Merchants all the Interchange Fees for the month but will not collect any fees until after its billing process is complete at the end of the month.

[153] The evidence of Mr. van Duynhoven was contradicted by that of Mr. McCormack who expressed the view that Acquirers resell the services provided by the Respondents and that the Acquirer merely provides ancillary services, such as POS (point of sale) terminal rentals and reporting services.

[154] However, as indicated earlier, the Tribunal preferred the evidence of Mr. van Duynhoven, a knowledgeable witness with profound knowledge of the Canadian Acquiring industry. On the other hand, Mr. McCormack had not listed any Canadian experience on his *curriculum vitae* and was not as familiar with the Canadian payments industry as Mr. van Duynhoven and thus made various errors regarding the role of Canadian Acquirers.

[155] The Commissioner has also suggested that the fact that an Acquirer's share of the Card Acceptance Fees is rather small shows that the services provided by Visa and MasterCard are the critical and main input supplied to Acquirers and that the latter only provide a small proportion of value-added services.

[156] The Tribunal agrees with the TD Bank in that the profit margins of the Acquirers are not a proper lens through which to determine whether there is a "resale". Further, much of the Card Acceptance Fees accrues to Issuers in the form of Interchange Fees; by the Commissioner's standards, this would imply that Issuers are much more important than either the networks of the Acquirers. Finally, if one were to use revenue shares to measure the relative value-added of the credit card networks and the Acquirers, the relevant comparison would be between the fraction of the Card Acceptance Fee that accrues to Acquirers and the fraction of the Card Acceptance Fees that accrues to the credit card networks, both of which are relatively small in comparison to the Interchange Fees.

[157] The Tribunal therefore finds that the requirement that a product comes for resale to a customer has not been established. This finding is fatal to the Commissioner's application. Therefore, on this finding, the Commissioner's application will be dismissed.

(2) The meaning of "has influenced upward" the price v. adverse effects

[158] However, in the event that we are wrong in our conclusions with respect to the legal interpretation of paragraph 76(1)(*a*)(*i*) or in our finding that the requirement has not been met, we continue with our analysis. This, in light of the fact that the parties adduced evidence and made submissions with respect to the other requirements.

(a) Overview of parties' submissions

[159] The Commissioner alleges that Visa and MasterCard, by requiring Acquirers to implement the Merchant Rules, have indirectly influenced upward, and do influence upward the price for Credit Card Network Services. She submits that in the absence of the Merchant Rules, Merchants could constrain Card Acceptance Fees by surcharging or threatening to surcharge certain credit cards or declining to accept higher-cost credit cards. In that regard, reference is made by the Commissioner to expert evidence adduced at the hearing and evidence from other jurisdictions (Australia, United Kingdom) relating to the "but for" world that would exist without the Merchant Rules.

[160] In the Commissioner's view, the Merchant Rules remove or reduce the incentive on the part of Visa and MasterCard to compete through lower fees to Merchants. She also says that the Merchant Rules allow the Respondents to maintain higher prices for their services, without facing meaningful countervailing pressure from Merchants, as would normally occur when a firm charges higher prices in a competitive market. Card Acceptance Fees are also influenced upwards, according to the Commissioner, because Merchants typically pass some or all of the increased costs resulting from high Card Acceptance Fees on to all of their customers regardless of the means of payment they use in the form of higher prices for goods and services. This means that the Respondents have a stronger incentive to increase their fees.

[161] The Respondents deny that they have engaged in conduct that has influenced upward, or has discouraged the reduction of, the price at which Acquirers supply or offer to supply or advertise a product within Canada and they submit the condition in paragraph 76(1)(*a*) has not been met. The Respondents dispute both the product market definition and the Commissioner's theory of how the No-Surcharge Rule lessens competition between them. They submit that the Tribunal cannot reach such a conclusion if the evidence does not establish that they have attempted to prevent Acquirers or Merchants from offering to sell their products at whatever price they see fit. They further allege that the Commissioner's interpretation turns section 76 in an open-ended vertical restraint provision as most anti-competitive conduct will have influenced prices upward. In their view, the reference to “has influenced upward or discouraged the reduction of the price of” cannot refer to the anti-competitive effects of a vertical restraint.

(b) Analysis

[162] We agree with the Respondents that the “influencing-upward” condition must mean something other than the consequences that flow from a company’s exercise of market power which results in adverse effects on competition in the form of an increase in prices in the downstream market. If not, section 76 would turn into an open-ended provision. There is no support, in the legislative history, other decisions, or commentary, for such an interpretation.

[163] As the Federal Court of Appeal noted in *Canada Pipe*, given a provision’s multi-element structure, “[e]ach statutory element must give rise to a distinct legal test, for otherwise the interpretation risks rendering a portion of the statute meaningless or redundant.” Under the Commissioner’s interpretation, in various factual scenarios, simply showing that conduct has resulted in an adverse effect on competition resulting in an increase in prices would be sufficient to meet the criteria set out in paragraph 76(1)(*a*)(*i*). This interpretation would render the requirement of adverse effects, found in paragraph (*b*), devoid of any meaning in various factual scenarios. It would also invite the Tribunal to read into paragraph (*a*) a reference to an agreement, threat or promise that had the “effect” of influencing a price upwards. The word “effect” or “effects” is used in various provisions of the Act (see e.g. : 74.1, 75, 77(2)(c), 79, 82, 83(1), 86(1)(a), 90.1(4), 93, 96, 100, 106.1) and is even found in paragraph 76(1)(*b*), but is absent in preceding paragraph (*a*)(*i*).

[164] Professor Côté commented as follows on the presumption against the addition or deletion of words:

> Assuming a statute to be well drafted, any interpretation which adds terms or provisions, or deprives terms or provisions of their meaning or utility should be considered dubious.
> […]
> Since the judge’s task is to interpret the statute, not to create it, as a general rule, interpretation should not add to the terms of the law. Legislation is deemed to be well drafted, and to express completely what the legislature wanted to say: “It is a strong thing to read into an Act of Parliament words which are not there, and in the absence of clear necessity it is a wrong thing to do.”
> […]
> It must also be assumed that each term, each sentence and each paragraph have been deliberately drafted with a specific result in mind. The legislature chooses its words carefully: it does not speak gratuitously.
>
> (see: Côté, Pierre-André, in collaboration with Stéphane Beaulac and Mathieu Devinat, *The Interpretation of Legislation in Canada*, 4th ed. (Toronto: Carswell, 2011, at pp. 293-295)

[165] We should also note that private parties can file applications for leave to commence a section 76 application under section 103.1 of the *Competition Act*. Under the Commissioner's interpretation, a corporation could seek leave to file a section 76 application with respect to various types of conduct other than conduct associated with typical resale price maintenance (for example, in our case, Canadian Merchants could have filed an application for leave with the Tribunal directly). In the past, notwithstanding support for making the abuse of dominance provision open to private party litigation, the legislator has not yet done so. It is unlikely that the legislator would have opened up an extremely broad price maintenance provision to private party litigation, without using clearer language to that effect.

[166] As a result we cannot espouse the interpretation advocated by the Commissioner. We further note that we conclude that "the conduct", referred to in paragraph 76(1)(*b*) refers to the conduct set out in paragraph (*a*)(*i*) or (*a*)(*ii*).

[167] To the extent that the Commissioner's application is based on this interpretation, her application must also fail on this basis. However, as explained above, the parties adduced evidence and made submissions with respect to the requirements and raise novel issues. As a result, we continue with our analysis.

[168] As the Commissioner's analysis commences with an assessment of the relevant geographic and product markets as well as market power, to then determine whether prices have been influenced upwards, we will do the same.

(3) Relevant Geographic Market

[169] The parties agree that the relevant geographic market is Canada and the Tribunal accepts this submission.

(4) Relevant Product Market

(a) Overview of the Parties' Submissions

[170] The Commissioner submits that the relevant market for the purpose of assessing the competitive effects of the Merchant Rules consists of general purpose Credit Card Network Services. In support of this submission, she notes that credit cards have features that clearly distinguish them from other methods of payment, that Merchants have continued to accept the Respondents' credit cards notwithstanding increasing Card Acceptance Fees, and that the Respondents' proposed market definition has been consistently rejected in other jurisdictions. She also relies on the application of the hypothetical monopolist test.

[171] The Respondents submit that the Commissioner's proposed product market has been defined too narrowly. In that regard, Visa submits that it competes for transaction volume with payment methods that include cash, debit, cheque, other credit card companies and new entrants such as PayPal. MasterCard, in its closing submissions, alleges that the market for payment services is the relevant product market.

[172] The Respondents further allege that the Commissioner's market definition is incorrect because it fails to take into the consideration the fact that they operate two-sided platforms. In their view, the application of the hypothetical monopolist test, as performed by the Commissioner's expert economists, is flawed.

(b) Analysis

[173] The Tribunal generally applies the hypothetical monopolist test when defining relevant markets (see: *The Commissioner of Competition v. CCS Corporation et al.*, 2012 Comp. Trib. 14, at para. 58, aff'd 2013 FCA 28). Under this approach, as is explained in the *Merger Enforcement Guidelines*, a relevant product market is defined as the smallest group of products in which a sole profit-maximizing seller (the hypothetical monopolist) would impose and sustain a small but significant and non-transitory increase in price (the "SSNIP") above competitive levels (see: Competition Bureau, *Merger Enforcement Guidelines* (October 6, 2011). Often, for the purposes of determining the SSNIP, objective benchmarks such as a 5 % increase in price lasting one year are used (see: *CCS Corporation et al.*, at para. 60). In the determination of whether a SSNIP would be profitable, the hypothetical monopolist test makes use of demand elasticity and cross-elasticity evidence as well as what are known as practical indicia.

[174] In the case at hand, the application of the hypothetical monopolist test leads the Tribunal to consider the following three questions:

(i) the application of the test to two-sided forums;
(ii) the stage in the vertical chain at which the test should be applied; and
(iii) the appropriate price to be used.

(i) <u>The application of the test to two-sided forums</u>

[175] Both the Commissioner's and the Respondents' expert economists agree that credit card networks are examples of two-sided platforms. They agree that a characteristic of two-sided platforms is that the attractiveness of the platform to potential users on one side depends on the number of users there are on the other side. For example, a newspaper, recognized by the experts as a reasonably representative example of a two-sided platform, is more valuable to advertisers the more readers it has and can be more valuable to readers the more advertisers it has. For that reason, the response to a change in the price charged to users on one side of the platform can also affect demand on the other side of the platform. A consequence of this interdependence or feedback effect is that it may be optimal from the perspective of maximizing use of the platform concerned, for users on one side of it to bear a disproportionate fraction of platform costs.

[176] The Commissioner and the Respondents agree that Cardholders find themselves on one side of the credit card network platform and that Merchants are on the other. They also agree that a card becomes more valuable to a Cardholder as the number of Merchants accepting it increases and that the benefit to a Merchant from accepting a particular card increases with the number of individuals holding and using the card. Merchants and Cardholders pay different prices for their use of the platform. Cardholders may pay annual fees and interest and may also receive rewards based on their card usage. Merchants pay Card Acceptance Fees which include an Interchange

Fee that accrues to Issuers. Interchange Fee revenue may be used, in part, by Issuers to fund rewards or other benefits to Cardholders. The Interchange Fee is an example of a balancing payment whereby users on one side of a platform may subsidize the use of its other side.

[177] The Commissioner's position is that it is appropriate to apply the hypothetical monopolist test to one side of the platform, that is, the supply of Credit Card Network Services by the Respondents to Acquirers. The Respondents emphasize the complexities involved in applying the hypothetical monopolist test to two-sided platforms. There is at least some agreement from the Commissioner's experts that this is the case. For example, Dr. Carlton notes that because changes in one price in a two-sided market may affect the price on the other side of the market, market definition in two-sided markets may be more difficult, and may have different implications than in a typical case.

[178] The Respondents submit that in this case, the application of the hypothetical monopolist test cannot be confined to one side of the credit card payment network platform. They maintain that it is wrong to focus only on the acceptance side of the platform and on the price charged either to Merchants or Acquirers rather than on the sum of the prices charged to the acquiring and issuing sides together. They further contend that substitution in favour of alternative means of payment in response to a price increase on one side of the platform can induce similar substitution on the other side of the platform with a resulting loss of profit on both sides. This may also set off subsequent rounds of feedback effects. These feedback effects may be amplified by network effects. If the interdependence of demand on both sides of the platform and feedback effects are ignored, then there is the potential to define the market much too narrowly.

[179] Dr. Carlton agreed that the hypothetical monopolist test should take account of any cross-platform demand interdependence and feedback effects arising from the application of a SSNIP to one side of the platform. Dr. Carlton stated explicitly that he had done so:

> **MR. KENT**: This is what I'm getting at. You have to take that into account, right? You have to take into account the negative impact on the opposite side of the platform that comes with raising a price on the first side of the platform?
>
> **DR. CARLTON**: Yes. In a sense, you have to take account of, if you were running a paper, all of your revenue sources. So when I went through my example in my direct testimony and I said I raised the price from 20 cents to 21 cents, what happens to total volume of credit card purchases? Do you think it is going to plummet?
>
> I have taken into account that, yes, a merchant could say "no". That will cause a reduction in the number of customers who say, No, I don't want a credit card. That will cause a subsequent reaction by merchants who say they don't.
> I am saying, taking all of that feedback or loop, as you put it, into account, do I expect such a large reduction to make the price increase unprofitable? I'm saying, looking at the evidence, it is pretty clear what the answer is. No, because I have seen such price increases occur over -- in Canada.

[180] The Respondents' expert economists, Dr. Church and Dr. Elzinga, also opined on the application of the hypothetical monopolist test to two-sided platforms. Dr. Church stated that, given that the hypothetical monopoly credit card network supplies Credit Card Network Services to both Issuers and Acquirers, the correct approach to product market definition is to apply the hypothetical monopolist test to both sides of the platform. This means that the SSNIP should be applied to the sum of the Acquirer Network Fee plus the Issuer Network Fee, which is the total amount paid by Issuers and Acquirers for the use of the credit card network platform and the test should assess the effect of the SSNIP on the combined profitability of both sides of the platform.

[181] Dr. Church did not actually perform the test or suggest what the relevant product market, as a result of such a test, might be. He confined himself to stating that the relevant product market cannot be as narrow as Dr. Winter defined it. In cross-examination, however, Dr. Church did appear to concede that the hypothetical monopolist test could be applied to one side of the platform provided the cross-platform interdependence of demand and feedback effects are taken into account. When asked his opinion about the application of the test to each side of a payment card platform by the United States Department of Justice, Dr. Church's response was that "there is more than one way to skin a cat":

> **MR. FANAKI**: You have no reason to disagree that was the approach the Department of Justice applied in that case?
> **PROFESSOR CHURCH**: Well, what would be interesting to know is, when they applied the hypothetical monopolist on one side versus the other side, whether they took into account the feedback effects from one side to the other and the lost margin from those feedback effects when they did it on one side.
> **MR. FANAKI**: Well, let's talk about feedback effects in one minute if we could, because I promised you I would come back to that. You have no reason to disagree this was the approach the DOJ took to define the relevant market in this case?
> **PROFESSOR CHURCH**: I think what is interesting about it is, as in most things, there is more than one way to skin a cat, and even within a one-sided market analysis, if you did the right margins and did the right elasticity measures, you could get the same answer as you would with a two-sided market.

[182] In the context of the related question of whether the SSNIP should be applied to the price charged to customers on one side of the platform or the sum of the prices charged to customers on both sides of the platform when performing the hypothetical monopolist test, Dr. Church also stated:

> **PROFESSOR CHURCH**:… When we were doing the two-sided market analysis, there is a total price for the whole network that is divided between the two sides. When you go to raise the price to 5 percent of the total network, you still have to divide it between the two sides. And if you look at the literature -- the economics literature as opposed to the Antitrust Law Journal written by lawyers, but economics literature which shows you how to do this -- you will find that you raise the price to 5 percent, and then you divide between the two sides based on their relative elasticities, based on the price increases that they face.

> So it is not -- you know, I think the way to think about this is to think there are two prices running around. The price for the margin is the price that is relevant to -- is just the network access fees and figuring out the profit-maximizing implications.
> The change in the price to issuers and acquirers is the change in their price, as suggested by this paragraph. So, you know, <u>I don't think that there is this -- there's unlikely to be this distinction that you are trying to raise between the one-sided and two-sided approach. If the one-sided approach is done correctly, you can get very close, if not exactly the same, answer as you would get on the two-sided approach.</u>
>
> [emphasis added]

[183] Dr. Elzinga was of the view that credit card networks compete as platforms with other payment platforms such as debit cards, cheques and cash in the market for payment services. In his opinion, it is incorrect to apply the hypothetical monopolist test to one side of a two-sided platform. Dr. Elzinga defined the price of a credit card transaction as the sum of the prices charged on to Cardholders and Merchants, that is, Card Acceptance Fees plus cardholder fees less cardholder rewards. In Dr. Elzinga's opinion, it is the sum of the prices charged on each side of the market that is relevant for antitrust purposes. The Tribunal takes this to mean that he would apply a SSNIP to the sum of the prices charged to Merchants and Cardholders and that their response would be such as to make this unprofitable, thus implying a broader product market.

[184] Dr. Elzinga did not explore the consequences of applying a SSNIP to the sum of the prices charged to Cardholders and Merchants. Instead, he suggested that a one-sided hypothetical monopolist test, in the form of a surcharge imposed on Cardholders by Merchants would show that Cardholders would respond by substituting in favour of other modes of payment in sufficient numbers to imply that the Commissioner has defined the market too narrowly:

> To see whether the Commissioner's proposed credit card market passes the "one-sided hypothetical monopolist test," would mean investigating how tenaciously consumers would cling to their credit cards if it meant paying 5% or 10% more than with an alternative payment mechanism at the point of sale.

[185] Dr. Elzinga concluded that enough consumers would switch to other modes of payment if they were subject to a 2 per cent surcharge (let alone a 5 or 10 per cent surcharge) on credit card transactions to make it unprofitable for a hypothetical monopolist to impose a price increase of this magnitude. To Dr. Elzinga, this implied that the relevant market must be broadened to include some of the alternative modes of payment to which consumers would switch.

[186] As Dr. Frankel points out in his Reply Report, however, the 2 per cent surcharge on the value of the goods and services purchased with a credit card assumed by Dr. Elzinga is not the same as a 2 per cent increase in either the net fees paid by Cardholders for the use of their cards or the price of a credit card transaction as Dr. Elzinga has defined it. The Tribunal finds Dr. Frankel's critique persuasive.

[187] In sum, with respect to the question of whether the product supplied to customers on one side of a two-sided platform can be a candidate relevant product market, the Tribunal's understanding of the evidence of the expert economist witnesses is as follows: the opinion of the Commissioner's three expert economists is that one side of a two-sided platform can be a relevant product market and that the SSNIP can be applied to the price charged to customers on one side of the platform. All three of them apply the hypothetical monopolist test to the card acceptance or acquisition side of the credit card network platform. One of the Commissioner's experts, Dr. Carlton, explicitly agreed that cross-platform demand interdependence and feedback effects must be taken into account when applying the hypothetical monopolist test to one side of a two-sided platform.

[188] The opinion of both of the Respondents' expert economists is that the smallest candidate relevant product market encompasses both sides of a card network platform and that the hypothetical monopolist test should assess the profitability to the platform as a whole of an increase in the sum of the prices paid by users on both sides of the platform. Neither performs a test of this nature. Moreover, one of the Respondents' experts, Dr. Church, appears to concede that provided cross-platform feedback effects are properly taken into account, the application of the hypothetical monopolist test to one side of a two-sided platform can yield the same conclusion with respect to market definition as applying it to the platform as a whole. For his part, Dr. Elzinga does do a hypothetical monopolist test but it is a "one-sided" test, applied to the cardholder fees. This test also appears to be methodologically flawed.

[189] Given the evidence before us, we find that one side of the platform can be a candidate relevant product market for the purposes of the hypothetical monopolist test and that the SSNIP can be applied to the price charged to customers on that side of the platform provided both the interdependence of demand, feedback effects and ultimately changes in profit on both sides of the platform are taken into account.

[190] We now turn to the remaining two questions with respect to the application of the hypothetical monopolist test.

(ii) <u>The stage in the vertical chain at which the test should be applied; and</u>
(iii) <u>The appropriate price to be used.</u>

[191] The Commissioner submits that the hypothetical monopolist test should be applied to the Credit Card Network Services supplied by the Respondents to Acquirers. She further submits that in applying the SSNIP test, one must use the price paid by Acquirers to the Respondents, which is comprised of the Interchange Fee and the Acquirer Network Fee. She disagrees with the contention that, in this case, the appropriate price for the purposes of the SSNIP test is the Acquirer Network Fee, and she notes that the "relevant price is the total price charged to Acquirers or to merchants, regardless of whether that price […] may ultimately be divided into Interchange Fees or Network Fees."

[192] The Commissioner further alleges that Acquirers would pass on the applicable increase to their Merchant customers in the form of higher Card Acceptance Fees and she notes that Credit Card Network Services are an example of derived demand, since demand for these services by Acquirers is ultimately derived from the demand of Merchants for credit card acceptance. She thus concludes that the relevant question to be asked under the test is whether so many Merchants would decline to accept credit cards in response to an increase in Card Acceptance Fees so as to render that price increase unprofitable.

[193] Professor Winter performs his hypothetical monopolist test in the upstream market in which the credit card networks are the sellers and the Acquirers are the buyers, but adds that his conclusions would remain the same if the test had been performed in the downstream market in which Acquirers sell services to Merchants. The price used by Dr. Winter is the current average price paid by Acquirers to the Respondents, the "Acquirer Fee", which is the sum of the Interchange Fee and the Acquirer Network Fee.

[194] Both Dr. Frankel and Dr. Carlton perform the hypothetical monopolist test in the downstream market in which Acquirers provide services to Merchants. Thus, they assume that a hypothetical monopoly Acquirer raises the Card Acceptance Fee it charges Merchants by a SSNIP.

[195] The Respondents submit that the hypothetical monopolist test, a market definition analysis, should be conducted on the market in which the Respondents participate, not a downstream market in which they do not participate.

[196] We agree with the Respondents that the appropriate market to use for the purposes of the hypothetical monopolist test is the market in which the Respondents compete. The Respondents compete on one side of their respective platforms to supply Credit Card Network Services to Acquirers. This leads the Tribunal to conclude that the appropriate relevant candidate product market for the purposes of the hypothetical monopolist test is the supply of Credit Card Network Services to Acquirers. The Tribunal recognizes, however, that the response of Acquirers to a change in the price of Credit Card Network Services is essentially determined by the response of their customers, the Merchants, to the price change passed on to them.

[197] The choice of the price to which the SSNIP should be applied is also at issue. The price that the customers (Acquirers) pay for the services provided by the hypothetical monopoly credit card network is the sum of the Acquirer Network Fee and the Interchange Fee. The price the credit card network receives from Acquirers is the Acquirer Network Fee. The Interchange Fee is remitted to Issuers. Dr. Winter applied the SSNIP to the sum of the Acquirer Network Fee and the Interchange Fee. Dr. Church expressed the view that in the context of a one-sided hypothetical monopolist test, the relevant price is the price received by the hypothetical monopolist and this would be the Acquirer Network Fee. He stated that the Interchange Fee is irrelevant to the profits of the hypothetical credit card network monopolist.

[198] The Tribunal holds the view that the purpose of the hypothetical monopolist test is to determine the extent to which customers in the candidate market will switch to other products in response to a SSNIP. Market definition is based on substitutability and focuses on demand responses to changes in prices (see, e.g., the Competition Bureau's *Merger Enforcement Guidelines*, October 2011). The SSNIP must therefore be applied to the price that is being paid by the purchasers of the candidate product. Acquirers are the purchasers of Credit Card Network Services and the price they pay for these services is the Acquirer Fee (Interchange Fee and Acquirer Network Fee).

[199] It is also true, however, that the hypothetical monopolist test turns on whether a SSNIP would be profitable. This requires that the hypothetical monopolist receive all the proceeds of the SSNIP. The Respondents and their experts have correctly pointed out that the hypothetical credit card network monopolist does not receive the proceeds of an increase in the Interchange Fee. To the extent that the SSNIP in the Acquirer Fee is the result of an increase in the Interchange Fee, the hypothetical monopolist network's profit margin does not increase. One way to satisfy the assumption underlying the hypothetical monopolist test is to assume, as Dr. Winter suggests, that the sum of the Interchange Fee plus the Acquirer Network Fee increases by a SSNIP that is due entirely to an increase in the Acquirer Network Fee[2]. As will be discussed in greater detail below, this requires a very large percentage increase in the Acquirer Network Fee.

[200] Dr. Church was asked in cross-examination to comment on an excerpt from an article dealing with defining relevant product markets in electronic payment network cases in the United States and which dealt indirectly with the above issue. The excerpt addressed the question of what the relevant price should be:

> **MR. FANAKI**: So if we could come back to document 530, which -- it is just the last exhibit we marked, Mr. LaRose. If we look at page 728, just at the bottom part of the page is the page we left off on last time. You see here the division is discussing this issue. It states that, "The Division also confronted the issue..."
> […]
> **MR. FANAKI**: "The division also confronted the issue of which fee to use when it applied the hypothetical monopolist test - the switch fee, the interchange fee, or both. Because the network retains only the switch fee, and not the interchange fee, one could argue that the switch fee is the appropriate measure of network market power and, therefore, that a SSNIP analysis should focus on the switch fee alone. Such an approach, however, is incorrect. While the industry developed in a way that resulted in most networks delineating separate interchange and switch fees, when networks set their fees and when merchants and issuers decide which networks to join, they base their decisions on the sum of the two fees. Merchants look at the total price, which consists of the sum of the interchange and the switch fees. Because issuers receive the interchange fee as a pass-through payment, issuers consider the interchange fee minus the switch fee. A network can exercise market power against a merchant by increasing the switch or interchange fee, and against an issuer by raising the switch fee or lowering the interchange fee. Consequently, as a practical matter, it makes little sense when defining product markets in the industry to consider either the switch or interchange fee in isolation (even though the network does not ultimately retain the interchange fee)."
> Do you see all of that?
> **PROFESSOR CHURCH**: I do.

MR. FANAKI: And, again, you have not reason to disagree that in approaching the definition of the relevant market, that the United States Department of Justice considered the relevant price to be the network fee and the interchange fee as opposed to focussing only on the network fee?
PROFESSOR CHURCH: So this is what they say that they did. I would just like to add a comment on it.

I think the distinction here is that when you think about the profit margin, you should be using the price that accrues to the supplier, which doesn't include interchange.

But when you think about the demand elasticity and the size of the magnitude of the change in demand from the price increase, that price increase, as this paragraph suggests, should be the price increase faced by the customer on that side.

When we were doing the two-sided market analysis, there is a total price for the whole network that is divided between the two sides. When you go to raise the price to 5 percent of the total network, you still have to divide it between the two sides. And if you look at the literature -- the economics literature as opposed to the Antitrust Law Journal written by lawyers, but economics literature which shows you how to do this -- you will find that you raise the price to 5 percent, and then you divide between the two sides based on their relative elasticities, based on the price increases that they face.

So it is not -- you know, I think the way to think about this is to think there are two prices running around. The price for the margin is the price that is relevant to -- is just the network access fees and figuring out the profit-maximizing implications.

The change in the price to issuers and acquirers is the change in their price, as suggested by this paragraph.

So, you know, I don't think that there is this -- there's unlikely to be this distinction that you are trying to raise between the one-sided and two-sided approach. If the one-sided approach is done correctly, you can get very close, if not exactly the same, answer as you would get on the two-sided approach.

[emphasis added]

[201] Dr. Church suggests that an alternative way of conducting a one sided hypothetical monopolist test would be to apply the SSNIP to the Acquirer Network Fee. This has the virtue of being the price the hypothetical monopoly card network actually receives from Acquirers. The problem with it is that, as will be discussed in greater detail below, a SSNIP in the Acquirer Network Fee results in a miniscule percentage increase in the Acquirer Fee.

[202] The differences between Dr. Church and Dr. Winter can be illuminated using the Acquirer Fee and Acquirer Network Fee assumed for the purposes of illustration by Dr. Winter in his reports and also by Dr. Church in his report. This is a 200 basis point Acquirer Fee, which is comprised of an Acquirer Network Fee of 5 basis points and an Interchange Fee of 195 basis points. Under Dr. Winter's approach, a 5% SSNIP in the Acquirer Fee would be 10 basis points which would require a 200% increase in the Acquirer Network Fee. Under Dr. Church's approach, a 5% SSNIP in the Acquirer Network Fee would be ¼ of a basis point or a one-eighth of a percent increase in the Acquirer Fee. The Commissioner argues that a percentage price increase of this magnitude would be all but undetectable and would therefore not generate a demand response and the Tribunal is inclined to agree.

[203] Dr. Church also suggests that in the event that a SSNIP is applied to the Acquirer Fee it would be more appropriate to assume that the network receives only a pro rata share (5/200) of this increase with the balance going to Issuers. The Tribunal is not persuaded that it is preferable to assume that a hypothetical monopoly network would increase the Acquirer Fee by 10 basis points and keep only .25 basis points for itself rather than keeping it all.

[204] Given that the application of the SSNIP to the Acquirer Network Fee would likely yield the same definition of the relevant product market as that proposed by the Commissioner and that Dr. Church appears to have accepted Dr. Winter's treatment of the SSNIP in the Acquirer Fee as being due to an increase in the Acquirer Network Fee, the Tribunal also accepts Dr. Winter's approach.

Application of the hypothetical monopolist test

[205] For the purposes of the application of the test, the Tribunal's findings are that: (1) the test can be applied on the card acceptance side of the credit card network platform provided cross-platform demand interdependence and feedback effects are taken into account; (2) the candidate product market should be a market in which the Respondents compete and this is the supply of Credit Card Network Services to Acquirers and; (3) the SSNIP should be applied to the Acquirer Fee but is assumed to be entirely attributable to an increase in the Acquirer Network Fee.

[206] The hypothetical monopolist test may define the relevant market too broadly in the presence of what is known as the cellophane fallacy. The cellophane fallacy can lead to an overly broad market definition if the price to which the SSNIP is applied is already above the competitive level. In this case, the hypothetical monopolist may find that a further price increase is unprofitable leading to the incorrect conclusion that the relevant market is broader. In the Commissioner's view, the prevailing Acquirer Fee is already above the competitive level so that a hypothetical Credit Card Network Services monopolist who finds it profitable to raise the prevailing Acquirer Fee by a SSNIP would also find it profitable to increase the Acquirer Fee above the competitive level by more than a SSNIP. The Commissioner regards her hypothetical monopolist test as conservative in that it would err in favour of the broader market definition advocated by the Respondents. The Tribunal accepts that to the extent that the prevailing Acquirer Fee is above the competitive level, the Commissioner's conclusion that the supply of Credit Card Network Services to Acquirers is a relevant product market is strengthened.

[207] For the purposes of the hypothetical monopolist test, we will continue to use the "price" of the candidate product used for purposes of illustration by Dr. Winter in his reports and also by Dr. Church in his report. This is a 200 basis points Acquirer Fee, which is comprised of an Acquirer Network Fee of 5 basis points and an Interchange Fee of 195 basis points. The Respondents' experts, for the purposes of their response, appear to have accepted that number.

[208] A 5 per cent SSNIP in the price of the candidate product would be 10 basis points (200 x 0.05) and this price increase could be achieved by increasing the Acquirer Network Fee by 10 basis points (200%) while holding the Interchange Fee constant. This would satisfy the requirements of a proper hypothetical monopolist test in that the proceeds of the SSNIP would accrue entirely to the hypothetical credit card network monopolist. The price of the candidate product would be increased by 5% and the additional revenue derived from this price increase would accrue entirely to the hypothetical credit card network monopolist. We must determine what Acquirers would do in the face of an increase of the Acquirer Fee of 10 basis points.

[209] The evidence establishes that Acquirers would likely pass on the 10 basis point increase in the Acquirer Fee in the form of higher Card Acceptance Fees. Depending on how Acquirers determine their prices, this increase could be a 5% increase in the Card Acceptance Fee or it could be less. In the Tribunal's view, any difference would not be sufficient to affect the outcome of the test.

[210] The hypothetical monopolist test asks whether substitution away from the candidate product in response to a SSNIP would be such that either the SSNIP would be unprofitable or a smaller price increase would be more profitable. In an attempt to provide a rough idea of the percentage loss in transaction volume a hypothetical monopolist would have to lose before a SSNIP became unprofitable, Dr. Winter estimated what is known as the Break-Even Critical Sales Loss ("BECSL"). The BECSL is the loss in sales at which a SSNIP would become unprofitable. Dr. Winter calculates that a 5 percent increase in the Acquirer Fee would be unprofitable only if card transaction dollar volume fell by more than 50 percent. Dr. Winter opines that for reasons given below a 5 percent increase in the Acquirer Fee (passed through by Acquirers to Merchants) would not result in a reduction in credit card acceptance of this magnitude. Hence a SSNIP would be profitable and the relevant product market is no broader than Credit Card Network Services sold to Acquirers.

[211] The Respondents, MasterCard in particular, disagree with Dr. Winter's use of the BECSL test. They cite the expert evidence of Dr. Church in support of their argument. There are three main points of disagreement. The first is that Dr. Winter ignores the Cardholder side of the platform when he applies the test. The second is that Dr. Winter does not estimate the BECSL correctly. The third is that the BECSL test is not the correct test to use.

[212] With respect to the application of the hypothetical monopolist test to one side of a two-sided platform, the Tribunal has already found that it is permissible to apply the hypothetical monopolist test to one side of a two sided platform, provided cross-platform demand interdependence and feedback effects are taken into account.

[213] With respect to his estimation of the BECSL, Dr. Winter makes use of approximate values for the Acquirer Fee, the Acquirer and Issuer Network Fees and the network contribution margin to illustrate the differences between Dr. Church and himself. The Tribunal is satisfied that nothing of substance turns on the use of these approximations. Dr. Winter assumes that the prevailing Acquirer Fee is 200 basis points. The SSNIP in the Acquirer Fee is then 10 basis points. As the test requires, Dr. Winter assumes that this 10 basis point increase in the Acquirer Fee accrues entirely to the hypothetical monopoly network. Dr. Winter assumes that the network's contribution margin (margin on variable cost) is under 10 basis points. Given an initial gross margin of under 10 basis points and a 10 basis point increase in the Acquirer Fee (all of which is retained by the card network), the network's gross margin more than doubles. This fee increase would then be unprofitable only if card transaction dollar volume fell by more than 50%.

[214] Dr. Winter also reaches the same conclusion using the formula for the BECSL that can be found in a textbook which Dr. Church co-authored.[3] Dr. Winter assumes that the sum of the Acquirer Network Fee and the Issuer Network Fee is 12 basis points and that the network contribution margin on the combined network access fees is **[CONFIDENTIAL]** percent or **[CONFIDENTIAL]** basis points **[CONFIDENTIAL]**. He then expresses this as a margin on the Acquirer Fee. This comes to **[CONFIDENTIAL]** which Dr. Winter rounds to **[CONFIDENTIAL]**. Plugging this contribution margin estimate into the BECSL formula yields a break even critical sales loss of **[CONFIDENTIAL]** (BECSL = SSNIP/(SSNIP + MARGIN) = **[CONFIDENTIAL]**.

[215] The Tribunal accepts the logic of Dr. Winter's expression of the network contribution margin as a fraction of the Acquirer Fee for purposes of this calculation.

[216] MasterCard emphasizes that the **[CONFIDENTIAL]** margin on which Dr. Winter relied is a contribution margin not a profit margin. The Tribunal accepts that this is a margin on direct costs and that it shows the fraction of network revenue that is available to cover fixed costs as well as profit. It need not imply anything about network profitability, supra-normal or otherwise. The Tribunal is also of the view, however, that the contribution margin is appropriate for Dr. Winter's purposes, that is, for the calculation of the BECSL. The contribution margin shows what the hypothetical monopolist stands to forego, in terms of coverage of overhead and profit, if it chooses to raise its price. The Tribunal also agrees that if Dr. Winter were to assume a lower contribution in his BECSL calculation, it would strengthen his conclusions.

[217] Dr. Church suggests that it would be more appropriate to assume that the network receives only a pro rata share (5/200) of the increase in the Acquirer Fee with the balance going to Issuers. This yields a BECSL of 2.51% and Dr. Church states that it is not obvious that merchant card acceptance would not fall by this amount in response to a 5% increase in the Acquirer Fee. As stated above, the Tribunal is not persuaded that it is preferable to assume that a hypothetical monopoly network would increase the Acquirer Fee by 10 basis points and keep only .25 basis points for itself rather than keeping it all.

[218] Dr. Church's preferred approach is to apply the SSNIP to the sum of the Acquirer Network Fee and the Issuer Network Fee which are the prices the hypothetical monopoly network actually charges to Acquirers and Issuers and receives for its services. On the assumption of a 5% SSNIP and an **[CONFIDENTIAL]** contribution margin, the BECSL formula yields a break-even critical sales loss of **[CONFIDENTIAL]** (BECSL= SSNIP/(SSNIP + MARGIN) = **[CONFIDENTIAL]**. A SSNIP would be unprofitable if it resulted in a decrease in card transaction dollar volume in excess of **[CONFIDENTIAL]** percent. This is obviously much lower than Dr. Winter's BECSL estimate.

[219] The Commissioner argues that Dr. Church's approach is "simply wrong" and should be dismissed out of hand. The Tribunal would not go that far. The Commissioner and Dr. Winter also point out, however, that a SSNIP in the sum of the Acquirer Network Fee and the Issuer Network Fee would result in a miniscule percentage increase in the Acquirer Fee. On the assumption that the Acquirer Network Fee and the Issuer Network Fee sum to approximately12 basis points, a 5% increase in this sum would amount to less than one basis point (actually 0.6 basis points).

[220] Dr. Church suggests that according to the economic theory of two-sided markets, the hypothetical monopolist would then find the most profitable allocation of this .6 basis point increase between the Acquirer Network Fee and the Issuer Network Fee. Even if this entire increase is allocated to the Acquirer Network Fee, raising it from 5 basis points to 5.6 basis points, the Acquirer Fee would only increase from 200 basis points to 200.6 basis points or 0.3%. It is hard to imagine that this would be noticeable by Merchants let alone induce a 5.8% reduction in credit card transactions they accept.

[221] With respect to the question of whether the BECSL is the proper way to interpret the hypothetical monopolist test, the Tribunal agrees with Dr. Church that the correct question is whether a SSNIP would be the hypothetical monopolist's profit-maximizing choice not whether a SSNIP would just break-even. The sales loss at which a SSNIP would maximize the hypothetical monopolist's profits is smaller than the sales loss at which a SSNIP would become unprofitable. The sales loss at which a SSNIP maximizes the hypothetical monopolist's profits is called the critical sales loss. Although neither Dr. Winter nor Dr. Church chose to do so, the critical sales loss can be calculated using a formula in the textbook co-authored by Dr. Church[4].

[222] Using this formula we note that the critical sales loss under Dr. Winter's approach is 33% and the critical sales loss under Dr. Church's approach is 5.5%.[5] This means that the hypothetical network monopolist's profit-maximizing increase in the Acquirer Fee would exceed 5% for sales losses less than 33% under Dr. Winter's approach and that the hypothetical network monopolist's profit-maximizing increase in the sum of the Acquirer Network Fee and the Issuer Network Fee would exceed 5 % for sales losses under 5.5% using Dr. Church's approach.

[223] Dr. Winter accepts that the critical sales loss (what the hypothetical monopolist would do) is the appropriate way to apply the hypothetical monopolist test but states that his conclusions would not have changed if he had used the critical sales loss test. Dr. Winter's view is that given the minimal likely sales losses involved, the hypothetical credit card network monopolist's profit-maximizing price increase would not be less than 5% and that Dr. Church has not provided any evidence to the contrary.

[224] The Tribunal agrees that it is appropriate to focus on what the hypothetical monopolist *would* do. As to whether this would lead to different conclusions than those reached by Dr. Winter, with respect to the definition of the relevant product market, this depends on the likely response of Merchants to a 10 basis point increase in the Acquirer Fee passed along to them in the form of an increase in the Card Acceptance Fee.

[225] We agree that merchant card acceptance would have to drop by a considerable amount either to render a 10 basis point increase in the Acquirer Fee unprofitable for a hypothetical credit card network monopolist or to render an Acquirer Fee increase of less than 10 basis points more profitable than a 10 basis point increase.

[226] We now turn to the evidence regarding the likely response of merchant card acceptance to a 10 basis point increase in the Acquirer Fee passed through to them by Acquirers as a 10 basis point increase in the Card Acceptance Fee. The evidence we consider includes: (1) evidence on the distinct characteristics of credit cards as a means of payment; (2) evidence from Merchant witnesses as to whether they would decline to accept credit cards in response to an increase in the Card Acceptance Fees and; (3) evidence of past response to Card Acceptance Fee increases. Our assessment of this evidence leads us to conclude that with the Merchant Rules in place, very few Merchants would cease accepting credit cards in response to a 10 basis point increase in the Card Acceptance Fee.

[227] We agree with the Commissioner that credit cards have distinct attributes from the perspective of Merchant's customers. Unlike payment methods such as debit cards or cash, credit cards allow the Cardholder to make a purchase without accessing the Cardholder's funds at the time of purchase and allow the Cardholder to pay outstanding balances over time. Credit cards can be used to make purchases remotely and also provide protection against fraudulent transactions. Cardholders of some credit cards receive reward points or other benefits that generally are not offered by other methods of payment.

[228] These distinct features have been recognized by the Respondents' own representatives. **[CONFIDENTIAL]**

[229] Notes prepared for the testimony of the President of MasterCard Canada before the Standing Senate Committee on Banking, Trade and Commerce in November 2010, include the following:

> Why are credit card interchange fees so much higher than those for debit?
>
> - Because they are completely different transactions.
> - A credit card purchase is an unsecured loan.
> - Furthermore, a credit card transaction has features that simply do not exist for a debit purchase, like fraud monitoring, charge-back protection, zero liability, and so on.

[230] Further, there is also evidence with respect to the reactions by Canadian Merchants. At the hearing, various lay witnesses testified on behalf of Merchants detailing how it is virtually impossible to discontinue the acceptance of credit cards as they have become ubiquitous. Ms. Li, WestJet's Treasurer, stated that "[d]espite [the] costs, as a practical matter, WestJet is unable to stop accepting credit cards."

[231] The Chief Financial Officer of Sobeys, Mr. Paul Jewer, explained that it is virtually impossible for grocers to discontinue their practice of accepting credit cards:

> Despite the high costs associated with credit cards, as a practical matter, Sobeys and other grocers cannot discontinue acceptance of Visa or MasterCard credit cards, even if Card Acceptance Fees exceed their profit margins. Customers have come to expect that their credit cards will be accepted in grocery stores.

[232] Representatives of other Merchants, such as IKEA, Best Buy, and Shoppers Drug Mart, provided testimonies in the same vein. They also stated that in the face of increasing Card Acceptance Fees, they continued to accept credit cards. Ms. Li stated that the average Card Acceptance Fees paid by WestJet, for Visa transactions, increased from **[CONFIDENTIAL]** in 2007 to **[CONFIDENTIAL]** in 2011. To mitigate the costs of credit card acceptance, some Merchants have entered into agreements to offer co-branded credit cards; as part of the agreement, the Merchant often pays reduced Card Acceptance Fees.

[233] Tim Broughton, a co-owner of a restaurant in Toronto, stated that the basic rate for credit card transactions had increased from **[CONFIDENTIAL]** in April 2009, to **[CONFIDENTIAL]** for a Visa credit card transaction and to **[CONFIDENTIAL]** for a MasterCard credit card transaction. He added that factoring in all of the fees paid to the Acquirer, the restaurant's effective cost of credit card acceptance has increased from **[CONFIDENTIAL]** for each credit card transaction in December 2008 to **[CONFIDENTIAL]** in December 2011. The restaurant, however, continued to accept credit cards notwithstanding this increase of 25% over a period of three years.

[234] The Tribunal exercises caution with respect to the conclusions that can be drawn, for the purposes of the hypothetical monopolist test, from the historical evidence that Merchants have continued to accept credit cards in spite of Card Acceptance Fee increases of more than 10 basis points. The relevance of these observations is limited given that these increases were often the result of increases in the Interchange Fee which accrues to Issuers and which could have been used to increase cardholder benefits or to promote credit cards as a means of payment. In such a case, we would be observing the combined effect of a SSNIP coupled with an increase in the attractiveness of credit cards rather than a "pure SSNIP effect".

[235] However, evidence was adduced with respect to a "natural experiment" that appears to hold card characteristics constant. Certain portfolios of credit cards had been converted by MasterCard to "premium" designations with higher Interchange Fees. When those portfolios were converted, however, some Cardholders were not issued new credit cards, nor were benefits changed for some Cardholders. In an e-mail of a MasterCard employee regarding the possibility of such a transfer, one can read as follows:

> "For high spend programs, there is no difference in the rewards offered to those cardholders receiving HSP [high-spend premium] interchange and those receiving core. The decision to enroll cardholders into ALM and make them eligible for HSP interchange is based entirely on our requirements for reaching a spend or income threshold. There is no additional communication to cardholders. **[CONFIDENTIAL]**

[236] In other e-mail correspondence between MasterCard's Director of Communications and other employees, dated February 2011, one can infer that the transfer has actually taken place:

> From: McLaughlin, Richard
> Sent: Wednesday, February 23, 2011 4:47 PM
> To: Sasha Krstic; Krstic, Sasha; Maraschiello, Tony
> Cc: Lapstra, Scott; richard.mclaughlin@mastercard.com
> Subject: RE: Premium card messaging for government
>
> […] Our practice as described is pretty hard to defend. […]
>
> ---
> From: Maraschiello, Tony
> Sent: Wednesday, February 23, 2011 03:54 PM
> To: McLaughlin, Richard; Sasha Krstic; Lapstra, Scott
> Subject: RE: Premium card messaging for government
>
> Thanks Richard. Finance originally wanted something back by today, but with Betty at the Task Force I've asked if we can have until Monday.
> <u>I think we all agree that our current practices are susceptible to criticism</u>. But this issue isn't going away, so I think by being as forthright as possible at this level (Finance) we can get a better sense as to where their painpoints are and make any necessary adjustments (if possible) before we're dragged in by Flaherty with an ultimatum
>
> […]
> ---
> From: Krstic, Sasha
> Sent: Thursday, February 24, 201 1 9:38 AM
> To: McTague, Tom
> Subject: Fw: Premium card messaging for government
> Hi Tom
> Head's up. ....Tony may ask you to participate in a mtg with Betty etc. on Fri to review our response to a gov't question re premium cards in mkt.<u> We're trying to figure out how to address the topic of HSP </u>**[CONFIDENTIAL]**

> Multiple issuers are doing this, **[CONFIDENTIAL]** I thought it would be helpful to have your view in the mtg.
>
> […]
>
> [emphasis added]

[237] We further note that the President of MasterCard did not explicitly deny that the practice had taken place:

> **MR. THOMSON**: …Based on all of that, Ms. Devita, I am obliged to put this to you, and so I am going to, which is that what's gone on here is that in the period after 2008, MasterCard has put in place a program that allows for substantially higher interchange fees to be paid to issuers in respect of these high-spend cards, with no identifier on the card, with no re-issuance of the card, with no requirement that the issuer provide additional benefits associated with those additional high rates, all of which ended up being passed into the laps of the merchants and the merchants got stuck with that situation.
>
> Do you accept that? That is what gave rise to the merchant concerns in the marketplace in 2008, 2009, 2010, 2011, and gave rise to the risk of regulatory intervention; fair comment?
>
> **MS. DEVITA**: Well, I mean, I think it is one side of the story, frankly. I don't think that it talks to the compliance with the code with regard to these people having spend that is above a core spend. So these people had to be either **[CONFIDENTIAL]** per year of spend and/or made meet income thresholds.
>
> Those were the practices at the time. They were code compliant.
>
> When I came in as the president, we reviewed it. We made some changes, and the transparency issue and badging issue will be eliminated.

[238] Notwithstanding these changes, merchant acceptance of MasterCard credit cards continued to increase. This illustrates that Merchants, in a world holding Cardholder benefits constant, continued to accept credit cards notwithstanding an increase in Card Acceptance Fees as a result of an increase in Interchange Fees. Merchants who have testified also pointed out that they have no option but to continue accepting credit cards.

[239] Dr. Frankel also cites the results of what he calls the natural experiment that occurred when Interac debit cards were introduced in 1994. He argues that if they were close substitutes, Visa and MasterCard might have been expected to reduce their Interchange Fees to compete with Interac's much lower interchange fee but instead they continued to trend upward instead. A problem with this type of evidence is that we do not know the counterfactual. That is, Visa and MasterCard Interchange Fees might have increased faster in the absence of competition from Interac. Another problem could be that Visa and MasterCard might also have responded to the entry of Interac by reducing cardholder fees or increasing cardholder rewards or both. As a result, we accord no weight to this experiment.

[240] Given the above, we agree with the Commissioner that, initially, few if any Merchants would respond to the SSNIP contemplated by refusing to accept the hypothetical monopolist's credit cards. Now we must address the question of whether this evidence properly takes cross-platform demand interdependence and subsequent feedback effects into account.

[241] To the extent that the SSNIP reduces the number of Merchants accepting the hypothetical monopolist's credit card(s), credit cards become less attractive to consumers as a means of payment. To the extent that Cardholders or potential Cardholders adopt other modes of payment (debit, cash, cheque), there is a further reduction in the demand by Acquirers for the hypothetical monopolist's Credit Card Network Services. This is called a cross-platform feedback effect.

[242] There can be many rounds of feedback effects. In the first round, some consumers respond to the initial reduction in the number of Merchants accepting the hypothetical monopolist's credit cards by adopting other modes of payment. This feeds back to the Merchant side where additional Merchants respond to the reduction in the number of consumers carrying credit cards by ceasing to accept them. This, in turn, induces additional consumers to respond to the further reduction in the number of Merchants accepting credit cards by ceasing to carry them.

[243] Feedback effects may get successively smaller over repeated rounds until they become infinitesimally small. The result is a new equilibrium demand for the hypothetical monopolist's Credit Card Network Services. This demand is lower than it would be if only the initial response by Merchants were taken into account. The implication is that while a SSNIP may be profitable if only the initial merchant response is taken into account, it may not be profitable once feedback effects are taken into account. Indeed, if subsequent feedback effects do not become successively smaller the result would be a "death spiral" in which the SSNIP resulted in a complete loss of business by the hypothetical Credit Card Network Services monopolist.

[244] Dr. Carlton acknowledged the conceptual requirement to take cross-platform feedback effects into account and states that he has done so although, as the Respondents point out, there is no reference to this in his report. The Commissioner argues, however, that since Merchants would "have no choice" but to continue to accept credit cards in the event that a SSNIP was passed on to them in the form of higher Card Acceptance Fees, "few if any" would respond by refusing to accept credit cards. Given the minimal initial response by Merchants to the SSNIP any cross-platform feedback effects would also be very small. That is, since few if any Merchants would respond to the SSNIP by ceasing to accept credit cards, credit cards would not become less attractive to consumers as a means of payment. Hence, the cross-platform demand effect is minimal and there would be no further feedback effect. Thus, as a practical matter, cross-platform demand and interdependence can be ignored.

[245] We conclude that cross-platform effects will be minimal so that the ultimate effect of the contemplated SSNIP on the volume of credit card transactions is likely to be very small. This implies that the contemplated SSNIP would be profitable and a greater percentage increase in the

Acquirer Fee might be even more profitable. This further implies that the relevant product market is no broader than the candidate product market which is the supply of Credit Card Network Services to Acquirers and the Tribunal so finds.

[246] We shall now turn to the question of whether each of the Respondents exercises unilateral market power in the market of Credit Card Network Services sold to Acquirers.

(5) Assessment of Market Power

(a) Overview of the Parties' Submissions

[247] The Commissioner submits that each of Visa and MasterCard exercises market power within the relevant market and she relies, in that regard, on the following indicators:

- Visa and MasterCard have each been able to increase prices above competitive levels, and sustain those price increases, without suffering any appreciable loss of transaction volume;
- the prices set by Visa and MasterCard are unrelated to costs, and are designed to extract as much of a Merchant's "willingness to pay" as possible;
- Visa and MasterCard have each engaged in extensive price discrimination by establishing fees that vary significantly based on the category of the Merchant, as well as the size and type of transaction;
- the primary constraint on Visa's and MasterCard's pricing is not competition within the relevant market, but the threat of regulatory action to curb Interchange Fees;
- the market for the supply of Credit Card Network Services is highly concentrated and each of Visa and MasterCard holds a substantial market share;
- the profit margins for Visa and MasterCard are very high; and
- barriers to entry into the relevant market for the supply of Credit Card Network Services are very high, as confirmed by the fact that there has not been a new entrant in Canada for at least 25 years.

[248] The Respondent Visa alleges that the Commissioner's market power analysis is flawed and raises, in particular, the following points:

- The Commissioner's references to increases in Merchants' costs of acceptance are not evidence of market power – in particular, given the two-sided nature of the industry, these increases cannot be considered in isolation;
- Interchange Fees do not generate revenues directly for Visa and MasterCard, and as such it would be incorrect as a matter of economics to rely on increases in Interchange Fees as evidence of market power. They have no interest in seeing interchange higher or lower, provided that it maximizes transaction volume on the network.
- There is no evidence demonstrating that Visa's margins have increased steadily over time; nor is there any analysis of whether such margins were used to fund investments in infrastructure, R & D or innovation;

- Visa's and MasterCard's market shares should be considered separately;
- There is vigorous competition between Visa and MasterCard and they face significant competitive restraints from others such as Amex, Interac. They also face significant pressures to remain competitive because of technological advances by new and potential entrants (e.g. PayPal, Microsoft, mobile companies, etc.).

[249] The Respondent MasterCard has adopted Visa's submissions and underlines that since each Respondent must be considered separately to determine whether they individually enjoy market power, the 30% market share of transaction volume of the Credit Card Network Services, attributed by the Commissioner to MasterCard, is not sufficient to be indicative of unilateral market power, particularly in the absence of evidence of barriers to new entry or expansion.

[250] With respect to barriers to entry, MasterCard submits that Discover and Interac represent two potential entrants in the credit card industry and that there is evidence of the accelerated pace of competition from new technologies, mainly mobile phone payments. It notes that PayPal's recent entry into Canada is further evidence of the market's dynamic.

(b) Analysis

[251] A company that enjoys "market power" is a company that has the "ability to profitably maintain prices above the competitive level, or to reduce levels of non-price competition (such as service, quality or innovation) for an economically meaningful period of time" (*CCS*, at para. 371).

[252] In *Director of Investigation and Research v. Laidlaw Waste Systems Ltd*., 40 C.P.R. (3d) 289, the Tribunal commented as follows on market power (at p. 325):

> In deciding whether a firm has substantial or complete control of a market, one asks whether the firm has market power in the economic sense. Market power in the economic sense is the power to maintain prices above the competitive level without losing so many sales that the higher price is not profitable. It is the *ability* to earn supra-normal profits by reducing output and charging more than the competitive price for a product. As was said in the *NutraSweet* decision: "Market power is generally accepted to mean an *ability* to set prices above competitive levels for a considerable period." (emphasis added)
>
> As was also stated in the *NutraSweet* decision:
>
>> While this [the ability to set prices above the competitive level] is a valid conceptual approach, it is not one that can readily be applied; one must ordinarily look to indicators of market power such as market share and entry barriers. The specific factors that need to be considered in evaluating control or market power will vary from case to case.
>
> A *prima facie* determination as to whether a firm is likely to have market power can be made by considering the share of the relevant market held by that firm. If

> that share is very large the firm will very likely have market power. But other considerations must also be taken into account including: how many competitors there are in the market and their respective market shares; how much excess capacity the firms in the market have and how easily a new firm can establish itself as a competitor.
>
> …
>
> Market share is only a *prima facie* indication of market power. As has been noted, other considerations must also be taken into account. One of these is barriers to entry: how easily can a firm commence business in the relevant market and establish itself there as a viable competitor? The term "entry" for an economist when used in the phrase "barriers to entry" is a term of art which carries with it the connotation of sustainability. The term "entry" will be used in that sense in these reasons. Related words such as "to enter" or "entrant" are used in their non-technical sense as meaning "to begin" or "to commence".

[253] With respect to market share, the Tribunal stated in *Director of Investigation and Research v. Hillsdown Holdings (Canada) Ltd*., 41 C.P.R. (3d) 289, that "market share is not necessarily a reliable determinant of market power" and that as an indicia of such it may either overstate or understate a firm's market power" (at p. 318).

[254] In this case, the parties agree that the issue to be decided is whether Visa and MasterCard each possess unilateral market power. There is no allegation that the Respondents have jointly exercised market power.

[255] Visa and MasterCard each have market power in the sense that their behavior differs from that of a textbook perfectly competitive firm. Their products are differentiated from each other. Each of them has price-setting discretion (setting network fees and default Interchange Fees) as opposed to being a price-taker. **[CONFIDENTIAL]** As the Commissioner notes, they charge different markups to different classes of customers based on willingness to pay and this is a form of price discrimination.

[256] Dr. Elzinga observes that many firms in differentiated products markets have pricing discretion. Dr. Winter concedes that there are many markets that economists would classify as competitive which involve prices substantially above operating cost. The Commissioner and her experts maintain that there is more to it than this.

[257] The Commissioner cites evidence that both Visa and MasterCard have operating and contribution margins respectively that, when expressed as a percentage of revenue, are well in excess of a percentage margin in accounting profit that the Tribunal deemed in its *Director of Investigation and Research v. Tele-Direct*, 73 C.P.R. (3d) 11, decision to be "extraordinarily high." The fact situation in *Tele-Direct* appears to differ from the present case. In this regard, MasterCard emphasizes that its contribution margin is what is available to cover fixed costs as well as profit.

[258] The Tribunal is of the view, however, that while a high gross or contribution margin is an indicator of the ability to set and maintain prices above marginal cost, this does not necessarily imply that either network's prices exceed their respective average costs plus a normal profit. The prevalence of sustained supra-normal profits (called "economic profits") can be an indicator of the existence of market power but there does not appear to be any evidence before the Tribunal as to whether either Visa or MasterCard is earning a supra-normal rate of return on investment on a sustained basis.

[259] Viewed from the perspective of market structure, the Respondents are the only two suppliers in the upstream market for the supply of Credit Card Network Services to Acquirers. Unlike the Respondents, American Express has direct acquiring relationships with Merchants. American Express does enter into routing agreements with Acquirers permitting them to offer American Express functionality through their terminals, but they play no role in cardholder authorization, financial settlement, or merchant billing for American Express transactions. As a result of its vertical integration, American Express cannot be viewed as a participant in the market for Credit Card Network Services supplied to Acquirers. Of course, American Express does compete with Visa and MasterCard Acquirers in the downstream market for Credit Card Acceptance Services sold to Merchants.

[260] The relevant product market as defined by the Commissioner is a differentiated product duopoly in which one duopolist, Visa, has two-thirds of the market with MasterCard holding the balance. This is obviously a very highly concentrated market.

[261] Product differentiation (branding) implies that the Visa and MasterCard networks are not perfect substitutes for each other. To some degree this would insulate them from price competition from each other even in the absence of the Merchant Rules. The pricing discretion of Visa and MasterCard may be enhanced to the extent that their Cardholders single-home (use one card exclusively). In that case each network is the "gatekeeper" of its Cardholder base and with the Merchant Rules in place, it can offer this base to individual Merchants on an all-or-nothing basis.

[262] An illustration of the pricing discretion of MasterCard is the "interchange fee gap" episode during which MasterCard was able to raise its Interchange Fees and thus its Acquirer Fees relative to Visa apparently without any loss of market share.

[263] While there are a number of factors at work to attenuate the competitive pressure on the Respondents to undercut each other's Acquirer Fees, Dr. Carlton emphasizes that price competition is still sufficient to keep Acquirer Fees below the level a monopolist would set and thus to oblige the Respondents to "leave money on the table."

[264] Barriers to entry into the supply of Credit Card Network Services must be regarded as high. Considerable capital is required, the minimum viable scale is significant relative to the size of the market and the chicken and egg problem (i.e. convincing Merchants to accept a card that is not held by many Cardholders, and convincing consumers to hold and use a card that is not accepted by many Merchants) implies that it could take a long time to reach the break-even point. Taken together, this implies significant fixed, sunk entry costs, investment that would not be recovered in the event that entry was not successful. With respect to minimum viable scale, Dr. Frankel cites a document from MasterCard stating that its card would not be viable in a national market with market share of much less than 35 percent:

> In 1998, when there was no duality in Canada (i.e., banks could only issue either MasterCard or Visa branded credit cards, but not both), MasterCard was concerned about the possibility that a proposed bank merger between the Royal Bank and the Bank of Montreal ("BMO") would result in the largest MasterCard issuer (i.e., BMO) becoming a Visa issuer. MasterCard explained that at the smaller network scale that would result from this change in Canada, "MasterCard anticipates there would be further erosion over a short time, to approximately 7% MasterCard, with Visa at 93%. At that level of participation in the marketplace," MasterCard explained, "MasterCard would no longer be a viable competitive alternative." Indeed, MasterCard disclosed then that "MasterCard's Global Board has determined that, as a long-term proposition, the card is not viable in a market with much less than a 35% share."

[265] With respect to potential competition from new payment technologies, the Tribunal accepts that payment technologies are evolving and that the Respondents are under competitive pressure to invest in technological improvements. The evidence adduced by the Respondents is insufficient, however, to support an inference that alternative payment technologies pose a competitive threat to them.

[266] In light of the foregoing behavior and structural considerations, the Tribunal concludes that with approximately two-thirds of the relevant market, Visa has unilateral market power.

[267] Given its one-third share of the relevant market and its apparent concern about whether a market share of this magnitude is sufficient for long-term viability, MasterCard might be regarded as being in a different situation. While it is true that the *Merger Enforcement Guidelines* state that a market share under 35% do not normally raise unilateral market power concerns, this does not mean that it can never do so. Taking into account MasterCard's pricing discretion, its margins and the very high barriers to entry, the Tribunal concludes that MasterCard also has market power in the relevant market.

[268] We now turn to the question of whether Visa and MasterCard have each directly or indirectly by agreement or any like means influenced upward, or have discouraged the reduction of the price at which an Acquirer or any other person to whom the product comes for resale supplies or offers to supply or advertises a product within Canada. We will assume that Acquirers are reselling the Credit Card Network Services to Merchants.

(6) Evidence regarding the requirement that each Respondent has influenced upward the price

[269] In a typical price maintenance case, the analysis of whether prices have been influenced upwards is relatively uncomplicated. For example, a manufacturer sets a minimum price at which its dealers may sell its product. This price is above the price at which its dealers would otherwise sell the product thereby directly influencing its resale price upward. It necessarily prevents resellers of the product from competing with each other by cutting their prices below the stipulated minimum price. While resale price maintenance softens intra-brand price competition downstream, it can increase the incentive for resellers to engage in non-price inter-brand competition and can therefore be demand-increasing. In this case there would be an upward influence on price but no adverse effect on competition. Under some circumstances, however, resale price maintenance can reduce both intra-brand and inter-brand competition and is demand-restricting as a consequence. In this case there would be both an upward influence on price and an adverse effect on competition.

[270] In this case, however, the Commissioner submits that the Merchant Rules have the effect of influencing the price at which Acquirers resell Credit Card Network Services upward. Her theory of the case is that "but for" the Merchant Rules, both the price at which the Respondents sell Credit Card Network Services to Acquirers (the Acquirer Fee) and the price at which Credit Card Network Services are then resold to Merchants by Acquirers (the Card Acceptance Fee) would be lower.

[271] Given the Commissioner's theory of the case, the Tribunal is asked under paragraph 76(1)(*a*) to determine whether the Merchant Rules have had the effect of influencing both Acquirer Fees and Card Acceptance Fees upwards. We shall first turn to the question of whether the No-Surcharge Rule has influenced these prices upward.

(a) The No-Surcharge Rule

[272] The Commissioner alleges that surcharging is effective at steering transactions to lower cost methods of payment and that the ability of Merchants to surcharge or threaten to surcharge on credit cards constrains the level of Card Acceptance Fees. In that regard, she relies on evidence coming from other jurisdictions and expert evidence. She submits that in the absence of the No-Surcharge Rule, Merchants could constrain Card Acceptance Fees by surcharging or threatening to surcharge certain credit cards. She alleges that by requiring Acquirers to implement the No-Surcharge Rule, the Respondents have influenced upward the price for Credit Card Network Services.

[273] Dr. Winter posits two mechanisms through which the Merchant Rules (both the No-Surcharge Rule and the Honour All Cards Rule) influence the price at which Credit Card Network Services are resold upwards:

(i) the Merchant Rules suppress price competition between credit card companies; and
(ii) the "cost-externalization" mechanism.

[274] The first means by which the Merchant Rules are alleged to enable the Respondents to influence upwards the price at which Acquirers resell Credit Card Network Services (the Card Acceptance Fees) is by suppressing price competition between the Respondents in the upstream market for Credit Card Network Services sold to Acquirers. A consequence of this suppression of price competition between Visa and MasterCard is that the price of Credit Card Network

Services sold to Acquirers and the price at which Credit Card Network Services are resold by Acquirers are both higher than they would be absent the Merchant Rules.

[275] According to the Commissioner, the No-Surcharge Rule suppresses price competition between Visa and MasterCard in the market for Credit Card Network Services sold to Acquirers by preventing Merchants from playing one credit card network off against the other by surcharging or threatening to surcharge one but not the other. The Merchant Rules also reduce the incentive of either Visa or MasterCard from seeking competitive advantage over the other by offering to discount its Acquirer Fee which would be passed along by Acquirers in the form of a lower Card Acceptance Fee in return for either avoiding a Merchant surcharge or a reduction in a surcharge already imposed by a Merchant.

[276] The second mechanism by which the Merchant Rules are alleged to influence Card Acceptance Fees upward is the cost-externalization or cross-subsidization mechanism. As Dr. Winter explains it, this mechanism operates through the No-Surcharge Rule. When a credit card network raises its Acquirer Fee in the presence of the No-Surcharge Rule, Merchants are obliged to pass on some of the cost of the resulting increase in Card Acceptance Fees to customers who purchase with cash or debit cards. As a consequence, Cardholders bear only part of the cost of higher Card Acceptance Fees and this reduces the sensitivity of their card use to changes in these Fees. Dr. Winter opines that this cost-externalization reduces the resistance of both Cardholders and Merchants to higher Card Acceptance Fees and thus leads to higher Acquirer Fees than would otherwise prevail.

[277] The distinction between the Commissioner’s competition-suppressing mechanism and her cost-externalization mechanism is that the competition suppressing mechanism insulates each of the Respondents from price competition from the other (price competition in the relevant market) while the cost-externalization mechanism insulates both of the Respondents from price competition from substitute means of payment. The competition-suppressing mechanism focuses on the ability of Merchants to use surcharging to steer their customer from higher cost to lower cost brands of credit cards. The cost-externalization mechanism focuses on the use of surcharges on credit cards by Merchants to steer their customers to lower cost means of payment such as cash and debit cards.

[278] According to the Commissioner’s theory, the cost-externalization mechanism serves to increase the unilateral market power of each of the Respondents by reducing the pricing discipline imposed on each of them by substitute means of payment. It need not have any effect on the pricing discipline that the Respondents impose on each other, that is, on price competition within the relevant market. For this reason, the Tribunal sees the relevance of the Commissioner’s cost-externalization mechanism as being to the question of whether the No-Surcharge Rule influences upward the resale price of Credit Card Network Services under paragraph76(1)(*a*). Dr. Carlton is explicit about this:

> Now, there is one other thing that the surcharge is doing. Let's forget about competition between Visa and MasterCard. The merchant might not like taking credit cards and, to dissuade customers, he might want to put a surcharge on credit cards. Under the no-surcharge rule, he can't. If he can't, that means he can't switch customers from credit card to cash. That means the merchant response, when, say,

> its merchant fees go up on credit cards, is not as strong as it would otherwise be in his ability to substitute away from high-cost credit cards.
>
> So from my point of view, what I think is pretty clear is that the no-surcharge rule reduces this competition between Visa and MasterCard, and also reduces the merchant response to a high credit card fee in general.

[279] Dr. Winter suggests in his report that the cost-externalization mechanism adversely affects competition among Merchants. However, the Commissioner has not established that "merchants" is a relevant market for purposes of the analysis of anti-competitive effects.

[280] The competition suppressing mechanism is used by the Commissioner both under paragraph 76(1)(*a*) to demonstrate that prices are influenced upward and under (*b*) to demonstrate an adverse effect. Under the Commissioner's theory, the Merchant Rules are alleged to affect price competition adversely in the relevant market (paragraph 76(1)(*b*), that is, between Visa and MasterCard), and this influences the price in the relevant market upward (paragraph 76(1)(*a*)).

[281] The Tribunal agrees with the Respondents that the Commissioner's competition suppressing theory cannot be used to satisfy both the upward influence requirement under paragraph 76(1)(*a*) and the adverse effect requirement under paragraph 76(1)(*b*).

[282] The Tribunal is of the view, however, that provided she meets her burden of proof, the Commissioner's cost-externalization mechanism could be taken to satisfy the upward influence requirement under paragraph 76(1)(*a*) and the competition softening mechanism could be taken to satisfy the adverse effect requirement under paragraph76(1)(*b*).

[283] The Tribunal turns first to the question of whether each Respondent, through the implementation of the No-Surcharge Rule, has influenced upward the price at which Acquirers resell Credit Card Network Services to Merchants via the cost-externalization mechanism.

[284] As explained above, according to the Commissioner, one means by which the No-Surcharge Rule enables the Respondents to influence upwards the price at which Acquirers resell Credit Card Network Services is what Dr. Winter called "cost externalization." The Commissioner also calls it "cross-subsidization". The Tribunal agrees with the Respondents that the issue is not one of cross-subsidization per se. Rather, it is that credit card users are likely to be insensitive to changes in Card Acceptance Fees because they pay only a fraction of them with the balance being paid by customers who use other means of payment.

[285] Cost-externalization means simply that Merchants are obliged by the No-Surcharge Rule to pass-on higher Card Acceptance Fees in the form of higher prices to all their customers regardless of the mode of payment they use. For example, the result of a 2% Card Acceptance Fee on credit card transactions accounting for 25% of a Merchant's sales would be that the price the Merchant charges to all its customers would be 0.5% higher. Since credit card users pay a small fraction of the cost of choosing this mode of payment and even this is not transparent to them, they are less resistant to increases in Card Acceptance Fees than if surcharging were allowed. As a consequence, a network contemplating an Acquirer Fee increase (passed along as a Card Acceptance Fee increase) could do so in the expectation that this would have little or no effect on Cardholders' decisions to use their cards and thus on competitive necessity of Merchants to accept them.

[286] In essence, the cost-externalization mechanism reduces the substitutability between the Respondents' cards and other modes of payment. This increases the profit-maximizing price of Credit Card Network Services and thus the Card Acceptance Fee for a given level of competition between Visa and MasterCard.

[287] Dr. Winter discusses the conceptual foundations of the cost-externalization mechanism in more detail:

> As a general economic principle, if the costs of a price increase by a supplier are borne downstream not just by the customers in its own supply chain, but by other consumers as well, then fewer customers will penalize the supplier (by declining to purchase the product) when the supplier increases its price. As a consequence, where a portion of the cost increases are borne by customers outside of the supplier's supply chain, the supplier has a greater incentive to set prices at higher levels. For example, if the impact of an increase in the price of coffee beans is shared by tea drinkers (because of a vertical restraint that the price of brewed coffee not exceed the price of tea) then a monopoly supplier of coffee beans has an incentive to set a higher price.
> Suppose, for example, that the supplier's own downstream customers bear only 50 percent of the cost of a price increase, because the supplier imposes a restraint that the price of its product (purchased by half of the buyers at the downstream firm) cannot exceed the price of another product sold downstream. The supplier will face a smaller drop in demand from any price increase than if that supplier's own downstream customers bear 100 percent of the cost of a price increase. The supplier will therefore have an incentive to set its price at a higher level.
> ...
> When a credit card company increases its prices, instead of downstream customers who use credit cards bearing the entire cost of a price increase, consumers from outside of the credit card system bear a portion of these costs. The price increases for consumers outside the system do not carry the penalty of decreased demand for the credit card company. This source of discipline against price increases by the credit card company is suppressed. A profit-maximizing credit card firm will necessarily set higher prices in the presence of the Merchant Rules.

[288] Counsel for Visa accepted that Merchants do, in fact, pass their costs of credit card acceptance on in the form of higher prices to all their customers. Visa's position is that there is nothing in the Merchant Rules that obliges them to do so:

> Card acceptance fees are a cost of doing business, no different than any other business cost that merchants incur. Just as acquirers can reasonably be expected to

> pass on their costs to their merchant customers, merchants can reasonably be expected to pass on their card acceptance costs to their customers. And all of the evidence in this case shows that that is precisely what merchants do. It will be suggested to you that the point of this case is to ensure that credit card users pay the costs associated with credit card use. Guess what?
> They already do.
> The fact that non-credit card users share in the costs of credit card use has nothing to do with Visa. It has nothing to do with Visa cardholders. That's a decision that merchants make to spread their costs across all their sales.

[289] At the hearing, Merchant witnesses testified that they typically pass some or all of the increased costs resulting from high Card Acceptance Fees onto all their customers in the form of higher retail prices for goods and services. For example, Mr. Broughton indicated that “all consumers end up paying higher prices as a result of the costs associated with premium credit cards”. Mr. Daigle, a Senior Director at Shoppers Drug Mart, stated that “higher costs, such as increased Card Acceptance Fees, are passed on to consumers in the form of higher retail prices”. Mr. Houle stated as follows in paragraph 46 of his witness statement:

> Whenever possible, increasing Merchant Services Fees are passed on to all of Air Canada's customers in the form of higher ticket prices, otherwise they are absorbed by Air Canada as a lower profit margin. Customers paying with Interac debit and other low-cost forms of payment are therefore subsidizing consumers paying with credit cards, particularly those consumers paying with more expensive credit cards.

[290] The Tribunal agrees that Merchants must cover their costs to remain in business. The evidence before the Tribunal is that Merchants have typically passed on some or all of Card Acceptance Fees costs in the form of higher prices to all their customers including those who use debit cards or cash to make purchases. On the evidence, cash and debit card customers subsidize credit card customers. What remains to be determined is whether this is a consequence of the No-Surcharge Rule.

[291] The Respondents regard the Commissioner’s cross-subsidization theory as absurd. First, they point out that Merchants commonly forego the opportunity to charge their customers separate prices for each individual service they supply them. Second, the magnitude of any cross-subsidy to Cardholders from customers using alternate means of payment is in doubt. Each means of payment involves costs and benefits for the Merchant. The cross-subsidy from cash customers to Cardholders, for example, would be the difference between the net costs to the Merchant of credit card acceptance and cash acceptance respectively. Efficient choice among alternative means of payment would ideally require that the consumer be exposed to the Merchant’s net cost (or relative net cost) of each alternative. Simply surcharging credit cards does not do this. Third, mere threats to surcharge would not eliminate cross-subsidization because there would still be no signaling of the Merchant’s cost of card acceptance to Cardholders.

[292] The Tribunal agrees that it is not uncommon for businesses to price a set of services as a package and that this can result in the subsidization of one type of customer by another. This is a choice made by the individual businesses concerned. In the case at hand, however, the No-Surcharge Rule does not permit Merchants to choose whether to charge their customers according to the payment method they use.

[293] The Tribunal also agrees that each method of payment entails its own costs and benefits to Merchants and that the magnitude of any cross-subsidy depends on the difference in the respective costs of accepting each mode of payment net of any benefits to the merchant concerned. It may be that debit card customers are subsidizing both cash and credit card customers. It may also be that insofar as consumer choice of payment mechanisms is concerned, the elimination of the No-Surcharge Rule would simply replace one set of distorted incentives by another. As we explain below, however, that is beside the point.

[294] To some extent, the impact of cross-subsidization is attenuated by the fact that the payment method is the customers' choice. Many consumers have both debit and credit cards as well as cash. They choose to use one form of payment or another for numerous reasons. For one purchase the customer is being cross-subsidized; for another purchase the customer cross-subsidizes.

[295] With respect to the Respondents' argument that the mere threat of surcharging cannot eliminate cross-subsidization because the Cardholder does not pay the cost of using her card, this is true as far as it goes. If the threat of surcharging would have constrained past increases in Card Acceptance Fees, however, the magnitude of any subsidization of card users by cash and debit users would be smaller. More importantly, paragraph 76(1)*(a)* does not require either that there would be no cross-subsidization or that the choice of means of payment would be efficient in the absence of the No-Surcharge Rule. It requires only that each of the Respondents, through the implementation of the No-Surcharge Rule, has influenced upwards the price at which Acquirers supply or offer to supply Credit Card Network Services. In this case, given the Commissioner's theory, it means that absent the No-Surcharge Rule, Card Acceptance Fees would have been lower.

[296] The Respondents argue that the Merchant Rules do not prevent Merchants from taking measures other than surcharging that would eliminate cost-externalization. They argue that Merchants could eliminate the cross-subsidization of their credit card customers by offering discounts or equivalent rewards to customers paying by means other than credit cards. They also submit that the Merchant Rules do not prevent Merchants from informing their customers about the relative costs of alternative means of payment.

[297] The Respondents maintain that a discount is arithmetically equivalent to a surcharge and that Merchants have "long been able to discount for cash, debit or other forms of payment" under the Merchant Rules. The Tribunal agrees that offering discounts for alternative means of payment could eliminate cost-externalization in theory. The question is whether this is a practical alternative.

[298] The Commissioner argues that offering discounts to customers choosing alternative means of payment is impractical for Merchants and would in any event not be as effective in steering consumers as surcharging. According to the Commissioner, offering discounts for lower cost forms of payment would be competitively disadvantageous because it would require the "inflation" of a Merchant's base or advertised price to cover the revenue lost by discounting. The Commissioner also tendered evidence from Merchant witnesses, from the Respondents' documents and from research in behavioural economics that consumers are more responsive to surcharges than they are to discounts.

[299] Merchant witnesses gave evidence regarding their experiences with discounting and surcharging.

[300] With respect to the relative effectiveness of discounting and surcharging, Mr. Jewer of Sobeys explained that Sobeys, in some of its stores, had offered a discount of $0.05 to customers for each plastic bag that they brought to the store and used for groceries. While this policy had very little impact on the consumption of plastic bags, he explained that after a $0.05 surcharge was introduced on plastic bags in Toronto, plastic bag consumption dropped by more than 60%.

[301] Also regarding the relative effectiveness of surcharging and discounting, Mr. Symons of IKEA explained that in the period of 2004 to 2010, the IKEA Group in the United Kingdom applied a surcharge of 70 pence (approximately $1.10) to all credit card transactions at its retail operations. As a result, in 2005, the volume of credit card transactions at those retail stores was reduced by 37% and the number of debit transactions increased by 16%. He further testified that the IKEA Group had used discounts in the past, but found such discounts to be ineffective or not as effective as surcharging in encouraging customers to use lower-cost payment methods and were not as clear to customers.

[302] Merchants also testified about the commercial impracticability of offering discounts for alternative means of payment. In particular, they explained that in order to offer a discount to customers using non-credit card payment methods, they would first have to raise their base price and then discount depending on the payment method used. For example, one can read as follows in paragraphs 39 to 41 of the witness statement of Mr. Shirley of Best Buy:

> Best Buy Canada has also considered introducing a discounting policy to encourage its customers to use less expensive forms of payment, like cash or Interac debit. However, Best Buy Canada is not convinced that discounting is effective as a means of encouraging customers to use lower-cost payment methods.
>
> First, Best Buy Canada would have to inflate its base prices for all customers in an effort to encourage customers paying with a credit card to use a different payment method. For example, to offer a $5 discount for a customer who is purchasing a $95 product with cash or debit, Best Buy Canada would have to increase the price of this product from $95 to $100, and then offer a $5 discount to only those customers paying with cash or debit. This is not a viable option as,

> given the highly competitive markets in which Best Buy Canada operates, Best Buy Canada must advertise the lowest prices available.
>
> In addition, a discount would be more costly to implement. To try and induce those customers currently using credit cards to switch to lower cost payment methods, Best Buy Canada would also have to provide a discount to the **[CONFIDENTIAL]** of customers that are already paying with cash, Interac debit, the Best Buy Card or the Future Shop Card. The costs of providing this discount would be prohibitive. This may be contrasted with a more targeted surcharge that focuses only on those customers paying with higher-cost credit cards

[303] Mr. Daigle of Shoppers Drug Mart also commented on the commercial practicality of offering discounts for payment other than by credit card in his witness statement, at paragraphs 40 to 42:

> First, Shoppers would be discounting from a "shelf price", whether on a fixed or percentage basis. Shoppers would have to set this shelf price based on an estimate of the mix of payment methods that would be used, which could vary significantly with location and in response to issuer marketing campaigns, prevailing card rewards levels and other factors. The variation in card fees and types means that it would be difficult to establish a standard discount, exacerbated by the fact that a payment card may carry different fees depending on its use, for example, "card present" versus "card not present" transactions.
>
> Second, given the competitive nature of retail sectors in which Shoppers competes, it must be able to advertise the lowest possible prices, not a price that will be further discounted depending on the payment method selected by the customer.
>
> Third, the discount would have to be offered to all customers, including those that otherwise would have paid with cash, Interac debit or lower-cost credit cards. In this regard, Interac debit accounted for about **[CONFIDENTIAL]** of Shoppers' sales in 2011.

[304] The Respondents describe the Merchants' statements that they would have to inflate their base price in order to offer a discount as "ridiculous", arguing that Merchants provide discounts of one form or another all the time (e.g. loyalty programs, coupons, promotions) and that the advertised or base price would presumably also have to be raised to cover their cost. They argue further that Merchants need not and do not confine themselves to advertising a single base price. The Respondents also observe that some Merchants have historically offered discounts for cash and that a number of the Merchant witnesses offer discounts to customers choosing to pay with their co-branded credit cards, that is, to steer their customers toward credit cards rather than away from them.

[305] The Respondents cite the survey conducted by Mr. Gauthier and interpreted by Dr. Mulvey as supporting their assertion that consumers would be more responsive to the offer of a discount for using a lower cost means of payment than they would to the imposition of a surcharge on a higher cost means of payment. This survey asked participants how they would respond to a rebate for paying by means other than a credit card and to a surcharge for paying with a credit card respectively. The Commissioner and her experts are very critical of the methodology employed in the Gauthier survey. The Tribunal finds some of these criticisms telling and, as a consequence, is inclined to put little weight on Mr. Gauthier's findings. The Tribunal was particularly troubled by the lack of context (survey respondents had no idea whether or not other Merchants they might patronize were also surcharging) and the assumption that the discount and surcharge are applied to the same base price.

[306] The Tribunal is persuaded that while the use of discounts to signal consumers as to the relative costs of alternative means of payment has a role to play in some instances, there are both doubts as to its efficacy and significant practical barriers to its widespread use. This leads us to reject the Respondents' argument that Merchants could eliminate the cross-subsidization of their credit card customers using discounts alone.

[307] The Respondents also argue that, as a matter of practice, the elimination of the No-Surcharge Rule would not have the disciplinary effect on their pricing that the Commissioner is claiming for it. The Respondents contest the Commissioner's allegation that Card Acceptance Fees would be lower in the absence of the No-Surcharge Rule. They argue that the Commissioner's submissions rely on factual assumptions that are entirely speculative in nature. More particularly, they argue as follows:

- The evidence does not establish that Merchants would actually surcharge, let alone that surcharging would be widespread;
- The evidence does not establish that there would be an actual or anticipated significant loss of transaction volume on the Respondents' networks so as to provide them with incentive to reduce Interchange or Network Fees;
- The evidence does not establish that they would lower the default Interchange Fees and/or Network Fees in the face of surcharging;
- If Interchange Fees or Network Fees were to be reduced, the evidence does not establish that Acquirers will lower Card Acceptance Fees to their Merchant customers.

[308] Visa argued that it would not necessarily fear a loss in its transaction volume due to surcharging if Cardholders could simply patronize non-surcharging Merchants. This would be the case if surcharging were not widespread. Visa noted that its business continued to grow in Australia despite the introduction of surcharging there. Again noting its Australian experience, Visa argued that surcharging might not induce it to reduce its Interchange Fees. The reason is that since surcharges tend to be well in excess of Card Acceptance Fees, it would have no reason to expect that a reduction in Card Acceptance Fees would result in a lower surcharge.

[309] With respect to the likelihood that, if permitted by the Merchant Rules, Merchants would either surcharge the Respondents' credit cards or could credibly threaten to do so in order to constrain increases in Card Acceptance Fees, Merchant witnesses indicated that they would consider both surcharging and the threat of it. However, some witnesses recognized that the “firstmover” problem (being the first to surcharge) might inhibit the actual implementation of surcharges.

[310] **[CONFIDENTIAL]** stated that **[CONFIDENTIAL]**, without the Merchant Rules, would threaten to surcharge or actually surcharge. **[CONFIDENTIAL]** indicated that **[CONFIDENTIAL]** would also use the absence of the No-Surcharge Rule in negotiations with the Respondents regarding fees. Ms. Li stated that WestJet would seriously consider assessing reasonable user fees for payments made using credit cards. Testimonies of other witnesses were to the same effect.

[311] The Commissioner underlined that according to a recent Australian study, 30% of Merchants surcharged at least one of the credit cards they accepted in December 2010, compared with just over 8 % in June 2007. Surcharging credit cards has been permitted in Australia since 2003. Dr. Frankel opined that it may take some time for surcharging to become widespread.

[312] With respect to the likely effect of surcharging on the Respondents’ transaction volume, the Tribunal finds, first, that the continued growth of Visa’s transaction volume in Australia after surcharging was permitted could have occurred for a variety of reasons such as the growth of on-line shopping. Second, the evidence that while 30% of Australian merchants surcharged at least one credit card, only 5% of transactions were actually surcharged is consistent with substitution by consumers in favour of other means of payment as well as with a shift in patronage toward non-surcharging merchants. Third, in support of his opinion that the relevant product market includes all payment platforms, the Tribunal takes Dr. Elzinga to be implying that a 2% surcharge could result in a significant diversion of transaction volume in favour of alternative means of payment.

[313] The Tribunal finds that if the Merchant Rules permitted it, surcharging would ultimately be sufficiently widespread to make threats to surcharge with concomitant losses in credit card network transaction volume credible.

[314] With respect to the Respondents’ assertion that they would not respond to threats to surcharge or to actual surcharges by lowering default Interchange Fees, this is contradicted by the Respondents’ own documents as well as by Merchant testimony.

[315] In submissions that it made to the Reserve Bank of Australia (“RBA”), MasterCard acknowledged the link between Card Acceptance Fees on one hand and both discounting and either actual or threatened surcharging on the other:

> MasterCard considers that the ability of merchants to discourage card use, by such means as cash discounts and surcharging, should be more than sufficient to avoid excessive interchange fees. Credit card schemes have an interest in avoiding discouragement by merchants, because it lessens card use. It should not, therefore, be surprising that schemes will set interchange fees to dissuade widespread discouragement practices by merchants. A low level of

> discouragement might therefore simply reflect that merchants are not unhappy with their current merchant fees relative to the benefits they obtain from accepting cards. That is simply the nature of bargaining – one does not need to exercise an option for it to have value to the merchant.
> The threat of discouragement has value to the merchant (in restraining merchant fees) as long as it is credible, even if it is not exercised.

[316] In an expert report, prepared for MasterCard and submitted to the RBA, Professor Christian von Weizsäcker made the same points:

> Price competition of payment systems for merchants is enhanced by the fact that surcharges (and cash discounts, etc.) are possible. From the point of view of the payments system, surcharging of the system by many merchants is to be avoided. The attractiveness of cards among cardholders is negatively affected by widespread surcharging… Therefore the risk of increased surcharging after an increase of fees is one of the most powerful forces to keep merchant fees low. We would expect that actual surcharging is rather infrequent because payment systems have a great interest to avoid merchant surcharging of their system. But nevertheless, merchants' right to surcharge imposes substantial downward pressure on merchant fees. The same analysis would apply with respect to discounts for preferred forms of payment like cash.

[317] Ms. Van Impe, the Director of Student Accounts & Treasury at the University of Saskatchewan, stated that the threat to surcharge had a salutary effect on her negotiations with Visa. She described in her witness statement the negotiations that were held between the University, its Acquirer, Moneris, and Visa with respect to the Card Acceptance Fees. At the time, the University was considering imposing an additional fee on credit card transactions to offset the increasing costs of credit card acceptance and she described the negotiations as follows:

> Moneris also arranged a conference call with myself and Chris Renton of Visa Canada on March 22, 2010. During this conference call, Mr. Renton stated that Visa would not allow the University to impose an additional fee for use of a Visa credit card.
>
> Visa's stated position was made publicly known in an article written by Brian Weiner, head of interchange for Visa Canada, to the Saskatoon StarPhoenix newspaper. ….Visa believed that the 1% fee proposed by the University constituted a “surcharge”. According to Visa, a surcharge is a practice whereby an additional fee is levied on purchasers when they pay with a particular card. Surcharging is prohibited by Visa's Merchant Rules. Visa was willing to discuss potential reductions in the Merchant Service Fees charged to the University and offered us a significant reduction in our Merchant Service Fee for large dollar tuition payments in order to offset our desire to impose a 1% administration fee on students who choose to pay with a credit card.

> However, because Visa can increase its fees at any time, the University determined that Visa's proposal would not give the University any control or certainty over its Merchant Service Fees.

[318] In the light of the foregoing, we find that in the absence of the No-Surcharge Rule, either surcharging or the threat of it would steer or threaten to steer credit card network transaction volume to other means of payment and this would either constrain increases or bring about reductions in the Interchange Fees and thus to the Acquirer Fees.

[319] With respect to the Respondents' assertion that any reduction in Acquirer Fees would not necessarily be passed along to Merchants in the form of lower Card Acceptance Fees, the evidence establishes that although they are not contractually obliged to do so, Acquirers would be obliged by competitive forces to pass on changes in Acquirer Fees in the form of commensurate changes in Card Acceptance Fees. The parties, in fact, agreed that the credit card acquiring business is very competitive. Mr. Van Duynhoven described Acquirers as being "fiercely competitive" and "highly competitive" and the Respondent Visa stated, in its closing submissions (at p. 142), that "Acquirers operate in a highly competitive market in which their margins are very small." The Merchants also described the market for Credit Card Acceptance Services as being a very competitive environment for Acquirers.

[320] With respect to the Respondents' line of argument that there is no factual basis for any of the assumptions underlying the Commissioner's theory that the No-Surcharge Rule has had the effect of influencing Card Acceptance Fees upwards, the Tribunal finds that there is evidentiary support for each of the requisite assumptions.

[321] Expressed in terms of the Commissioner's cost-externalization theory, we find that the No-Surcharge Rule effectively constrains Merchants to pass on higher Card Acceptance Fees to all customers, independent of the method of payment used so that an increase in the Card Acceptance Fee does not affect the means of payment chosen by a Merchant's customers. In particular, Cardholders have no reason to reduce the use of their cards in response to an increase in the Card Acceptance Fee. When contemplating an increase in their respective Acquirer Fees, each of the Respondents would be aware that the resulting increase in their Card Acceptance Fees would not affect their Cardholders' decisions to use their cards and that, as a consequence, Merchants would have "little choice" but to continue to accept their cards. The No-Surcharge Rule thus reduces the discipline on the Respondents' pricing that would otherwise come from substitution or threatened substitution in favour of other means of payment and this results in Acquirer Fees (and Card Acceptance Fees) that are higher than would otherwise prevail.

[322] Each Respondent has therefore indirectly influenced upward, through the implementation of the No-Surcharge Rule, the price at which the Acquirers sell Credit Card Network Services to Merchants.

[323] The Commissioner's experts were unable to quantify the extent to which Card Acceptance Fees have been influenced upward by the No-Surcharge Rule. Interchange Fees have risen over time from an average of **[CONFIDENTIAL]** in the nineties to an average of **[CONFIDENTIAL]** for Visa and **[CONFIDENTIAL]** for MasterCard in 2012 according to

Mr. McCormack but the magnitude and causes of this increase are disputed. Attribution of this increase to the No-Surcharge Rule is difficult because it has been in place for a great number of years so that there is no "before and after" benchmark. The Tribunal is of the view that the No-Surcharge Rule has amplified the effect of other developments such as dual issuing and possibly increased single-homing, on Interchange Fees and thus on Card Acceptance Fees. In any event, paragraph 76(1)(*a*)(*i*) requires only a finding that the Respondent has influenced upward the price and we find that this influence to have been more than just *de minimis*.

[324] We now turn to the Honour All Cards Rule in order to determine whether, by implementing the Honour All Cards Rule, each Respondent has indirectly influenced prices upward.

(b) The Honour All Cards Rule

[325] The Commissioner alleges that the Honour All Cards Rule has two main aspects: (i) an "all products" aspect that prohibits a Merchant from accepting some types of Visa or MasterCard credit cards, but not others; and (ii) an "all issuers" aspect that prohibits a Merchant from accepting some credit cards, but not others, based on the identity of the Issuer.

[326] With respect to the first aspect, the Commissioner submits that by eliminating an option for Merchants to selectively accept only some of either Respondent's credit cards, the Honour All Cards Rule allows the Respondents to maintain higher Card Acceptance Fees than they otherwise could. In the absence of the Honour All Cards Rule, Merchants could make separate acceptance decisions with respect to different card types, and selectively refuse, for example, a premium MasterCard credit card carrying a very high Interchange Fee, based on the Merchant's own evaluation of the costs and benefits of accepting those particular cards.

[327] In his report, Dr. Winter discusses the Honour All Cards Rule in connection with his competition suppression mechanism. He states that in the absence of the Honour All Cards Rule, selective refusal to accept certain cards within a brand would be the most important source of competitive discipline:

> 83. The weak remaining source of competitive discipline against high prices under the Merchant Rules, the ability merchants to refuse a credit card, is further diminished by another of the Merchant Rules: the Honour-All-Cards Rule. The anticompetitive impact of the Merchant Rules is strongest for premium credit cards because these cards impose the highest cost on merchants. It is precisely these credit cards for which the option of merchants to decline to accept certain credit cards within a brand would be the most important source of competitive discipline. Under the Honour-All-Cards Rule, merchants cannot selectively decline to accept premium credit cards. Merchants that are forced into a choice of accepting all Visa credit cards or no Visa credit cards, for example, are much less likely to respond to an increase in the Interchange Fee on premium Visa credit cards than if they had the option to drop only premium cards. The cost to a merchant of dropping all Visa credit cards is higher than the cost of dropping only

premium credit cards, making the merchant less responsive to increases in the cost of any one type of credit card.

[328] With regard to the second aspect, the Commissioner submits that eliminating the Honour All Cards Rule would make the development of intra-brand price competition between Issuers possible. If a Merchant could make separate acceptance decisions based on Issuer identity, each Issuer would have an increased incentive to compete with one another over the fees charged to Merchants.

[329] The Respondents submit that the Honour All Cards Rule has a pro-competitive business rationale and that the Commissioner's theory depends on factual assumptions that are entirely speculative. They assert that:

• The evidence does not establish that the refusal of Merchants to accept certain types of credit cards would be widespread or feared by the Respondents to be widespread;
• The evidence does not establish that in the face of those refusals, there would be an actual or anticipated significant loss of transaction volume on the Respondents' networks.
• The Respondents would lower the default Interchange Rates and/or Network Fees as a result; and
• The Acquirers would, in turn, lower Card Acceptance Fees to their customers.

[330] The Respondents also submit that the ability of Merchants to refuse the cards of selected Issuers would make it much more difficult for new Issuers to enter the market.

[331] With respect to the ability of Merchants to discriminate among Issuers, the Commissioner has not defined a market within which the Tribunal could assess the state of competition among Issuers. In any event, there is insufficient evidence to establish that prices of Credit Card Network Services have been influenced upward by each Respondent on the basis that the Honour All Cards Rule has prohibited Merchants from accepting some credit cards, but not others, based on the identity of the Issuer.

[332] With respect to the ability of Merchants to discriminate among types and brands of cards, we must determine the role the Honour All Cards Rule plays in influencing Card Acceptance Fees upwards through both the suppression of competition mechanism and the cost-externalization mechanism.

[333] There is very little evidence before the Tribunal regarding the role that the Honour All Cards Rule might play in facilitating the operation of the cost-externalization mechanism.

[334] Dr. Winter agreed on cross-examination that the Honour All Cards Rule plays only a supporting role in his analysis and that his concerns would be addressed if the No-Surcharge Rule were removed.

[335] Dr. Winter does not mention the Honour All Cards Rule in his explanation of the cost externalization mechanism.

[336] Dr. Frankel states in his report that the Honour All Cards Rule makes demand facing each network less elastic but provides no analysis or other support for this statement. He also states that the elimination of the Honour All Cards Rule would provide Merchants with "another competitive tool" in the form of selective refusal of premium cards.

[337] Evidence regarding the Honour All Cards Rule from Merchant witnesses was largely confined to statements that they would consider declining to accept certain types of credit cards.

[338] Cross-subsidization would appear to continue to exist as long as the credit cards accepted by Merchants are more costly to them than other means of payment. The Tribunal is left to speculate as to how the Respondents might reprice their remaining card offerings given selective refusals to accept their premium cards.

[339] The Tribunal concludes that there is not sufficient evidence to support the argument that by implementing the Honour All Cards Rule the Respondents have influenced Card Acceptance Fees upward via the cost-externalization mechanism.

[340] The possibility remains that the Honour All Cards Rule may have facilitated a suppression of price competition between the Respondents thereby influencing Card Acceptance Fees upward. As stated above, however, the finding of an adverse effect on price competition cannot be used to satisfy both the upward influence requirement under paragraph 76(1)(*a*) and the adverse effect requirement under paragraph76(1)(*b*). Since a finding that the Honour All Cards Rule had an adverse effect on competition between the Respondents would have to do double duty, the Tribunal does not pursue this question further.

(c) The No Discrimination Rule

[341] As explained above, the Commissioner also alleges that MasterCard, by implementing the No-Discrimination Rule, has influenced upwards the price at which Acquirers sell Credit Card Network Services to Merchants. The Visa Regulations do not contain a similar Rule.

[342] While the Commissioner refers briefly to the No-Discrimination Rule in her closing submissions and oral argument, the bulk of her submissions were focused on the No-Surcharge Rule and the Honour All Cards Rule. In her closing submissions, while explicit reference is made to how the latter two allegedly influenced prices upwards, no similar submissions are found for the No-Discrimination Rule. In other paragraphs, the Commissioner refers to the Merchant Rules collectively. In these circumstances, it is difficult for us to reach a conclusion with respect to this issue as there is so little emphasis on this Rule and its effects. Nonetheless, the Tribunal recognizes the logical possibility that MasterCard's No Discrimination Rule could have had an impact on the magnitude of any adverse effect on price competition arising from the implementation of the No-Surcharge Rule. We discuss this matter briefly when drawing our conclusions under paragraph 76(1)(*b*).

(d) Conclusion

[343] We conclude that the criteria under paragraph 76(1)(*a*) have been met with respect to the No-Surcharge Rule. We shall now examine whether the conduct has had, is having or is likely to have an adverse effect on competition in a market.

B. Paragraph 76(1)(*b*)

(1) Position of the Commissioner

[344] As explained above, the Commissioner states that the relevant market for the purpose of assessing the competitive effects of the No-Surcharge Rule consists of general purpose Credit Card Network Services. The Commissioner further states that the evidence before the Tribunal demonstrates that Visa and MasterCard each exercise market power within the relevant market.

[345] As regards to adverse effects, the Commissioner submits that the elimination of the Merchant Rules would unleash competitive forces that have been lacking in the market for Credit Card Network Services for years. She contends that the Merchant Rules have adverse effects on competition by substantially reducing or eliminating the incentives of the Respondents to reduce fees, by distorting the price signals that are provided to customers when electing to use a payment method at the point of sale and by suppressing competition between Visa and MasterCard with respect to those fees.

[346] The Commissioner also argues that the Merchant Rules increase barriers to entry and impede competition from other existing or new payment providers and networks. Through this, the Commissioner argues that the Merchant Rules preserve and enhance the Respondents' market power.

[347] Other arguments put forth by the Commissioner are that the Merchant Rules (1) have harmed consumers including consumers who pay for goods and services using less expensive forms of payment (sometimes referred to as the cross-subsidization theory of harm); (2) have undermined the transparency in the industry and (3) have undermined the ability of Merchants to protect themselves in a meaningful fashion, including by steering consumer effectively towards other lower-cost forms of payment.

[348] The Commissioner also states that the Respondents' purported defences or justifications are irrelevant to the question of whether the Merchant Rules contravene section 76 and are merely self-serving assertions that are unsupported by the evidence and in many cases, are fundamentally at odds with market realities.

(2) Position of the Respondents

[349] The Respondents submit that the Commissioner has failed to establish that the Merchant Rules adversely affect competition in any market. They raise a number of deficiencies in the Commissioner's "adverse effects" analysis including the following:

- The Commissioner's failure to consider the impact of the alleged conduct on all facets of competition (e.g. price, quality, service, consumer choice and innovation).
- The Commissioner's failure to consider the two-sided nature of the market.
- The Commissioner's failure to consider the pro-competitive and efficiency enhancing aspects of the Merchant Rules. They state that the evidence in this proceeding demonstrates that the rules are pro-competitive and efficiency enhancing business practices based on sound economic logic. The Merchant Rules balance the credit card system, protect legitimate franchisor interests and protect the Respondents from reputational damage. It also affirms that no evidence of anti-competitive motive underlying the No-Surcharge Rule or the Honour All Cards Rule has been tendered.
- The Commissioner's suppression of competition theory is dependent on proof, on a balance of probabilities, that several speculative steps will result in lower Card Acceptance Fees. The Respondents state that there are significant deficiencies with each step in the causal chain and as such the Commissioner's suppression of competition theory is unsustainable.
- The Commissioner's cross-subsidization theory has nothing to do with whether there are adverse effects on competition and it is impossible to prove adverse effects under this theory. Further, the Respondents submit that there was no evidence to show that retail prices are higher as a result of the Merchant Rules and, in any event, the retail industry is not a relevant market for purposes of paragraph 76(1)(*b*).

(3) The Meaning of "adverse effect on competition in a market"

[350] The expression "adverse effect on competition in a market" has been interpreted by the Tribunal in the context of paragraph 75(1)(*e*) of the Act in *B-Filer et al. v. The Bank of Nova Scotia*, 2006 Comp. Trib. 42. Paragraph 75(1)(*e*) also requires an adverse effect on competition, but is limited to two time frames. In *B-Filer*, the Tribunal held that the provision requires an assessment of the competitiveness of a market with, and without, the practice, and, more particularly, that the remaining market participants must be placed in a position, as a result of the practice, of created, enhanced or preserved market power:

> Thus, we conclude that paragraph 75(1)(e) of the Act similarly requires an assessment of the competitiveness or likely competitiveness of a market with, and without, the refusal to deal. This raises the question of what is meant by "competitiveness".
> …
> Aside from the jurisprudence cited above, which indicates that a relative assessment of market competitiveness has to do with an assessment of market

> power, and how it may have changed, this is also suggested by the very nature of the various means by which firms compete.
> Adverse effects in a market are generally likely to manifest themselves in the form of an increase in price, the preservation of a price that would otherwise have been lower, a decrease in the quality of products sold in the market (including such product features as warranties, quality of service and product innovation) or a decrease in the variety of products made available to buyers. The question to be answered is whether any of these or other competitive factors can be adversely affected absent an exercise of market power.
>
> Product variety (including variety in terms of differing geographic locations in which the product is sold) in a market characterized by differentiated products is the most obvious potential factor that might be adversely affected in the absence of an exercise of market power. A business' product can be eliminated or made less commonly available through a refusal to deal without the remaining market participants exercising market power. However, in a market that remains competitive subsequent to a refusal to deal, the effect of the disappearance of one firm's product on consumers is negligible. This is the very nature of competitive markets: no single seller has any influence over price or any other factor of competition, including variety. In such a market, one less firm selling a product in a relevant market will either go unnoticed or will allow for a profitable opportunity for entry.
>
> This is similarly the case in regard to the impact of a refusal to deal on price, product quality, and any other factor of competition. Consequently, in our view, for a refusal to deal to have an adverse effect on a market, the remaining market participants must be placed in a position, as result of the refusal, of created, enhanced or preserved market power.

[351] The Tribunal further held that "adverse" is a lower threshold than substantial.

[352] The above approach was confirmed by the Tribunal in *Nadeau Poultry Farm Limited v. Groupe Westco Inc. et al*., 2009 Comp. Trib. 6, aff'd 2011 FCA 188, leave to appeal to SCC refused, 34401 (December 22, 2011).

[353] The Tribunal must thus compare the level of competitiveness of the market in the presence of the conduct with that which would exist in its absence, and then determine whether the effect on competition, if any, is adverse. This comparison must be done with reference to actual effects in the past and present, as well as likely future effects (see *Commissioner of Competition v. Canada Pipe Company Ltd*., 2006 FCA 233, leave to appeal to SCC refused, 31637 (May 10, 2007)).

(4) Analysis

[354] When determining whether the conduct has adversely affected price competition between the Respondents in the market for Credit Card Network Services sold to Acquirers, we recognize that any adverse effect on price competition between the Respondents would involve an upward influence on their respective Acquirer Fees.

[355] According to the Commissioner, the No-Surcharge Rule reduces price competition between Visa and MasterCard in the market for Credit Card Network Services sold to Acquirers by preventing Merchants from playing one credit card network off against the other by surcharging or threatening to surcharge one but not the other (differential or selective surcharging). The Merchant Rules also reduce the incentive of either Visa or MasterCard to seek competitive advantage over the other by offering to discount its Acquirer Fee (which would be passed along by Acquirers in the form of a lower Card Acceptance Fee) in return for either avoiding a Merchant surcharge or securing a reduction in a surcharge already imposed by a Merchant:

> 488. In the "but for world" without the Merchant Restraints, Visa and MasterCard would have a substantially greater incentive than they now do to ensure that Card Acceptance Fees are set at competitive levels. For example, in the absence of the Merchant Restraints, Visa could reduce Interchange Fees to eliminate or reduce the likelihood that merchants would surcharge on Visa credit cards while continuing to surcharge on MasterCard credit cards. As in a normal competitive market, the lower price set by Visa would attract a higher volume of transactions and gain additional market share. Cardholders that held Visa credit cards even before the reduction or removal of the surcharges would respond to the reduced or eliminated surcharges by using those Visa credit cards for more transactions. Other consumers would obtain Visa credit cards, in order to have access to a credit card that attracts lower (or no) surcharges.
>
> 489. These sources of increased demand that result from undercutting higher Card Acceptance Fees would prevent the Respondents from imposing or sustaining supracompetitive Card Acceptance Fees. As Dr. Winter concludes: "[i]n a world with surcharges, the ability to differentially surcharge between Visa and MasterCard credit cards would be a significant source of competitive discipline that would keep Merchant Service Fees at competitive levels".

[356] Dr. Winter provided more detail as to how the elimination of the No-Surcharge Rule would intensify price competition between Visa and MasterCard with respect to the fees they charge to Acquirers in his Expert Report:

> 72. Consider the nature of competition between Visa and MasterCard in a four-party credit card system without the Merchant Rules. In a market without the Merchant Rules, merchants could surcharge on credit card transactions. Visa and MasterCard would be competing in the relevant market on the basis of prices, i.e.,

fees charged to Acquirers (as well as the proportion of the price allocated to Issuers). In the absence of the Merchant Rules, a supra-competitive price by either firm could not be sustained. A supracompetitive price charged by Visa, for example, would give MasterCard an incentive to reduce the fees it charges to Acquirers, in order to undercut Visa's price and thus reduce the likelihood of, or level of, surcharging by merchants. MasterCard's lower Acquirer Fee would be passed on by Acquirers to merchants in the form of lower Merchant Service Fees, given the significant competition between Acquirers. Merchants would, in turn, pass on some or all of the lower Merchant Service Fees in the form of lower prices on MasterCard transactions, either by not surcharging MasterCard credit cards or by applying a lower surcharge on MasterCard credit cards than on Visa credit cards. The lower fee for MasterCard credit card transactions would then attract a greater volume of transactions – a higher market share – from three sources: (a) those consumers who had MasterCard credit cards even before the reduction or removal of surcharges would respond to the reduced surcharges by using their MasterCard credit cards for more transactions. This would be potentially a very strong source of increased market share for MasterCard because the consumer holding multiple credit cards would, at the point of sale, have the opportunity to buy the same product, but at a lower total price.
Approximately one-half of all credit card holders in Canada carry more than one brand of credit card, such as both a Visa and a MasterCard credit card; (b) additional consumers would obtain MasterCard credit cards, attracted by lower surcharges or the absence of surcharges; and (c) some of the merchants that did not accept MasterCard credit cards would begin to accept them, since they would face lower Merchant Service Fees. The merchants would also respond to the fact that MasterCard would be more popular among cardholders (because of the effects described in subparagraphs (a) and (b), above).

73. All of these sources of increased demand that result from undercutting high Acquirer Fees would prevent credit card companies from imposing or sustaining supracompetitive Acquirer Fees in a competitive market for Credit Card Network Services supplied to Acquirers. In a world with surcharges, the ability to differentially surcharge between Visa and MasterCard credit cards would be a significant source of competitive discipline that would keep Merchant Service Fees at competitive levels.

[357] In his testimony, Dr. Carlton traced the effect of the No-Surcharge Rule on competition between Visa and MasterCard as follows:

So in the context of credit cards, let's suppose Visa wanted to stimulate the usage of Visa cards and it cuts the service fee. Well, it cuts the service fee, that will lead to lower merchant fee, if we're using Visa cards. Well, maybe that means the merchant wants to say to a customer, Gee, I would like you to use your Visa card, not your MasterCard, because now Visa is real cheap for me to use.
The merchant can't do that with the no- surcharge rule. So it diminishes the incentive of Visa to cut price. So what the no-surcharge rule is doing is

> diminishing the incentive to compete between Visa and MasterCard on service fees and interchange.

[358] In his report, Dr. Frankel also explained how selective surcharging could stimulate inter-brand competition if it were permitted:

> 131. Because higher fees lead to more surcharging (and at higher amounts)– when surcharging is permitted – and because more surcharging leads to less usage of the surcharged cards, the credit card networks have a strong economic incentive to keep fees lower when merchants can surcharge than when they cannot. This is why they have a correspondingly strong economic incentive to enforce no-surcharge rules.
> […]
> 139. In short, the credit card networks and their consultants have repeatedly acknowledged the economic reality that merchant surcharging intensified competition over the level of interchange fees – the largest component of Card Acceptance Fees. <u>The competitive logic is straightforward: as Card Acceptance Fees for a brand or a particular set of a brand's cards increases, merchants will have an increased incentive to surcharge the cards, and at higher rates for more costly cards.</u> Evidence confirms that this in fact occurs. Consumers confronted by surcharges – and differential surcharges – at the point of sale will have an economic incentive to reduce their use of surcharged cards or cards carrying the highest surcharges. Again, evidence confirms that this occurs.
>
> 140. Finally, card networks confronted by reduced usage of their branded cards due to surcharging induced by high Card Acceptance Fees for their brand will have an economic incentive to reduce those fees that does not exist in the presence of no-surcharge rules. Once again, evidence confirms this effect.
>
> [emphasis added]

[359] The Respondents dispute the Commissioner's contention that the Merchant Rules adversely affect competition fundamentally on the grounds that she ignores one side of the platform. The Respondents also argue that even if the Commissioner's competition suppression theory were correct, its effect in the market for Credit Card Network Services sold to Acquirers would be undone by competition in the market for credit card network services sold to Issuers where the Merchant Rules don't apply.

[360] For reasons given above, the Tribunal accepts the Commissioner's position that the relevant product market is the supply of Credit Card Network Services to Acquirers and that the Respondents have each market power in this market. It remains to be determined whether the No-Surcharge Rule has either preserved or enhanced this market power. In this regard, the Tribunal does not view the possibility that the Merchant Rules may have affected competition in other, undefined markets as a relevant consideration.

[361] Accepting the Commissioner's market definition for purposes of argument, the Respondents maintain: (1) that for a variety of reasons, the No-Surcharge Rule is generally pro-competitive in intent and effect; (2) that the Commissioner's case is about bilateral bargaining between Merchants and card networks rather than about competition; and (3) that the evidence does not support the series of assumptions underlying the Commissioner's contention that there would have been more price competition in the relevant market in the absence of the No-Surcharge Rule.

[362] While we have serious doubts about the appropriateness of considering all of these allegations under paragraph 76(1)(*b*), as opposed to considering them as relevant factors when exercising our discretion in determining whether an order should issue, we will assume for the purposes of this decision that they can be considered as part of the adverse-effect-analysis.

Pro-competitive rationale

[363] The Respondents cite the expert reports of Dr. Elzinga and Dr. Church to the effect that the Merchant Rules have an efficiency-enhancing, pro-competitive business rationale. Dr. Elzinga calls them "cardholder assurances". They are intended to prevent merchant hold-up and free-riding:

> Merchants (especially those that do not expect repeat business) have an incentive to engage in hold up, i.e., add a surcharge, after the consumer has taken steps to acquire the product or service in question. This type of conduct creates an inherent incentive to free ride on the investments made by the card network and other merchants that abide by the Visa Rules and do not surcharge: the free riding occurs because the merchants who engage in hold up benefit from the increase in system demand that emanates from the expectation that all forms of payment will be accepted and that cardholders will not be surcharged. The free riding merchant is able to increase its profits by switching the customer to a less costly form of payment or by adding a surcharge.

[364] The Respondents further argue that no evidence has been found in any of the documents they were obliged to produce that the Merchant Rules were intended to prevent or reduce competition between them. Moreover, the Respondent Visa observes that the Merchant Rules have been in place for more than thirty years thus stemming from a period well before Visa was alleged to have market power. As well, smaller competing payment platforms with no market power currently apply rules similar to the Merchant Rules.

[365] The Commissioner counters that the consumer protection justification for the Merchant Rules is a mere pretext. Among the Commissioner's arguments are, first, that a surcharge is not a hold-up if consumers are informed of it in advance. Second, concern over acquiring a reputation for opportunistic behaviour should deter Merchants from hold-ups in the form of surprise or excessive surcharges much as it deters hold-up strategies with respect to other services such as parking. Third, initial surprise over being surcharged should decline as surcharging becomes more common. Fourth, the discipline of reputation effects could be supplemented by a requirement for proper disclosure of surcharges as is the Respondents' apparent practice in

Australia and New Zealand. Fifth, the Respondents have adduced no evidence of bait and switch or other misleading tactics among Merchants charging convenience fees in jurisdictions where they are allowed.

[366] The Tribunal agrees with the Commissioner that a surcharge (or a refusal to accept a card) does not formally qualify as a hold-up if Cardholders are properly informed of it in advance. The Tribunal also accepts that reputation effects and contractual requirements to disclose card surcharges and acceptance policies can diminish the incidence of surprise surcharges or refusals to accept a card. We are also of the view that conduct that is pro-competitive under one set of market circumstances can be anti-competitive under another.

[367] The Respondents extend their consumer protection justification of the No-Surcharge Rule to the prevention of excessive surcharging by Merchants. They cite concerns in both Australia and the United Kingdom over surcharges that are apparently well in excess of merchants' costs of card acceptance. The Commissioner argues that the Respondents have not established either that a substantial fraction of the "merchant sector" possesses market power or that allowing Merchants to surcharge bestows market power on them. Rather, surcharging is the normal passing on of the cost of a service (means of payment) a customer has selected.

[368] It is the Tribunal's understanding that while permitting a Merchant to surcharge does not bestow market power on that Merchant, it does open another margin on which a Merchant with market power could extract profits. This is confirmed by Dr. Church in his response to a question from the Tribunal:

> **JUSTICE PHELAN**: Okay. How does the no-surcharge rule change things? If they've got market power now, they would presumably be extracting the maximum that they can. And so if you impose a surcharge on them, are you just changing the way in which they maximize?
> **PROFESSOR CHURCH**: No, because you're giving -- so consumers have a demand curve for card usage, and it allows surcharges. Then it allows for the merchants to exercise their market power, if they have any, on that demand curve; whereas, if you ban surcharges, then they can't do it.

[369] The Commissioner argues that estimates of the magnitude of excess surcharges in Australia may be overstated. The Commissioner states the East & Partners study of surcharging in Australia is not an "apples to apples" comparison in that it compares the surcharges of merchants who surcharge with the average Card Acceptance Fee. If merchants who surcharge pay a higher than average Card Acceptance Fee then the excess surcharge estimate is too high. The Commissioner does not present any further evidence on this matter and no one who was directly involved in estimating the extent and magnitude of surcharging in Australia gave evidence before the Tribunal. All that can be said is that the magnitude of excess surcharges in Australia is in dispute.

[370] As we have stated above, the parties have not established that "merchants" is a market within which the extent of market power can be assessed. The statements of Merchant witnesses that they face intense competition are not sufficient in this regard. For this reason, the Tribunal has no basis for assessing the weight, if any, to attach to assertions by the Respondents that the

No-Surcharge Rule is pro-competitive in the sense that it is intended to protect Cardholders from excessive surcharges. What is apparent and what the Tribunal will revisit in its discussion of the exercise of its discretion is that allegations of excessive surcharging appear to constitute significant concerns for public policy in Australia and the United Kingdom.

[371] The Respondents argue that the Merchant Rules are pro-competitive in effect in that they have increased output in the relevant market. Dr. Elzinga observes that a "necessary corollary of card acceptance fees that are too high, as the Commissioner alleges, is that transaction volume in the networks must be too low. Anticompetitive conduct in any market, whether real or hypothetical, always results in output being restricted."

[372] Dr. Elzinga examined a number of measures of the volume of credit card transactions. Dr. Elzinga's evidence is that both Visa and MasterCard dollar transaction volume as a percentage of personal consumption expenditure increased over the period 2003-2010 although they both declined over the period 2008-2009. The number of Merchants accepting Visa and MasterCard declined between 2003 and 2004, grew steadily between 2004 and 2009 and appeared to level off between 2009 and 2010. While he concedes that there could be other factors influencing the volume of credit card transactions, Dr. Elzinga concludes that the evidence shows no sign of output restriction, rather "the economic track record is one of increasing output."

[373] The Tribunal agrees that supra-competitive pricing and output restriction go hand-in-hand although if demand is inelastic the output restriction involved could be quite small. The Tribunal is also of the view, however, that the observed growth in the use of credit cards could have occurred for a variety of reasons and does not, by itself, imply that the Merchant Rules have not had an output-restricting effect. The observation that demand in a market has grown over time need not say anything about the presence or absence of market power or about whether the price in the relevant market is above the competitive level or not. The presence of market power implies that the market price is higher and the demand is lower than it would be under competitive conditions at any point in time. It does not imply that demand is not growing. The demand for Credit Card Network Services could have increased (shifted outward) for a variety of reasons such as increased on-line shopping or increased use of electronic payment in parking lots or vending machines or general changes in preferences regarding carrying cash (loonies and toonies) or writing cheques.

[374] The Merchant Rules may also have contributed to the observed increase in demand for Credit Card Network Services. Indeed, it is hard to imagine that either network would have agreed to set higher default Interchange Fees unless it anticipated that this would increase network volume. To the extent that they have resulted in higher Interchange Fees than would otherwise have prevailed, the Merchant Rules may have provided Issuers with both the means and incentive to promote card use more heavily. In the Tribunal's view, this should not be interpreted as an offsetting pro-competitive effect of the No-Surcharge Rule. The softening of price competition between the Respondents is a reduction in inter-brand competition in the relevant market. It is not a defence for conduct that lessens inter-brand competition that it also provides an incentive for additional promotion of market demand.

The Commissioner seeks to increase the bargaining leverage of individual Merchants rather than increase competition between Visa and MasterCard

[375] The Respondents argue that the Commissioner's case is more about increasing the bargaining leverage that individual Merchants have over Visa and MasterCard than it is about competition between Visa and MasterCard. They submit that rebalancing the respective negotiating positions of two individual entities is not the aim of the *Competition Act*.

[376] The Tribunal observes that it is not being asked to intervene in negotiations between two entities. The Order that is being sought by the Commissioner would apply to all transactions in the market for Credit Card Network Services sold to Acquirers. The Tribunal also observes that any increase in competition among sellers increases the leverage of buyers in the sense that they have better alternatives and are able to get a better deal whether this involves formal negotiation or not. The remedy sought by the Commissioner can be viewed both as enabling Merchants to induce the Respondents to compete more intensively on price and as increasing the incentive of the Respondents to compete more intensively on price.

The evidence does not support the Commissioner's theory that price competition between the Respondents would have been more intense absent the No-Surcharge Rule.

[377] The Respondents submit that Dr. Winter's suppression of competition theory relies on the following factual assumptions which have not been established (the gist of their submissions follows the factual assumption):

- Removing the Merchant Rules will lead to Merchants sending "price (payment cost) signals" to customers via surcharges.
  - Other price signals, such as discounting, disclosing card acceptance information to the public, refusing to accept Visa or MasterCard credit cards, exist.
- This surcharging would be widespread, or threat of it being widespread would be sufficient to accomplish the same objective.
  - There is no evidence in this regard. Several witnesses discussed the "first mover" problem (i.e. if they were the first to surcharge, they would risk losing sales to a competitor who did not surcharge) and the Respondents are of the view that most Merchants would not surcharge.
- This widespread surcharging will be precise enough for customers to distinguish between Card Acceptance Fees associated with Visa and MasterCard (along with other credit networks, cash and debit) as well as between Card Acceptance Fees associated with standard and premium credit cards.
  - There is no evidence in this regard. Rather, the evidence is that, where surcharging is permitted, Merchants are more likely to engage in blended surcharging and/or excessive surcharging.
- This accurate and widespread surcharging or discrimination (or the threat thereof) will lead to a significant reduction in cardholder usage of the relevant brand of card and will lead to fewer Canadians enrolling for membership of the relevant brand of card, i.e. lower transaction volume.

- The evidence from Australia does not suggest that surcharging is likely to lead to lower volume on a network that is surcharged; in fact, quite the opposite. There are various other outcomes when a customer is faced with a surcharge (e.g. he may proceed with the purchase, may go to another store that does not surcharge).

- In the face of this reduced cardholder usage and enrolment, Visa and MasterCard would each lower default (or specific) interchange rates and/or Network Fees in order to stem the tide of the volume losses on their network or out of fear of significant volume losses on their network.
  - The Respondents are not likely to lower Interchange Fees or Network Fees in response to surcharging.
- This lowering of default interchange rates or Network Fees would be passed on to Merchants by Acquirers in the form of lower Card Acceptance Fees rather than being retained by Acquirers.
  - There is no evidence to substantiate this assertion. The Merchant Rules do not require Acquirers to pass on reductions to Merchants and no Acquirer has testified that all savings in Acquirers' costs would be passed on to Merchants.
- These lower Card Acceptance Fees would be passed on to consumers in the form of lower prices at retail rather than being retained by Merchants.
  - There is no evidence to substantiate this assertion.

[378] Some aspects of the Respondents' line of argument regarding the absence of evidence to support the Commissioner's theory of the case have already been addressed in connection with the Tribunal's assessment of the Commissioner's theory that the No-Surcharge Rule has had the effect of influencing Card Acceptance Fees upward via the cost-externalization mechanism. There are, however, some aspects of the Respondents' arguments that are specific to the Commissioner's suppression of competition theory and these are dealt with below.

[379] With respect to the argument that the Merchant Rules permit Merchants to use selective discounting or the threat of it (rather than surcharges) to stimulate price competition between the Respondents, the Tribunal agrees that in theory, Merchants could seek a discount from either Visa or MasterCard in return for passing this discount on to customers who pay with the card of the network offering the discount. The Commissioner counters that offering discounts for payment by a type or brand of credit card or for alternative modes of payment is impractical for Merchants and would in any event not be as effective in steering consumers as surcharging. The Tribunal agrees that in practice, the ability of Merchants to offer discounts for payment by lower cost types or brands of credit cards has not been sufficient to mitigate the adverse effect of the No-Surcharge Rule on competition in the relevant market.

[380] With respect to the question of whether Merchants would surcharge or could credibly threaten to do so, the Tribunal found above that over time surcharging would become sufficiently widespread that the threat of it would be credible. More relevant to the suppression of competition theory is the question of whether Merchants would engage in the type of selective (brand and card type specific) surcharging that would be required to play one of the Respondents off against the other. In this regard, the Respondents observe that, as implemented in Australia, surcharges do not differentiate between types of credit cards (they are called blended surcharges) or between the Visa and MasterCard brands.

[381] The Tribunal agrees that the Commissioner's suppression of competition mechanism relies on selective surcharging to stimulate price competition in the relevant market and on its absence under the No-Surcharge Rule to inhibit it. While recognizing the apparent prevalence of blended surcharging in Australia, the Tribunal also notes the differential surcharging of Amex cards in Australia as well as the statements of Merchant witnesses that see selective surcharging as a plausible business strategy.

[382] Mr. Symons of IKEA testified as follows in that regard:

> Similarly, selectively surcharging one credit card networks' products, such as imposing a surcharge on Visa credit cards but not on MasterCard credit cards, will create a significant incentive for that network to compete through reduced Card Acceptance Fees and improved service.

[383] **[CONFIDENTIAL]** gave similar statements.

[384] It would appear to be in the self-interest of Merchants to make what use they can of both actual and threatened differential surcharging to obtain lower Card Acceptance Fees.

[385] With respect to the question of whether actual or threatened selective surcharging of one brand of credit card would result in an actual or threatened loss of transaction volume of the credit card network concerned, the Tribunal found above that surcharging would result in a shift of transaction volume toward non-surcharged means of payment. This would include a shift toward brands or types of credit cards not subject to surcharge.

[386] With respect to the question of whether an actual or threatened loss of transaction volume would either constrain increases or induce reductions in the Acquirer Fees of the credit card network concerned, the Tribunal found above that a response of this nature would likely occur. As well, one interpretation of Amex' reduction of its card acceptance fees in Australia is that this was a response to the differential surcharges imposed by merchants on its cardholders.

[387] With respect to the questions of whether reductions in Acquirer Fees would be passed onto Merchants and whether reductions in Card Acceptance Fees would be passed on to consumers, the Tribunal found above that reductions in Acquirer Fees would be passed along in the form of lower Card Acceptance Fees. Section 76 does not require a finding that reductions in Card Acceptance Fees would ultimately be passed along to consumers by Merchants in the form of lower prices.

[388] In conclusion, the Tribunal is not persuaded by the Respondents' line of argument that there is no evidence to support the assumptions underlying the Commissioner's proposition that the conduct of each Respondent has had an adverse effect on competition in the relevant market. The evidence does, in fact, support the Commissioner's allegation that the No-Surcharge Rule has had the effect of suppressing price competition between the Respondents in the market for Credit Card Network Services sold to Acquirers.

[389] The Tribunal has concluded that each of the Respondents has enjoyed and continues to enjoy market power in the market for Credit Card Network Services. We have also found that the No-Surcharge Rule has inhibited price competition in this market and that this constitutes an enhancement of the market power. More particularly, referring to the three timeframes found in paragraph 76(1)(*b*) and assessing the market with and without the conduct at issue for these timeframes, we find that there has been an adverse effect on competition in the market for Credit Card Network Services in the past, present and that it is likely to occur in the future.

[390] Before turning to the Tribunal's overall conclusion, a few words need to be said about the interplay between the No-Surcharge Rule and the No-Discrimination Rule. As explained above, the Commissioner examined the Merchant Rules mostly collectively and no exhaustive analysis was performed with respect to each separate Rule and its effect on the other Rules. While no explicit argument was made to the effect, an argument could have been made that in the but-for-world which would have existed in the absence of the No-Surcharge Rule, Merchants could have threatened to only surcharge Visa credit cards but could not have threatened to surcharge only MasterCard credit cards because of MasterCard's No-Discrimination Rule. However, no evidence was adduced with respect to this issue. In our view, even if Merchants would have faced obstacles in threatening to selectively surcharge MasterCard credit cards, our above conclusion regarding an adverse effect on competition would remain unchanged.

C. Conclusion

[391] We engaged in the above analysis in the event that we are wrong in our conclusions with respect to the legal interpretation of section 76 or in our finding that the requirement of a resale has not been met. Under this alternative analysis, we find that each Respondent has indirectly (by contractually implementing the No-Surcharge Rule) influenced upward the price at which Acquirers supply or offer to supply Credit Card Network Services within Canada and that this conduct has had, is having and is likely to have an adverse effect on competition in the market of Credit Card Network Services.

[392] However, even under this alternative scenario, an order under section 76 would not have issued because we would have been of the view that this is not a proper case to exercise our discretion.

VIII. EXERCISE OF DISCRETION

[393] The relief set out in section 76 of the Act is discretionary in nature and the Respondents as well as the TD Bank submit that even if all the elements in subsection 76(1) have been met, the Tribunal should not grant the relief sought by the Commissioner. In that regard, they submit that the Tribunal should consider the following factors :

- An Order granting the relief sought will call for ongoing supervision and enforcement and the Tribunal has already stated that such ongoing supervision is not desirable;
- Merchants will likely levy surcharges in excess of their costs of acceptance (excessive surcharging), with the true intention of earning additional profit rather than steering Cardholders to alternative forms of payment. Surcharging will give Merchants a new profit centre to exploit;
- If the Order sought is granted, competing networks such as Amex will obtain an unfair competitive advantage and will increase their market share;
- If surcharging is allowed, the technological obstacles to differential surcharging will result in blended rates being employed;
- Merchants currently have the right to steer to forms of payment other than credit cards, including the right to provide discounts;
- The regulatory intervention which has occurred so far through the Code of Conduct, should be allowed to take effect before further intervention is contemplated – the Commissioner’s application is premature;
- Merchants do not intend to actually surcharge – they are really asking the Tribunal to provide them with negotiating leverage. Where the beneficiaries of the discretionary order do not even intend to exercise the powers that would be granted to them, this should militate against the issuance of that order;
- The Order sought has the potential to reduce credit card transaction volumes – the Tribunal cannot ignore the tangible economic detriment likely to be the result for the Canadian economy; and
- The Order sought will lead to an adverse effect on competition (e.g., the order sought would make the payment system less competitive and less efficient and it would decrease output, eliminating the Honour All Cards Rules would undermine the foundation of the credit card networks).

[394] We are unanimously of the view that even if the requirements under section 76 had been met, this is not a proper case to grant discretionary relief. Given the evidence adduced, it is clear that the proper solution to the legitimate concerns raised by the Commissioner of Competition is going to require a regulatory framework. We are typically reluctant to decline to exercise our discretion in favour of regulation as we agree that generally speaking even very imperfect competition is preferable to regulation.

[395] However, this is an exceptional case and we are convinced that it makes more sense to begin with a regulatory approach rather than to back into it. A section 76 Order would be a blunt instrument and there will be technical hitches, unforeseen consequences, a need for ongoing adjustment and stakeholder consultation. The experience in other jurisdictions such as Australia and the United Kingdom shows that concerns will be raised by consumers regarding surcharging and possible gouging, and rather sooner than later, intervention will have to take place by way of regulation.

[396] The “but for” world that the Commissioner postulates does not take sufficient account of the negative competition impacts or the effects on customers. It does not address the negative experiences of other countries. The order sought would apply to a broad swath of the Canadian economy which the Commissioner categorizes as “the merchant sector” and simply assumes to be uniformly competitive. To the extent that markets within "the merchant sector" depart from this assumption, the order sought by the Commissioner risks replacing one set of distorted incentives by another.

[397] The powers of the Tribunal to effectively fashion a remedy are limited. Ongoing monitoring and enforcement are impossible. The "merchants" are not before the Tribunal, so the effectiveness of the remedy or the necessary safeguards cannot be assured.

[398] The Tribunal is mindful that a change in one part of the credit card system is likely to have consequences in other parts, such as cardholder fees and benefits while price reductions to consumers may be undetectable. The law of unintended consequences is likely to be a significant force. It is uncertain that the supposed "cure" will not be worse than the "disease".

[399] The credit card environment still is marked by significant competition and increasing supply – an unusual circumstance in anti-competitive scenarios.

[400] We further note that the exercise of our discretion is encumbered by our finding that the Commissioner has failed to establish that MasterCard has engaged in price maintenance through the implementation of the No-Discrimination Rule. This would mean that Merchants may have difficulties differentially surcharging MasterCard credit cards even in the absence of the No-Surcharge Rule.

[401] With all the uncertainties and infirmities of the Commissioner's case, the proposed remedy is not an attractive one absent some form of regulatory supervision, of which there is some but which, for policy choices, did not deal with the issues in this case.

IX. COSTS

[402] The Tribunal may award costs in accordance with the provisions governing costs in the *Federal Courts Rules*, 1998 (see: s. 8.1 of the *Competition Tribunal Act*, R.S.C. 1985, c. 19 (2nd Supp.)). Costs are sought by the Respondents and the TD Bank.

[403] The Tribunal has full discretionary power over the amount and allocation of costs under Rule 400. Rule 407 provides that unless the Tribunal provides otherwise, party-and-party costs shall be assessed in accordance with column III of the table to Tariff B. As stated in *B-Filer et al. v. The Bank of Nova Scotia*, 2007 Comp. Trib. 26, the Tribunal has followed the jurisprudence to the effect that there must be sound reasons to depart from Rule 407.

[404] We are of the view that sound reasons exist to depart from Rule 407.

[405] In considering costs, the Tribunal observes that this is a case of mixed result (in the alternative findings). The case is novel and does not mirror the legal basis on which similar cases proceeded in other jurisdictions as Canadian law is different from that of the other jurisdictions. Novelty is not necessarily a bad thing.

[406] The Commissioner advanced a case which should be brought; even if she was not entirely successful. Competition law in Canada will not advance if a Commissioner is afraid to lose cases which ought to be brought. The courage to advance these cases is in the public interest. Gaps in our laws and policy will not be identified or remedied. Canadian competition law will develop more opaquely behind the scenes.

[407] There is a broad public interest in bringing this case. It is even so for the Respondents as it may add some certainty to their position. The public debate on the issues in this case and more broadly are enhanced by this proceeding.

[408] Therefore the Tribunal will make no award of costs.

THEREFORE, THE TRIBUNAL ORDERS THAT:

[409] The Commissioner's application for an order pursuant to section 76 is dismissed without costs.

DATED at Ottawa, this 23rd day of July, 2013.

SIGNED on behalf of the Tribunal by the panel members.

(s) Michael L. Phelan

(s) Wiktor Askanas

(s) Keith L. Montgomery

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[1] We note that where the words "Tribunal" or "we" are used and the decision relates to a matter of law alone, that decision has been made solely by the presiding judicial member.

[2] Although they conduct their hypothetical monopolist tests at a different stage in the vertical chain, both Dr. Carlton and Dr. Frankel also suggest assuming that the SSNIP is due to an increase in the Acquirer Network Fee.

[3] In the case of a linear demand schedule, this formula can be written as BECSL = (SSNIP)/(SSNIP + MARGIN). It can be found in Jeffrey Church and Roger Ware, *Industrial Organization: A Strategic Approach* (New York: Irwin McGraw Hill, 2000), at p.609.

[4] In the case of linear demand, the critical sales loss (CSL) can be written as CSL = SSNIP/(2xSSNIP + MARGIN). It can be found in Jeffrey Church and Roger Ware, *Industrial Organization: A Strategic Approach* (New York: Irwin McGraw Hill, 2000) , at p.608.

[5] Using Dr. Winter's approach CSL = SSNIP/(2xSSNIP + MARGIN) = **[CONFIDENTIAL]**. Using Dr. Church's approach, CSL = **[CONFIDENTIAL]**.

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