Public version

CT-2010-010

THE COMPETITION TRIBUNAL

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.

BETWEEN:

THE COMMISSIONER OF COMPETITION

Applicant

- and -

VISA CANADA CORPORATION and MASTERCARD INTERNATIONAL INCORPORATED

Respondents

- and -

THE TORONTO-DOMINION BANK and CANADIAN BANKERS ASSOCIATION

Intervenors

CLOSING ARGUMENT OF THE INTERVENOR, CANADIAN BANKERS ASSOCIATION

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A. Overview

1. The Canadian Bankers Association ("CBA") was granted leave to intervene in this proceeding to address "[t]he Issuer's perspective on the role of Card Acceptance Fees" and "[t]he impact of the Proposed Order on Issuers and Acquirers."[1]

2. The CBA is the national voice of the Canadian banking industry. It brings the unique perspective of the Canadian banks (large and small) in their capacities as the principal customers of the Respondents and the principal Issuers of credit cards in Canada. The Commissioner has stated that the Proposed Order she seeks in this case would impact some 20 million Canadians who hold Visa or MasterCard credit cards.[2] The vast majority of these Canadian cardholders are customers of Canada's banks. As Issuers derive their revenue exclusively from cardholders, any impact of the Commissioner's Proposed Order on cardholders will necessarily have a substantial impact on Issuers.

3. The CBA called two witnesses in this proceeding: Mr. Robert Livingston, President of Capital One Bank (Canada Branch) ("Capital One Canada") and Ms Karen Leggett, Executive Vice President, Marketing, National Bank of Canada (formerly Senior Vice President, Cards and Payment Solutions, Royal Bank of Canada).

4. Mr. Livingston is responsible for the strategic guidance of Capital One Canada's credit card business, its operations, and everything customer-facing and market-facing.[3] Mr. Livingston testified that eliminating the Honour All Cards Rule would substantially harm Issuers by: (i) reducing competition among Issuers, with smaller Issuers and Issuers without strong brand recognition in Canada being placed at a competitive disadvantage relative to larger Issuers and Issuers with strong brand recognition; (ii) reducing Issuers' ability and incentive to offer a broad range of credit card options to cardholders; and (iii) causing cardholder frustration, embarrassment, and inconvenience at the point of sale.

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1 *The Commissioner of Competition v. Visa Canada Corporation and MasterCard International Incorporated*, 2011 Comp. Trib 2, ¶51 ("Intervention Reasons").

2 *Id.*, ¶31.

3 Livingston Evidence, Hearing Transcript, volume 15 (Public), p. 2528.

5. Ms Leggett is currently responsible for National Bank's credit card portfolio[4] and, until recently, headed up Royal Bank's credit card business and served as Chair of the Board of Moneris Solutions Corporation, an Acquirer jointly owned by the Royal Bank of Canada and the Bank of Montreal.[5]

6. Ms Leggett testified that: (i) assuming surcharging becomes widespread and has the effects contended by the Commissioner, eliminating the No Surcharge Rule would harm Issuers by reducing credit card benefits, rewards, and overall credit card usage, but at the same time, would create a new profit centre for merchants; and (ii) eliminating the Honour All Cards Rule would harm Issuers by undermining the core value proposition of credit cards – namely, their ubiquity and certainty of acceptance.

7. The CBA submits that the Visa and MasterCard credit card networks are complex, competitive ecosystems involving cardholders, merchants, Acquirers, Issuers, and the networks themselves. Changes to this system can have unintended, adverse consequences, just as they did in Australia in 2003 following the Reserve Bank of Australia's regulatory intervention in the marketplace by capping interchange and eliminating the No Surcharge Rule. In Canada, following extensive and lengthy consultation and Parliamentary hearings involving merchants, the networks, Issuers, and Acquirers, the Minister of Finance very carefully considered whether to eliminate the No Surcharge Rule and, in 2010, expressly decided not to do so. Instead, the Minister of Finance expressly affirmed the powerful right of merchants to discount for cash and other payment methods – which the Minister himself recently confirmed is "the best of all reward programs."

8. For these reasons, and the reasons elaborated below, the CBA respectfully submits that the Tribunal should be cautious in accepting the Commissioner's invitation to stretch the law of price maintenance in an unprecedented fashion. This Application should be dismissed.

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4 Leggett Evidence, Hearing Transcript, volume 16 (Public), pp. 2583-2584.

5 *Id.,* p. 2584.

B. The CBA

9. The CBA is the national voice of the Canadian banking industry. Its members are 53 domestic chartered banks, subsidiaries of foreign banks, and foreign bank branches operating in Canada. The CBA deals with matters of concern to the banking industry as a whole. Its main activities are in the fields of legislation, education, publications, public relations, and information.[6] The CBA's members are listed in Schedules I, II, and III to the *Bank Act*,[7] and currently include the following 53 banks:

Schedule I banks (Domestic chartered banks)	**Schedule II banks** (Foreign bank subsidiaries)	**Schedule III banks** (Foreign bank branches)
Bank of Montreal Bank West Bridgewater Bank Canadian Imperial Bank of Commerce Canadian Tire Bank Canadian Western Bank Citizens Bank of Canada Dundee Bank of Canada Laurentian Bank of Canada Manulife Bank of Canada National Bank of Canada The Bank of Nova Scotia Pacific & Western Bank of Canada President's Choice Bank Royal Bank of Canada The Toronto-Dominion Bank	Amex Bank of Canada Bank of America Canada Bank of China (Canada) Bank of Tokyo-Mitsubishi UFJ (Canada) BNP Paribas (Canada) Citibank Canada Habib Canadian Bank HSBC Bank Canada ICICI Bank Canada Industrial and Commercial Bank of China (Canada) ING Bank of Canada J.P. Morgan Bank Canada Korea Exchange Bank of Canada Mega International Commercial Bank (Canada) Société Général (Canada) State Bank of India (Canada) Sumitomo Mitsui Banking Corporation of Canada The Royal Bank of Scotland (Can.) UBS Bank (Canada) Walmart Canada Bank	Bank of America, National Association The Bank of New York Mellon Barclays Bank PLC Capital One Bank (Canada Branch) Citibank, N.A. Comerica Bank Credit Suisse AG Deutsche Bank A.G. HSBC Bank USA, N.A. JPMorgan Chase Bank, National Association Maple Bank GmbH Mizuho Corporate Bank Ltd. Société Général (Canada Branch) The Royal Bank of Scotland, N.V. State Street Bank and Trust UBS AG PNC Bank, National Association

10. As can be seen, the CBA's member banks include the largest banks in Canada, as well as the smallest banks in Canada, and everything in between. Among the CBA's members are:

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6 *The Commissioner of Competition v. Visa Canada Corporation and MasterCard International Incorporated*, 2011 Comp. Trib. 2 ("Intervention Reasons"), ¶8.

7 S.C. 1991, as amended.

- 16 domestic chartered banks (Schedule I banks), including the "big 5" domestic banks (Royal Bank of Canada, Toronto-Dominion Bank, Bank of Nova Scotia, Bank of Montreal, and Canadian Imperial Bank of Commerce), as well as smaller domestic banks such as Canadian Tire Bank and President's Choice Bank.

- 20 foreign bank subsidiaries (Schedule II banks), such as Amex Bank of Canada, Citibank Canada, and Walmart Canada Bank.

- 17 foreign bank branches operating in Canada (Schedule III banks), such as Barclays Bank, Credit Suisse, and Capital One Bank (Canada Branch).

C. The CBA's Intervention in this Proceeding

11. The CBA has intervened in this case to speak not just for Canada's big banks, but also for Canada's smaller banks – it speaks for the Canadian banking industry as a whole.

12. The Commissioner has acknowledged that her Proposed Order would impact the 670,000 merchants who accept credit cards in Canada and the 20 million Canadians who hold such credit cards.[8] The vast majority of these Canadian credit cardholders are customers of Canada's banks – they hold Visa or MasterCards issued by Canada's banks, and many of them also have broader banking relationships with Canada's banks. As Madam Justice Simpson found, these relationships with the banks' cardholders would be directly impacted if the Commissioner's Proposed Order were granted.[9]

13. Madam Justice Simpson allowed the CBA to intervene over the Commissioner's strenuous objections. She said that she was "satisfied" that many of the CBA member banks are directly affected by the Commissioner's Proposed Order.[10] She also accepted the CBA's evidence that if the Tribunal grants the Commissioner's Proposed Order, so that merchants could refuse to honour all cards and start surcharging Visa and MasterCard cardholders, cardholders

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8 Intervention Reasons, ¶31.

9 *Id.*, ¶41.

10 *Id.*, ¶41.

"will complain to Issuers and cancel their credit cards if these cards are refused by merchants."[11] She also acknowledged that two of the CBA's members (Royal Bank of Canada and Bank of Montreal) have a 50% interest in an acquirer business (Moneris), and that "their contracts with merchants will change if the Proposed Order is made."[12]

14. Importantly, Madam Justice Simpson noted that even though issuing banks and banks with interests in acquirers are participants in Visa's and MasterCard's respective four-party credit card networks, the Commissioner has not alleged that any of Canada's banks or their acquirers has engaged in any anticompetitive conduct. She noted that the Commissioner has alleged "no impropriety" whatsoever against Toronto-Dominion Bank, nor against any of the CBA's other member banks.[13] Nor has the Commissioner alleged that any of the CBA member banks has engaged in collusion with Visa or MasterCard, or with each other. Lastly, the Commissioner seeks no order against any of Canada's banks: her application is targeted solely against Visa and MasterCard.[14]

D. The CBA's Intervention Topics

15. Madam Justice Simpson granted the CBA leave to intervene on two intervention topics: (A) The Issuer's perspective on the role of Card Acceptance Fees; and (B) the impact of the Proposed Order on Issuers and Acquirers.[15] Following a brief discussion of what Issuers do, each topic is addressed in turn below.

E. What Issuers Do

16. In order to address the intervention topics, it is important to explain what Issuers do. Ms Leggett explained that Issuers perform several different functions, "which include everything from the creation of credit card products," to the "marketing of products to consumers and to

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[11] *Id.*, ¶39.

[12] *Id.,* ¶40.

[13] *Id*., ¶34.

[14] Notice of Application dated 2010-12-14, *The Commissioner of Competition v. Visa Canada Corporation and MasterCard International Incorporated*, CT-2010-10.

[15] Intervention Reasons, ¶51.

cardholders. Issuers also create the reward and value propositions associated with the different products, as well as all of the operational as well as technological aspects of managing a credit card business."[16] Ms Leggett testified that this includes "everything from adjudicating a consumer that applies for a credit card and assessing what limit they're entitled to, as well as, once [...] a cardholder starts using the card, accepting payment, collections functions if there is a bad debt that needs to be written off – that's the sole responsibility of the issuer – as well as fraud monitoring, investigations, full call centre infrastructure and other [...] activities."[17]

17. In short, an Issuer's business begins and ends with cardholders. Issuers derive their revenue exclusively from cardholders both directly (from cardholder fees and interest) and indirectly when cardholders use their cards (from interchange fees paid by Acquirers to Issuers). Accordingly, assessing the impact of the Proposed Order on Issuers necessarily involves assessing the impact of the Proposed Order on Issuers' customers, the cardholders.

F. The Issuer's Perspective on the Role of Card Acceptance Fees

(a) The Relevance of the CBA's Perspective on the Role of Card Acceptance Fees

18. In granting the CBA leave to intervene, Madam Justice Simpson noted that "the application also deals with the portion of Card Acceptance Fees known as 'Interchange Fees'. Interchange Fees are retained by Issuers and represent a significant portion of Card Acceptance Fees. The Commissioner asks the Tribunal to order the abolition of the Merchant Restraints (the 'Proposed Order') saying that such an order will promote competition in the setting of Card Acceptance Fees. ***The suggestion is that, if competition is introduced, Card Acceptance Fees will decline***."[18]

19. Madam Justice Simpson further stated that the Commissioner "alleges that, with the Proposed Order, there will be an incentive for Issuers to compete with one another by issuing credit cards with reduced Interchange Fees so that merchants will accept their cards without surcharges. In view of this allegation, it would be relevant for the Proposed Intervenors to

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[16] Leggett Evidence, Hearing Transcript, volume 16 (Public), p. 2585.

[17] *Id.*.

[18] Intervention Reasons, ¶4 (emphasis added).

adduce evidence about the likely impact of the Proposed Order on Interchange Fees."[19] Madam Justice Simpson concluded that "[t]he Issuers' perspective on the role of Card Acceptance Fees and, in particular, Interchange Fees is relevant."[20]

(b) The CBA's Evidence on the Role of Card Acceptance Fees

(i) Revenue flows among the participants in the four-party credit card system

20. The four-party credit card networks of Visa and MasterCard include Issuers (whose customers are credit cardholders), Acquirers, merchants, and the credit card networks.[21] Ms Leggett noted that "each of those parties perform very, very different functions in the payment system, earn their revenues from very different sources, and, as well, have a very varied cost base they need to take into account when establishing their pricing for their services."[22] The revenue sources for each party are described below.

1. Issuers

21. Issuers earn revenue from three primary sources: "cardholder fees, the interest we [Issuers] earn on revolving balances, as well as the interchange fees that are earned from acquirers."[23]

22. Ms Leggett testified that interchange "is not the most important source of [Issuers'] revenue. And it helps to offset all of the costs, the resulting costs, that are required to actually run an issuing business."[24] All three sources of Issuers' revenue offset the costs of issuing reward cards, be they premium or non-premium cards, including the "accumulation of benefits – whether that is points accumulation, or cash-back rewards, or the insurances that are offered, the warranty redemptions, the various redemption options available on a credit card, [...] gift

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19 *Id.,* ¶47.

20 *Id.,* ¶49.

21 Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471, ¶26.

22 Leggett Evidence, Hearing Transcript, volume 16 (Public), p. 2594; see also Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471, ¶¶26-27, 38-41.

23 Leggett Evidence, Hearing Transcript, volume 16 (Public), p. 2595; see also Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471, ¶26.

24 Leggett Evidence, Hearing Transcript, volume 16 (Public), p. 2614.

certificates, merchandise, [...] online travel booking tools that are established – all of those costs are offset by those three sources of revenue."[25]

2. Merchants

23. Merchants earn revenue by providing goods and services to their customers, who can use many forms of payment, including credit cards if the merchant chooses to accept them.[26]

3. Acquirers

24. Acquirers earn revenue "from providing a diverse suite of value-added services, including your typical processing, clearing, [and] settlement, but they also invest in value-added services, such as having the ability to integrate into a merchant's account payable system, a merchant's sales system. They will sell services for competitive analytical benchmarking to their merchant."[27] Merchants are "free to select which [Acquirer] services they would like to take advantage of, and the pricing for that is then embedded into the merchant's cost, which is the merchant discount rate, the price to the merchant."[28]

4. Credit Card Networks

25. Ms Leggett testified that "if you take Visa and MasterCard as technology companies, they in fact earn their fees from acquirers and issuers in order to utilize their brand, their right to use the clearing and settlement functions, as well as any other value-added services that they may provide."[29]

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25 *Id.*, pp. 2614-2615.

26 *Id.*, pp. 2594-2595; Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471, ¶26.

27 Leggett Evidence, Hearing Transcript, volume 16 (Public), p. 2595; Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471, ¶¶26, 41.

28 Leggett Evidence, Hearing Transcript, volume 16 (Public), p. 2595.

29 *Id.*, pp. 2595-2596; Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471, ¶26.

(ii) The role of Interchange and the Merchant Discount Rate (MDR)

26. Ms Leggett explained that "[i]nterchange is clearly one of the input costs that acquirers have to take into account when establishing the price to the merchant, and the price to the merchant is the merchant discount rate."[30]

27. She noted that the MDR "is assessed on a number of different factors, and this is done by each respective acquirer. And what they will do is clearly assess the price and different number of services that the merchant will want to take advantage of. It [the MDR] will also be based on the transaction volume that [the] individual merchant will generate, as well as the average transaction price expected by that merchant to generate, and will also take into account the industry risk, as well as the individual merchant risk profile, which is all taken into account in assessing the acquirer's price to the merchant."[31]

(iii) Merchants already recover the MDR because it is embedded in merchants' retail prices

28. Based on Ms Leggett's experience in overseeing credit card issuing and acquiring businesses, she stated that "this MDR, or cost, would be embedded in a merchant's retail prices to their customers,"[32] just "like any other merchant cost, whether it would be heating, or property taxes or staff".[33] She noted that "merchants have been accepting credit cards for over 40 years. They've had card acceptance fees that have been a part of their input costs for over 40 years. And the way that they have treated those [costs] has been to include them and embed them in their retail prices."[34]

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30 Leggett Evidence, Hearing Transcript, volume 16 (Public), p. 2596; Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471, ¶28.

31 Leggett Evidence, Hearing Transcript, volume 16 (Public), p. 2596; Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471, ¶32.

32 Leggett Evidence, Hearing Transcript, volume 16 (Public), p. 2597.

33 *Id.*, pp. 2596-2597.

34 *Id.*, p. 2618; Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471, ¶¶35-36.

29. Ms Leggett also noted that merchants' various input costs – including card acceptance costs – are embedded in merchants' retail prices, "irrespective of whether a customer actually utilizes all of the services that a merchant makes available or not."[35]

30. Ms Leggett's evidence that merchants recover the MDR for credit card acceptance through their retail prices is hardly controversial. The Commissioner admitted this in her Notice of Application, stating that "[m]erchants typically pass some or all of the increased costs resulting from high Card Acceptance Fees onto their customers in the form of higher retail prices for goods and services."[36] The Commissioner's merchant witnesses also accepted that they generally recover the MDR for credit card acceptance from their customers.[37] As Mr. de Armas of Walmart acknowledged, "interchange fees are baked into the overall costs of the goods sold."[38]

31. In sum, interchange fees are one component of Card Acceptance Fees, and an input cost for Acquirers, who typically incorporate that cost into their prices (the MDRs) to merchants. Similarly, Card Acceptance Fees are merely one of many input costs for those merchants who choose to accept credit cards, which merchants have incorporated into their retail prices for the last 40 years.

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35 Leggett Evidence, Hearing Transcript, volume 16 (Public), p. 2620; Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471, ¶¶35-36.

36 Notice of Application dated 2010-12-14, *The Commissioner of Competition v. Visa Canada Corporation and MasterCard International Incorporated*, CT-2010-10, ¶4.

37 Hearing Transcript, volume 2 (Public), pp. 270-271 (Walmart); volume 2 (Public), pp. 345-346, 374-376, and [redacted] (C'est What); volume 2 (Public), pp. 381-382, volume 3 (Public), pp. 428-429 [redacted] (Shoppers Drug Mart); volume 3 (Public), pp. 529-536 [redacted] (Air Canada); [redacted]; volume 8 (Public), pp. 1571-1575 (WestJet); volume 8 (Public), pp. 1598-1600, [redacted] (IKEA); [redacted] volume 10 (Public), pp. 1737-1738 (Sobeys).

38 Hearing Transcript, volume 2 (Public), p. 270.

G. The Impact of the Proposed Order on Issuers and Acquirers

(a) The Relevance of the CBA's Perspective On the Impact of the Proposed Order on Issuers and Acquirers

32. In her reasons granting the CBA leave to intervene, Madam Justice Simpson accepted that "the fact that many Canadians hold credit cards from Issuers and numerous merchants deal with Acquirers does not mean that the banks which offer contracts to those cardholders and merchants are not directly affected in their businesses of issuing and acquiring if those contracts are to change as a result of the Proposed Order."[39] She accepted that "cardholders will complain to Issuers and cancel their credit cards if these cards are refused by merchants," and that as a result many of the CBA's member banks are "directly affected" by the Proposed Order.[40] She also found that "the impact of the Proposed Order on the benefits and services available to cardholders is also relevant." As a result, Madam Justice Simpson concluded that the "views of the [CBA's] members about the impact of the Proposed Order on Issuers and Acquirers may well assist the Tribunal."[41]

(b) The Adverse Impacts on Issuers of Eliminating the Honour All Cards Rule

33. Mr. Robert Livingston, the President of Capital One Canada, focussed his evidence on the adverse impacts on Issuers of eliminating the Honour All Cards Rule (so as to avoid overlap with the evidence of the CBA's second witness, Ms Karen Leggett). As noted above, Capital One Canada is a schedule III bank – a foreign bank branch operating in Canada. Capital One Canada starting doing business in Canada only in 1996, and in the Province of Québec only in 2011.[42]

34. Mr. Livingston explained that, in Canada, Capital One Canada is a "monoline issuer", which means that it does one thing, and one thing only – it issues credit cards (MasterCards) to

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39 Intervention Reasons, ¶32.

40 *Id.,* ¶¶39, 41.

41 *Id.,* ¶49.

42 Livingston Evidence, Hearing Transcript, volume 15 (Public), p. 2532; Witness Statement of Robert Livingston dated 2012-04-10, Exhibit No. IB-466, ¶¶9, 13.

its customers. It does not operate bank accounts, nor does it offer or have broader banking relationships with its customers in Canada.[43]

35. Mr. Livingston noted that Capital One Canada had virtually no brand recognition in Canada as a whole when it began issuing credit cards in 1996, and even less brand recognition in Québec when it began issuing credit cards in that province in 2011. Capital One Canada also had no Canadian banking relationships with any Canadians, nor any physical or other presence in this country. And it still does not have physical branches, nor broader banking relationships.[44] How, then, could it possibly build a credit card business in Canada?

36. Capital One Canada has in fact built a successful credit card business in Canada. Despite remaining a relatively small bank – ranked 20th in terms of assets – Capital One Canada is now Canada's 7th largest issuer of credit cards, admittedly still behind the "big 5" banks and the Caisse Populaire Desjardins, but ahead of the more than 20 other banks that issue Visa or MasterCard credit cards.[45]

37. Capital One Canada credit cards are winning national consumer awards for being voted among the best in Canada in several categories and competing very successfully with credit card products offered by the largest and most powerful banks in Canada.[46] They offer significant product choice to Canadians, who have been eager to choose their leading products over products offered by some of Canada's largest banks.

38. How has Capital One Canada been able to do this? Mr. Livingston explained that a principal reason has been the Honour All Cards Rule – the very rule that the Commissioner asks the Tribunal to eliminate. Mr. Livingston explained that the Honour All Cards Rule ensures the "ubiquity" of card acceptance – a Canadian cardholder knows that his or her Capital One Canada

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43 Livingston Evidence, Hearing Transcript, volume 15 (Public), p. 2532; Witness Statement of Robert Livingston dated 2012-04-10, Exhibit No. IB-466, ¶11.

44 Livingston Evidence, Hearing Transcript, volume 15 (Public), pp. 2532, 2534-2536; Witness Statement of Robert Livingston dated 2012-04-10, Exhibit No. IB-466, ¶¶11, 25.

45 Livingston Evidence, Hearing Transcript, volume 15 (Public), p. 2532; Witness Statement of Robert Livingston dated 2012-04-10, Exhibit No. IB-466, ¶¶26, 28.

46 Livingston Evidence, Hearing Transcript, volume 15 (Public), pp. 2532-2533; Witness Statement of Robert Livingston dated 2012-04-10, Exhibit No. IB-466, ¶15.

MasterCard will be accepted everywhere that displays the MasterCard brand. The cardholder does not need to rely on the merchant being familiar with Capital One Canada's brand. Mr. Livingston explained that the Honour All Cards Rule is particularly important for smaller Issuers or Issuers with little or no brand recognition, such as Capital One Canada when it entered Canada. These Issuers depend on the Honour All Cards Rule to ensure acceptance of their cards.[47] As Mr. Livingston explained:

> We also, of course, had no banking relationships [with Canadians], as well. It was paramount for us and very important for us to enter with the halo of the MasterCard brand and relying on it, and the MasterCard brand, in our view, wouldn't have been powerful if a Capital One MasterCard wasn't as useful, didn't have the same utility, as a Bank of Montreal MasterCard or an RBC Visa card or any other big bank credit card.[48]

39. Mr. Livingston further explained how the MasterCard brand and the Honour All Cards Rule were critical to Capital One Canada's entry into the Québec marketplace in 2011:

> In 2011, we had a very recent case study of what it is like to enter a marketplace without brand knowledge when we entered francophone Quebec. In francophone Quebec, we had brands [sic] recognition below 5 percent, whereas the big five banks were all in the 90-plus percent range, and Desjardins was close to 100 percent.
>
> We simply wouldn't have been able to compete in Quebec without a brand such as MasterCard that had similar brand recognition to the bigger Canadian financial institutions.
>
> And, again, it is that ubiquity, and the ability to use a MasterCard wherever MasterCard is accepted and this idea that a MasterCard is a MasterCard, that really enabled our customers in Quebec to feel confident when signing up for Capital One.[49]

40. On cross-examination, Mr. Livingston confirmed that "we would have been unlikely to make the investment in a bilingual infrastructure [in Québec] if we weren't guaranteed the

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[47] Livingston Evidence, Hearing Transcript, volume 15 (Public), pp. 2533-2537; Witness Statement of Robert Livingston dated 2012-04-10, Exhibit No. IB-466, ¶¶18-23.

[48] Livingston Evidence, Hearing Transcript, volume 15 (Public), p. 2536.

[49] *Id.*, pp. 2536-2537; Witness Statement of Robert Livingston dated 2012-04-10, Exhibit No. IB-466, ¶¶30-32.

prospect of a relatively successful market entry. And, in our opinion, one of the things that ensure that that will happen is the fact that the MasterCard brand is trusted and is ubiquitous in the Province of Quebec as it is in the rest of Canada."[50]

41. Mr. Livingston also explained how eliminating the Honour All Cards Rule would harm Capital One Canada's ability to compete with other credit card Issuers in Canada, ultimately resulting in Issuers providing fewer credit card benefits and reduced choice for Canadian cardholders. Mr. Livingston identified, in particular: (1) the harm to smaller Issuers and Issuers without strong brand recognition in Canada; (2) the prospect of larger merchants entering into arrangements with larger banks to selectively decline credit cards issued by rival banks; (3) the loss of point of sale predictability; and (4) the resulting reduced competition amongst Issuers and fewer options and benefits provided by Issuers to cardholders.[51]

1. Harm to smaller Issuers and Issuers without strong brand recognition in Canada

42. Mr. Livingston explained how, without the Honour All Cards Rule, larger Canadian banks and other Issuers with more established brands in Canada, or banks with broader banking relationships with cardholders, would be much more likely to secure cardholders than new entrants to Canada like Capital One Canada. As Mr. Livingston explained, "if our cards weren't accepted at every sort of retailer [...] we believe that cardholders would migrate to larger issuers with brand recognition, the big five banks, the National Bank, the Desjardins of the world, and

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[50] Livingston Evidence, Hearing Transcript, volume 15 (Public), p. 2556.

[51] Commissioner's counsel sought to discredit Mr. Livingston's evidence on the basis that Capital One Canada had not conducted any empirical studies or surveys in support of his views, and on the basis that the CBA had no provided disclosure of Capital One Canada's documents. Neither contention has any merit. First, Mr. Livingston explained that his views on the impact of the granting the Commissioner's Proposed Order on Issuers are based on his experience as president of a bank that issues 4 million MasterCard credit cards in Canada. As Mr. Livingston explained, his evidence was "based on my experience in the credit card industry over the last 16 years in the US, UK, but mostly here in Canada." He added: "It is also based off of my assessment as a leader of Capital One's Canadian business, as well as a consumer, of the confusion and the harm that this would cause both issuers and our customers, if the honour-all-cards rule were to be rescinded." See Livingston Evidence, Hearing Transcript, volume 15 (Public), p. 2577. Second, the CBA, an intervenor in this proceeding, was not required to produce all evidence in the possession of witnesses called on its behalf, any more than the Commissioner was obliged to produce all documents in the possession of its many merchant witnesses. The CBA made full and proper production in accordance with the *Rules of the Competition Tribunal* and the intervention order of Madam Justice Simpson. The Commissioner has at no time complained about the extent or appropriateness of the CBA's productions in the discovery process. To the contrary, the Commissioner's position has been that it was satisfied with the CBA's productions.

we also believe that it would be more difficult for us to acquire new customers, as the value of the Capital One MasterCard would have less utility than other banks' MasterCards."[52] Thus, larger, more established Canadian banks would be better able to rely on their bank's brand to ensure acceptance of their credit cards. This would harm Capital One Canada's place in the marketplace and restrict its ability to compete with larger banks, ultimately reducing cardholder choice.

43. The Tribunal asked Mr. Livingston whether the brand of the Issuer or the network is more important. Mr. Livingston explained that the network's brand is more important for card acceptance, whereas the Issuer's brand, the programs and rewards, and credit terms are more important in the decision to choose a credit card for the first time. As Mr. Livingston explained:

> **MR. LIVINGSTON:** It depends on what the purpose is. If the purpose is to say, Will my card be useful at a merchant, it is very much more the Visa or the MasterCard or American Express.
>
> If you think about acceptance, there is – American Express isn't accepted in as many locations, and cardholders are very aware of that.
>
> If you think, though, about the decision to choose a card for the first time, I would say it is more important about the issuer and the programs that they're offering, either the terms or the rewards or the access to credit, because that isn't common across all issuers.[53]

2. Larger merchants entering into arrangements with particular banks to selectively decline credit cards issued by rival banks

44. In Mr. Livingston's view, eliminating the Honour All Cards Rule would also potentially allow some merchants (especially larger merchants) to enter into exclusive banking arrangements with larger banks to selectively decline credit cards issued by rival banks. As Mr. Livingston explained: "[w]e worry very much that merchants, especially larger merchants, would pick and choose which cards they accept, and that could be either based off the rates that they're charged or, in our mind, more dangerously, let's say that you had a large merchant that had an

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[52] Livingston Evidence, Hearing Transcript, volume 15 (Public), p. 2538; Witness Statement of Robert Livingston dated 2012-04-10, Exhibit No. IB-466, ¶23.

[53] Livingston Evidence, Hearing Transcript, volume 15 (Public), p. 2578.

exclusive banking relationship with one of the Canadian big five banks and used that to choose not to accept any other rival bank's MasterCards in their stores. We find that to be a very worrisome prospect if it were to come to pass."[54]

45. On cross-examination, Mr. Livingston was asked whether merchants would continue to accept Capital One Canada credit cards so long as the card acceptance fees associated with its cards remain reasonable. Mr. Livingston explained that, notwithstanding the costs associated with accepting Capital Canada One credit cards, merchants "could still have a relationship with a bank, say the Royal Bank of Canada, and the merchant wants to guide more business to their bank. They could have a situation where they have a co-branded card, such as Canadian Tire, with their MasterCard and they would not want any other MasterCard to be accepted there. P.C. Financial is part of Loblaws, and Loblaws is the largest grocery chain in Canada. ***From our perspective, it would be horrible if Loblaws all of a sudden decided to stop accepting competing MasterCards and turned it into a closed network***."[55]

46. Mr. Livingston went on to note that, of the top ten merchants in Canada, "eight have co-brand agreements. [...] Your average local hardware store or mom-and-pop shop isn't going to have a co-brand agreement, but the largest retailers in Canada, almost all do."[56] Indeed, several of the Commissioner's merchant witnesses already have co-brand agreements with some of Canada's largest banks, showing that the likelihood of merchants steering customers to particular larger Issuers is a significant concern.[57]

3. Loss of point of sale predictability

47. Mr. Livingston also explained that, in his view, eliminating the Honour All Cards Rule would mean that Capital One Canada's cardholders would not know until the point of sale whether their preferred form of payment will even be accepted. This point of sale predictability

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54 *Id.*, p. 2538; Witness Statement of Robert Livingston dated 2012-04-10, Exhibit No. IB-466, ¶23.

55 Livingston Evidence, Hearing Transcript, volume 15 (Public), p. 2561 (emphasis added).

56 *Id.*, p. 2562.

57 These include Walmart, Shoppers Drug Mart, Sobeys, Best Buy, WestJet, IKEA, and Air Canada (through Aeroplan).

is critical for cardholders.[58] Mr. Livingston testified that Capital One Canada's cardholders would otherwise experience frustration, embarrassment, and inconvenience at the point of sale because they would no longer know whether their cards would be accepted, "depending upon the whims of the merchant."[59]

4. Reduced competition amongst Issuers and fewer options and benefits provided by Issuers to cardholders

48. Mr. Livingston concluded that the selective acceptance of credit cards by merchants in the absence of the Honour All Cards Rule "would result in reduced competition amongst issuers, and particularly disadvantage smaller issuers such as Capital One, and that would, in turn, result in reduced cardholder choice, fewer credit cards options, fewer rewards, fewer opportunities for cardholders to benefit from the increased number of smaller issuers who are currently in the marketplace. [...] We have 4 million customers in Canada and they certainly wouldn't have the option of Capital One's cards, or pricing and our services without the support that we felt coming into the marketplace from the MasterCard brand."[60]

49. Mr. Livingston also explained that "[i]f you had a completely fragmented marketplace, where a MasterCard wasn't useful in every location, your wallets would need to be three times as fat as they already are with credit cards in them."[61]

50. Ms Leggett, of National Bank and formerly of the Royal Bank, expressed the same underlying concern. She explained that "***issuers sell ubiquity. We sell universal card acceptance anywhere in the world that a customer chooses to use a Visa or MasterCard where a merchant accepts a Visa or MasterCard. That is what we sell.*** We sell the confidence, the certainty and the predictability that a cardholder will be able to use their card at that merchant. And the removal of the honour-all-cards significantly undermines that premise, which is part of the core

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[58] Livingston Evidence, Hearing Transcript, volume 15 (Public), p. 2534; Witness Statement of Robert Livingston dated 2012-04-10, Exhibit No. IB-466, ¶¶20-21.

[59] Livingston Evidence, Hearing Transcript, volume 15 (Public), p. 2534; see also Witness Statement of Robert Livingston dated 2012-04-10, Exhibit No. IB-466, ¶¶20-21.

[60] Livingston Evidence, Hearing Transcript, volume 15 (Public), pp. 2535, 2538-2539; Witness Statement of Robert Livingston dated 2012-04-10, Exhibit No. IB-466, ¶¶22-23, 32.

[61] Livingston Evidence, Hearing Transcript, volume 15 (Public), p. 2535.

value of a credit card and a customer using that credit card, and it would really have a profound impact. Eliminating that rule would have a profound impact on our issuing business."[62]

51. Ms Leggett also underscored that, "in spite of the fact that a few other jurisdictions in the world have chosen to cap interchange or have chosen to permit merchant surcharging in isolated instances, ***there isn't a single jurisdiction in the world that has agreed to eliminate this fundamental aspect of honour-all-cards***."[63]

5. Conclusion

52. In sum, the Honour All Cards Rule creates a level playing field among banks. Eliminating the rule would skew the playing field and disproportionately hurt smaller banks, restricting their ability to compete and to offer attractive credit card products to cardholders in the Canadian marketplace.

(c) The Adverse Impacts On Issuers and Acquirers of Eliminating the No Surcharge Rule

53. The CBA's second intervention topic concerns the impact on Issuers and Acquirers of the Commissioner's request for the Tribunal to eliminate the No Surcharge Rule – the Commissioner's claim that the Tribunal should relieve merchants of their contractual commitment to Acquirers not to surcharge cardholders when using their Visa and MasterCard credit cards.

54. Ms Leggett addressed this second intervention topic on behalf of the CBA. Fundamentally, she explained that if surcharging becomes widespread in Canada, as it has in Australia, demand for those credit cards that are widely surcharged may be reduced. Based on her experience as the head of the credit card business for Canada's largest bank, Royal Bank, she explained that Canadian cardholders will not react well when charged more to use a particular credit card. She described surcharging as "a financial penalty on consumers who pay by credit

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[62] Leggett Evidence, Hearing Transcript, volume 16 (Public), p. 2606 (emphasis added); Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471, ¶¶68-78.

[63] Leggett Evidence, Hearing Transcript, volume 16 (Public), p. 2606 (emphasis added).

cards".[64] Ms Leggett explained that reduced demand for credit cards that are widely surcharged will result in banks responding to that reduced demand by making fewer credit card products available to Canadian cardholders. This will ultimately reduce competition amongst Issuers and reduce product choice for Canadian cardholders.[65]

55. Ms Leggett also explained that, based on her experience and the experience in other jurisdictions that have allowed surcharging (particularly Australia), relieving merchants of their contractual commitment not to surcharge Canadian cardholders would create the conditions for excessive surcharging, well in excess of the costs of card acceptance – thereby creating a new profit centre for certain merchants, particularly large and powerful merchants such as those who testified for the Commissioner. This, too, may decrease the demand for the credit cards targeted for surcharging. As a result, surcharging will negatively impact both Issuers and Acquirers.[66]

56. Ms Leggett's evidence focussed on the impacts on Issuers and Acquirers of eliminating the No Surcharge Rule, drawing in part on the Australian experience with surcharging. In particular, she described: (1) the problems of widespread "excessive surcharging" and "blended surcharging" in Australia; (2) how Issuers may respond to surcharging as they did in Australia, by offering fewer rewards to cardholders and by increasing cardholder fees, while the networks may respond by increasing interchange; (3) the prospect of partnerships between large merchants and large Issuers, whereby merchants would agree not to surcharge credit cards issued by large Issuers; (4) the plethora of unintended consequences experienced in Australia when merchants were allowed to surcharge; and (5) how, in 2010, Canada's Minister of Finance rejected merchants' entreaties to allow surcharging, but affirmed their ability to discount for cash and other payment methods. Each point is addressed in turn below.

1. Widespread excessive surcharging and blended surcharging

57. Ms Leggett described the impact on Issuers and Acquirers of eliminating the No Surcharge Rule by describing the "real world example" of "a jurisdiction where merchant

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64 Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471, ¶6.

65 *Id.*, ¶¶63-67; Leggett Evidence, Hearing Transcript, volume 16 (Public), pp. 2603-2604.

66 Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471, ¶¶45-58, 65-66; Leggett Evidence, Hearing Transcript, volume 16 (Public), pp. 2598-2603.

surcharging has been permitted since 2003, and that is Australia."[67] As the Tribunal heard from various witnesses, Australia is one of the jurisdictions that took a ***regulatory approach***, through the Reserve Bank of Australia ("RBA") intervening in the marketplace in 2003 to ban the No Surcharge Rule and to cap interchange fees.[68] Ms Leggett noted that "Australia is clearly a market that issuers, like myself, have studied very closely in order to understand the impact to cardholders and to the payment system when allowing merchants to surcharge."[69] As the former head of Royal Bank's credit card business and now the head of National Bank's credit card business, Ms Leggett stated that "I have no reason to believe that if that were – if merchant surcharging were to be allowed in Canada, that we would see a different experience. I don't believe that we would in Canada. I have no reason to believe that we would."[70]

58. ***Surcharging has become widespread in Australia.*** The RBA has candidly acknowledged that, in recent years, merchant surcharging has "risen substantially" in Australia. It cited recent data that, as of the end of June 2011, at least 30% of merchants applied a surcharge on at least one of the credit cards they accepted. The RBA noted that "surcharging continues to be more common among very large merchants (those with annual turnover of over $530 million), with 47 per cent applying a surcharge."[71] Indeed, in a June 2011 consultation document on surcharging, the RBA noted that "only around 20 per cent of merchants [have] no surcharging plans."[72] Clearly, then, surcharging has become widespread in Australia.

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67 Leggett Evidence, Hearing Transcript, volume 16 (Public), p. 2598.

68 RBA, *Review of Card Surcharging: A Consultation Document* (June 2011), p. 2, Exhibit U to the Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471.

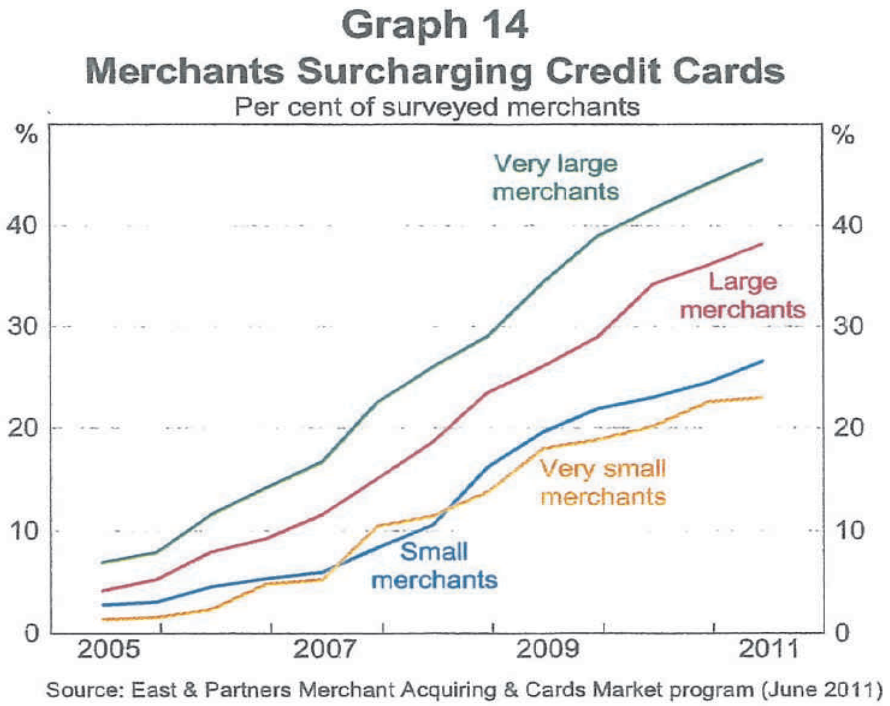
69 Leggett Evidence, Hearing Transcript, volume 16 (Public), p. 2598.

70 *Id.*, pp. 2599-2600; see also Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471, ¶45.

71 RBA, *Payments System Board Annual Report 2011*, p. 23, Exhibit Q to the Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471.

72 RBA, *Review of Card Surcharging: A Consultation Document* (June 2011), p. 3, Exhibit U to the Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471.

59. In its *2011 Annual Report*, the RBA reproduced the following chart showing the growing prevalence of surcharging in Australia over the period 2005 to 2011, particularly amongst large and very large merchants, but also amongst small and very small merchants:[73]



60. While the RBA has been reluctant to declare its own regulatory intervention a failure,[74] it has acknowledged two significant unintended consequences have flowed from its decision to remove the No Surcharge Rule: (1) the advent of "excessive surcharging," far in excess of the

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[73] RBA, *Payments System Board Annual Report 2011*, p. 23, Graph 14, Exhibit Q to the Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471.

[74] Indeed, the RBA has declared that "surcharging has been successful" in achieving benefits for the efficiency of the payments system: see RBA, *A Variation to the Surcharging Standards: A Consultation Document* (December 2011), p. 2, Exhibit V to the Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471. Others do not share this view: see, for example, H. Chang, D.S. Evans, and D.D. Garcia Swartz, "The Effect of Regulatory Intervention in Two-Sided Markets: An Assessment of Interchange-Fee Capping in Australia" (2005), *Review of Network Economics*, vol. 4, Issue 4 (December 2005), pp. 349-350 ("the evidence indicates that the [RBA's] intervention has not achieved its goals"), Exhibit S to the Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471; and, more recently, CRA International, "Regulatory intervention in the payment card industry by the Reserve Bank of Australia: Analysis of the evidence" (April 28, 2008), p. 4 ("while the RBA's regulations have clearly harmed consumers by causing higher cardholder fees and less valuable reward programmes, there is no evidence that these undeniable losses to consumers have been offset by reductions in retail prices or improvement in the quality of retailer service. The RBA's intervention has redistributed wealth in favour of merchants"), Exhibit R to the Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471.

costs to merchants of card acceptance; and (2) the advent of "blended" surcharging, where merchants surcharge different cards at the same rate despite significant differences in card acceptance costs.

61. ***The problem of "excessive surcharging".*** In its *2011 Annual Report*, and also in its June 2011 and December 2011 consultation documents on surcharging, the RBA acknowledged the problem of "excessive surcharging" by merchants.[75] The RBA noted that "[i]n some cases merchants may be setting surcharges ***well in excess*** of the cost of card acceptance. There is evidence that this may be concentrated in some industries and payment channels, and that these tend to be segments where a larger proportion of transactions are surcharged (for example, online payments). A related concern is the lack of genuine payment alternatives where credit card surcharges are levied on online payments."[76]

62. The RBA highlighted that "concerns [were] expressed through consultation that surcharging is being exploited by firms with market power" and noted the "increasing evidence to suggest that it is now becoming more common for merchants to set surcharges at levels that are higher than average merchant service fees."[77] The RBA cited concrete evidence supporting the levels of excessive surcharging. It noted that the average merchant discount rate on Visa and MasterCard in 2010/2011 was 0.81% of the value of transactions,[78] yet "[i]n December 2010, the average surcharge for MasterCard credit cards was 1.8 per cent, for Visa it was 1.9 per cent, for American Express it was 2.9 per cent, and for Diners Club it was 4 per cent. These average surcharge levels are around 1 percentage point higher than merchant service fees for American Express, MasterCard and Visa cards, and around 1.8 percentage points higher for Diners Club

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[75] RBA, *Payments System Board Annual Report 2011*, pp. 23-24, Exhibit Q to the Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471; RBA, *Review of Card Surcharging: A Consultation Document* (June 2011), pp. 1-3, 5-6, Exhibit U to the Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471; and RBA, *A Variation to the Surcharging Standards: A Consultation Document* (December 2011), pp. 3-4, 8, Exhibit V to the Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471.

[76] RBA, *Payments System Board Annual Report 2011*, p. 24 (emphasis added), Exhibit Q to the Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471; RBA, *A Variation to the Surcharging Standards: A Consultation Document* (December 2011), p. 3, Exhibit V to the Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471.

[77] RBA, *Review of Card Surcharging: A Consultation Document* (June 2011), p. 1, Exhibit U to the Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471.

[78] RBA, *Payments System Board Annual Report 2011*, p. 15 (emphasis added), Exhibit Q to the Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471

cards. Surcharges also vary substantially across different merchants; East & Partners' data indicate that around 10 per cent of merchants apply a surcharge of 5 per cent or more."[79]

63. The RBA also noted that "the incidence of surcharging is much higher for online purchases than those made in person," citing evidence that "respondents paid a credit card surcharge on around 18 per cent of transactions made online compared with 4 per cent of those made in person." The RBA noted that "East & Partners' data suggest that surcharges paid for online transactions also tend to be higher, at around 4 per cent of the purchase value, on average, compared with around 2 per cent for merchants with a physical presence. A related concern about surcharging that has been expressed by both industry participants and consumers is that there may sometimes be a lack of genuine payment alternatives where credit card surcharges are applied to online payments."[80] The RBA noted that concerns have been expressed that merchants in Australia are using surcharging as a new profit centre, rather than for genuine cost recovery. As the RBA explained: "concern has been expressed to the Bank that some merchants may be using surcharging as an additional means of generating revenue, rather than simply covering the costs of card acceptance."[81]

64. In its June 2011 surcharging consultation document, the RBA reproduced the following chart showing how the average merchant surcharge is ***well in excess*** of the average merchant service fee on credit cards for both larger merchants and smaller merchants:[82]

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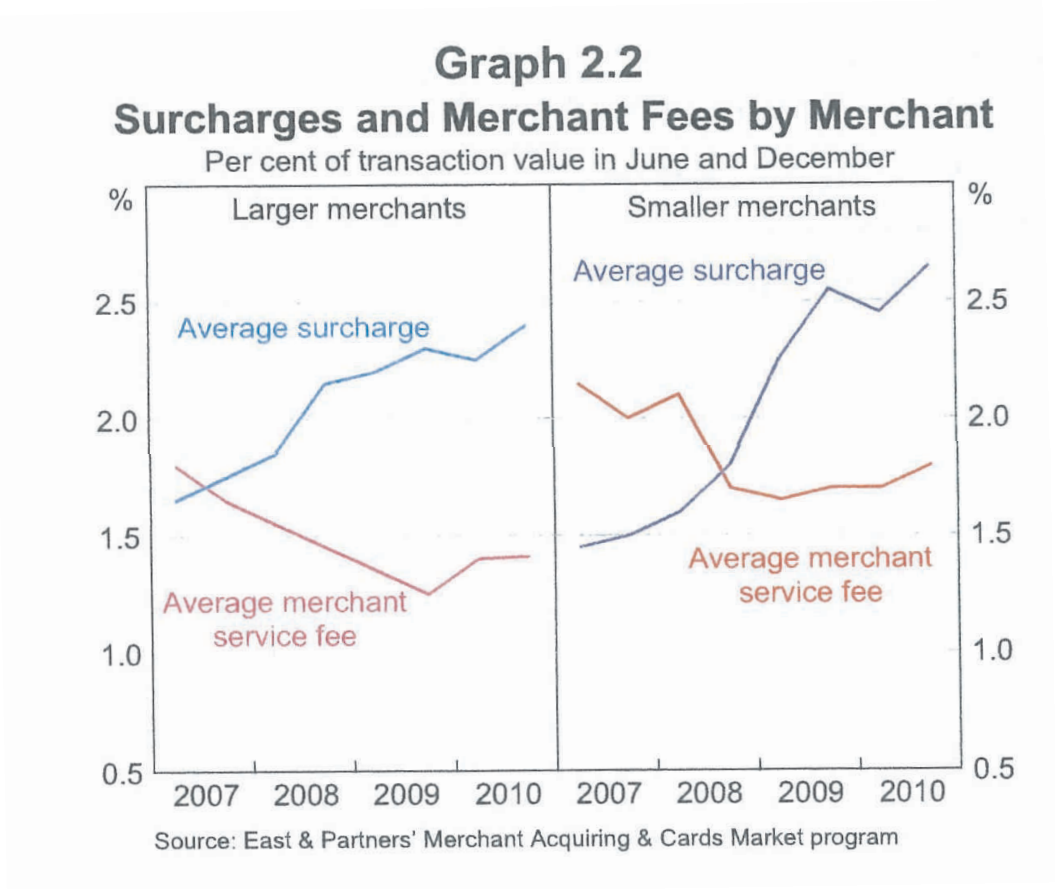
[79] RBA, *Review of Card Surcharging: A Consultation Document* (June 2011), p. 3, Exhibit U to the Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471.

[80] *Id.*, p. 5.

[81] *Id.*

[82] *Id.*, p. 3.



65. ***The problem of "blended surcharging".*** The RBA also identified a related problem and unintended consequence of eliminating the No Surcharge Rule – the advent of so-called "blended surcharging." As the RBA explained in its 2011 Annual Report: "*Blended surcharging:* There appears to have been some increase in the incidence of blended surcharging, where cards from different schemes are surcharged at the same rate despite significant differences in acceptance costs. While some merchants might prefer a simple pricing structure, the Board is concerned that encouragement of blended surcharges might act to blunt price signals."[83] In its June 2011 surcharging consultation document, the RBA Board added that "[a] related issue is that ***there appear to be few, if any, instances where merchants apply different surcharges for different cards within a card scheme*** (that is, 'differential' surcharging)."[84] In short, the Australian experience shows that few if any merchants are surcharging premium cards

[83] RBA, *Payments System Board Annual Report 2011*, p. 24 (emphasis added), Exhibit Q to the Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471.

[84] RBA, *Review of Card Surcharging: A Consultation Document* (June 2011), p. 6 (emphasis added), Exhibit U to the Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471.

differentially; instead, they are surcharging ***all*** credit cards by imposing a blended surcharge on everyone.

66. ***No evidence of merchants reducing retail prices.*** There is no concrete evidence that the RBA's regulatory intervention in the marketplace has caused merchants to reduce retail prices. Neither the RBA nor Australian merchants have presented any empirical evidence establishing that reductions in merchants' credit card acceptance costs have been passed through to consumers in the form of lower retail prices.[85] [redacted] Indeed, consistent with the Australian experience, many of the Canadian merchant witnesses who gave evidence before the Tribunal would not confirm that they would reduce retail prices commensurate with any ability to surcharge.[87]

2. Issuers may offer fewer rewards for cardholders, cardholder fees may increase, while the networks may increase interchange

67. Ms Leggett explained that if Canadian Issuers have a similar experience with merchant surcharging as in Australia (and she saw no reason why Canada's experience would be any different), Issuers would be harmed by declining credit card usage. In its 2011 Annual Report, the RBA cited its 2010 Consumer Payments Use Study, which noted that "around half of consumers who hold a credit card will seek to avoid paying a surcharge by either using a

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85 CRA International, "Regulatory intervention in the payment card industry by the Reserve Bank of Australia: Analysis of the evidence" (April 28, 2008), pp. 13, 31, Exhibit R to the Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471.

86 [redacted]

87 Hearing Transcript, volume 2 (Public), pp. 374-376 (C'est What); volume 3 (Public), pp. 531-536 (Air Canada); [redacted].

different payment method that does not attract a surcharge (debit card or cash) or going to another store."[88]

68. As Ms Leggett explained, drawing on the Australian experience, the risk to Canadian Issuers is that cardholders will seek to avoid surcharging and will choose other payment methods. This in turn will result in "a material reduction in the use of credit cards, which would clearly have a material impact to issuers, to our revenues and to our profitability and to our business overall."[89] As Ms Leggett elaborated, "[c]redit card usage – by utilizing a credit card, that is how we earn cardholder fees. That is how we earn interchange, and this is also how we earn the interest on revolving balances. So credit card usage is a precursor to earning any revenue. So any drop in card usage would clearly create concern and create an impact and create risk to our issuing business."[90]

69. In Australia, even the RBA has recognized that its regulatory intervention in the marketplace has resulted in fewer benefits to cardholders. The RBA noted in its 2011 Annual Report that, "[o]verall, there is evidence to suggest that ***rewards programs have become less valuable***. In the year to June 2011, the average rewards to cardholders fell by 4 cents for every $100 spent on standard cards, 5 cents on gold cards and 1 cent on platinum cards. ***This is in line with longer-term trends observed since the credit card reforms in 2003, in which average rewards benefits to cardholders have consistently declined***."[91] The RBA has also noted that, as a result of its regulatory intervention, cardholders in Australia are now paying approximately AU$480 million each year in additional fees to issuing banks for Visa and MasterCard credit cards.[92]

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88 RBA, *Payments System Board Annual Report 2011*, p. 23, Exhibit Q to the Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471.

89 Leggett Evidence, Hearing Transcript, volume 16 (Public), p. 2603.

90 *Id.*, p. 2616.

91 RBA, *Payments System Board Annual Report 2011*, p. 17 (emphasis added), Exhibit Q to the Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471.

92 CRA International, "Regulatory intervention in the payment card industry by the Reserve Bank of Australia: Analysis of the evidence" (April 28, 2008), pp. 13-14, Exhibit R to the Witness Statement of Karen Leggett dated 2012-04-05, Exhibit IB-471, citing RBA data from 2007/2008.

70. Drawing on the Australian experience, Ms Leggett explained that Canadian Issuers might likewise respond to any decline in credit card usage and the declining fee revenue by potentially increasing cardholder fees and reducing cardholder benefits, while the networks might respond to any reduced credit card volume by increasing interchange (rather than reducing it, as assumed by the Commissioner).[93] As Ms Leggett explained, Issuers would have to consider a number of different options to offset any adverse impact of lower credit card usage that would be caused by surcharging: "It could actually be an increase in cardholder fees. It could actually be a reduction in cardholder benefit[s] and services. ***The networks may choose to increase interchange to offset the impact***, or some combination thereof."[94]

3. Partnerships between large merchants and large Issuers agreeing not to surcharge credit cards issued by large Issuers

71. Similar to Mr. Livingston's concern about the impact of abolishing the Honour All Cards Rule, Ms Leggett noted that abolishing the No Surcharge Rule could result in large or very large merchants partnering with large or very large Issuers to agree, in exchange for payment from the Issuer, not to surcharge that particular Issuer's credit cards. As Ms Leggett explained, "now that I am with a much smaller credit card issuer, namely National Bank, that is a serious competitive disadvantage for my business as an issuer and for any small issuer in Canada, as well as any small merchant who, again, will not be able to compete with the very large merchants that continue to be advantaged in this way."[95]

4. The law of unintended consequences

72. On cross-examination, Ms Leggett noted that that the lesson she draws from the Australian experience is "there are a lot of unintended consequences." As she explained: "Because this is such an ecosystem that needs to be in equilibrium to function effectively, when you start tinkering with one or two or three aspects of the payments system, you can't really understand what the ultimate impact is going to be."[96] Earlier in her evidence, Ms Leggett

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93 Notice of Application dated 2010-12-14, *The Commissioner of Competition v. Visa Canada Corporation and MasterCard International Incorporated*, CT-2010-10, ¶¶71, 73-74.

94 Leggett Evidence, Hearing Transcript, volume 16 (Public), p. 2603 (emphasis added).

95 *Id.*, pp. 2604-2605.

96 *Id.*, p. 2655.

similarly cautioned that "the Australian example should serve as an important warning of what the negative, unintended consequences can be when making material changes to what is a complex, multi-faceted payment system that needs to be in equilibrium in order to function effectively."[97]

73. In sum, by confirming the law of unintended consequences, the Australian experience with regulatory intervention provides a cautionary tale for Canada about the need for restraint in heeding the Commissioner's call for the Tribunal to intervene in the marketplace through an expansive – and unprecedented – interpretation of the price maintenance provision in s. 76.

5. The Minister of Finance decided not to abolish the No Surcharge Rule in the Code of Conduct for the Debit and Credit Card Industry in Canada *and continues to believe that price regulation is not the answer*

74. As Senior Vice President, Cards and Payment Solutions at the Royal Bank of Canada, Ms Leggett was involved in the broad and extensive consultation process for the Federal Department of Finance's *Code of Conduct for the Debit and Credit Card Industry in Canada* ("*Code of Conduct*"). As Ms Leggett explained, the Canadian Federation of Independent Business ("CFIB") urged the Department of Finance to allow merchants to surcharge credit cards. Following those consultations, and after carefully assessing CFIB's proposal, the Department of Finance specifically decided not to allow merchants to surcharge credit cards, but nevertheless confirmed merchants' right to discount for other forms of payment, including cash.

75. Ms Leggett stated that it "is particularly relevant that [the Department of Finance] chose to make that decision. And I think when you look at the Australian experience, that clearly demonstrates what the negative unintended consequences are of eliminating this rule."[98]

76. As recently as June 8th, 2012, in a speech delivered at the *2012 Payments Panorama Conference* hosted by the Canadian Payments Association in Québec City, the Minister of Finance, the Hon. Jim Flaherty, reiterated the Government of Canada's commitment to the *Code of Conduct* and confirmed the power of merchants to steer consumers through discounting for

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97 *Id.*, p. 2607.

98 *Id.,* p. 2605.

cash and other lower cost payment methods. Minister Flaherty stated that "controlling prices does not work" and "that is why rate regulation has never been the name of the game in the Canadian financial sector." He underscored that through the *Code of Conduct* the Government has "taken steps to preserve Canada's low cost debit system by prohibiting competing domestic payment applications and empowering merchants to steer consumers toward low cost options through steering and discounting." He also reiterated that "merchants have the power to offer consumers discounts for paying with a low cost payment method," such as cash, and that "this is the best of all reward programs." He stated that "[b]efore calling for rate regulation and asking the government to limit reward programs for consumers, merchants should realize that they hold a significant competitive advantage and can change the way consumers choose payment options." As Minister Flaherty explained:

> Some jurisdictions around the world have chosen highly prescriptive and constraining rules governing credit and debit payments, even dictating prices. As practices evolve these rules are bound to become obsolete and to have significant unintended consequences. I understand that some players in the payments system would like me to cap interchange rates. Similarly many people would like the price of gas to be capped, their cellphone bills to be capped and their groceries to be capped.
>
> We all know that controlling prices does not work and that what we need is healthy competitive innovative markets. That is why rate regulation has never been the name of the game in the Canadian financial sector. Canada benefits from a good low cost debit option that almost all consumers have access to. With the code of conduct I have taken steps to preserve Canada's low cost debit system by prohibiting competing domestic payment applications and empowering merchants to steer consumers toward low cost options through steering and discounting.
>
> ***With this code of conduct merchants have the power to offer consumers discounts for paying with a low cost payment method. I suggest to you isn't that the best of all reward programs. Before calling for rate regulation and asking the government to limit reward programs for consumers, merchants should realize that they hold a significant competitive advantage and can change the way consumers choose payment options***.[99]

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[99] Hon. Jim Flaherty, Minister of Finance, speech as part of the 2012 Payments Panorama Conference hosted by the Canadian Payments Association, Québec City, 2012-06-08 (emphasis added).

H. Conclusion

77. As the CBA's evidence showed, the Commissioner's request that the Tribunal abolish the Honour All Cards Rule and allow merchants to charge Canadians more when they use their Visa or MasterCard credit cards will be bad for Issuers and Acquirers, bad for cardholder choice, and, ultimately, bad for Canadians. As in Australia, it will, however, be very good for one group of people in the marketplace – merchants, particularly large and powerful merchants, who will be relieved of their contractual commitments to Acquirers and free to charge Canadians more simply for the privilege of paying by credit card.

78. In 2010, the Minister of Finance carefully considered merchants' entreaty to relieve them of their contractual commitment not to surcharge Canadians. Following broad consultation and careful study, the Department of Finance rejected the merchants' request, but maintained their powerful right to discount for cash and other forms of payment. That was the right decision in 2010; it remains the right decision today.

79. For these reasons, the CBA respectfully submits that the Commissioner's Application should be dismissed.

ALL OF WHICH IS RESPECTFULLY SUBMITTED,

Ottawa, June 21st, 2012

_____
Mahmud Jamal

_____
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_____
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