PUBLIC

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 –

CANADIAN BANKERS ASSOCIATION and
THE TORONTO-DOMINION BANK

Intervenors

CLOSING SUBMISSIONS OF THE COMMISSIONER OF COMPETITION

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TABLE OF CONTENTS

Overview

1. The Commissioner brings this Application under section 76 of the *Competition Act* for an Order prohibiting each of the Respondents from implementing or enforcing the No Surcharge Rule, the Honour All Card Rule and the No Discrimination Rule (collectively, the "**Merchant Restraints**").

2. As described herein and as established during the hearing of the Application, each of the Respondents requires their Acquirers to impose the Merchant Restraints on merchants as a condition of providing Credit Card Network Services (as defined below) to merchants. The Merchant Restraints are vertical restraints that prohibit merchants who accept Visa and MasterCard credit cards from, among other things, declining to accept particular credit cards (such as premium credit cards), applying a surcharge for those customers that elect to pay with credit cards, or engaging in other forms of discrimination that discourage the use of credit cards or steer customers towards lower cost payment methods in an effective manner.

3. The evidence before the Tribunal establishes that the Merchant Restraints are being used by Visa and MasterCard to preserve the more than $5 billion in Card Acceptance Fees paid each year by merchants in Canada, by preventing merchants from taking steps to effectively constrain these Card Acceptance Fees. There can be no doubt that the Merchant Restraints seriously distort the normal competitive process.

4. The Commissioner submits that evidence adduced before the Tribunal leads inescapably to the conclusion that the Merchant Restraints satisfy the requisite elements for granting an order pursuant to section 76(2) of the *Competition Act*.

5. There is no dispute that Visa and MasterCard fall within the group of persons that may the subject of an order under section 76. For example, Visa and MasterCard each supply a service and they each hold exclusive rights under trademarks. In addition, section 76(3) explicitly states that an order may be made under section 76 against a person who is engaged in a business relating to credit cards. In fact, credit card businesses are the only type of business explicitly identified in section 76. In the Commissioner's submission, this demonstrates that credit card companies, such as Visa and MasterCard, were clearly intended to fall within the scope of the price maintenance provisions.

6. Equally, there can be can be no question that the Merchant Restraints are implemented "by agreement", thus satisfying the second element of section 76. As discussed below, in order to access the Visa and MasterCard networks, Acquirers must agree to include the Merchant Restraints in each and every one of their agreements with merchants. The Respondents explicitly require that each Acquirer have written agreements with their merchants and that those written agreement incorporate the Merchant Restraints. The evidence demonstrates that Acquirers in Canada have, in fact, implemented the Merchant Restraints by imposing largely non-negotiable agreements upon merchants in Canada that wish to accept credit cards for payment. As a consequence, the Merchant Restraints are clearly implemented "by agreement", and there can be no question that the second element of section 76 has also been met in this case.

7. The last three elements of section 76 – influencing upward, vertical relationship and adverse effect on competition – are where the Commissioner has joined issue with the Respondents with respect to both the proper interpretation and application of section 76. In the Commissioner's respectful submission, however, there can be no question based on the record before the Tribunal that those elements of the applicable test for price maintenance are also satisfied.

8. The relevant market for the purpose of assessing the competitive effects of the Merchant Restraints consists of Credit Card Network Services (as defined below) supplied in Canada in respect of general purpose credit card and charge cards. Participants in this relevant market include Visa, MasterCard and American Express.

9. While the Respondents seek to substantially expand the relevant product market beyond credit cards to include all forms of payment, such as cash, cheques, debit cards and wire transfers, they have offered no credible evidence or any economic analysis to support their proposed market definition. Although remarkable, this is perhaps not surprising when one considers that the "all payments" market alleged by the Respondents is not supported by the well-established hypothetical monopolist test (indeed, the Respondents experts made no effort to apply that test). Moreover, that alleged market has been repeatedly and consistently rejected by courts and competition authorities around the world for more than 25 years. The alleged

"all payments" market is at odds and cannot be reconciled with, among other things, the distinct attributes of credit cards as compared with other payment methods, the inability of merchants to effectively substitute other payment methods (even in the face of significant price increases), and Visa and MasterCard's own internal documents and statements which belie the relevant market advocated by the Respondents in this proceeding.

10. The evidence also clearly establishes that the market for the supply of Credit Card Network Services is highly concentrated, and that each of Visa and MasterCard holds a substantial market share. There is no question that Visa and MasterCard are the two largest suppliers of Credit Card Network Services in Canada. With a combined market share of 94.2% (by number of transactions) and 92% (by dollar volume of transactions), the market for Credit Card Network Services in Canada is effectively a duopoly.

11. It is also clear on the record that within the relevant market, each of Visa and MasterCard possesses and exercises substantial market power. The evidence of the Respondents' market power includes both direct and indirect indicators of market power, such as the Respondents' ability to raise prices above competitive levels without suffering any appreciable loss of transaction volume, the setting of prices by the Respondents unrelated to costs and aimed at extracting as much of Canadian merchants' "willingness to pay" as possible, the prevalence of extensive price discrimination by the Respondents and the fact that the primary (if not the sole) constraint on Visa and MasterCard's pricing is not competition from other payment methods (or even one another), [redacted]

12. In this regard, the evidence shows that Visa and MasterCard have each increased both Interchange and Network Fees since 2007, with the result that the Card Acceptance Fees paid by merchants in Canada have increased substantially in that period. There has, however, been no unprofitable loss to either Visa or MasterCard of transaction volumes. To the contrary, the number of Canadian merchants that accept the credit cards of Visa and MasterCard has increased during the same period that Card Acceptance Fees have increased.

13. Through the Merchant Restraints, Visa and MasterCard dictate key terms upon which Acquirers may supply Credit Card Network Services to merchants, including the relative prices

that may be charged by merchants for those services. By requiring Acquirers to implement the Merchant Restraints, the Respondents have influenced upward, and discouraged the reduction of, the price at which their customers (Acquirers) supply Credit Card Network Services, thereby satisfying the third element of section 76.

14. In the absence of the Merchant Restraints, merchants could constrain Card Acceptance Fees through the most effective and straightforward means available; namely, by surcharging or threatening to surcharge certain credit cards or declining to accept higher-cost credit cards.

15. The Commissioner has illustrated the effect of the Merchant Restraints on Card Acceptance Fees by providing expert evidence and evidence from other jurisdictions relating to the "but for" world that would exist without the Merchant Restraints. This is the approach mandated by the Tribunal in its most recent jurisprudence in this area. In the absence of the Merchant Restraints, a merchant could effectively respond to higher Card Acceptance Fees for a particular credit card by attempting to steer consumers to a different and less expensive credit card or method of payment. As will be explained in further detail below, alternative methods of steering, such as discounting, are simply not effective substitutes for surcharging or refusing certain cards.

16. Because the Merchant Restraints prevent merchants from effectively encouraging customers to use lower-cost payment methods, the Merchant Restraints remove or reduce any incentive on the part of Visa and MasterCard to compete by reducing either Interchange Fees, Network Fees or, indirectly, Card Acceptance Fees. Instead, the Merchant Restraints allow Visa and MasterCard to maintain higher prices and Interchange Fees associated with the provision of Credit Card Network Services in Canada, without facing meaningful countervailing pressure from merchants or otherwise suffering any loss in volume as would normally occur when a firm charges higher prices in a competitive market. In fact, with the Merchant Restraints in place, the Respondents "compete" primarily over which network can offer Issuers the opportunity to collect the *highest* fee revenues from merchants. This turns the traditional competitive model on its head.

17. The evidence establishes that Acquirers are customers of Visa and MasterCard. This is sufficient to bring this relationship into the scope of section 76 – it is clearly a vertical relationship.

18. With respect to the fifth and final element – "adverse effects" – the evidence clearly demonstrates that the Merchant Restraints have adverse effects on competition by substantially reducing or eliminating the incentive of the Respondents to reduce Network Fees, Interchange Fees or, indirectly, Card Acceptance Fees. Moreover, the Merchant Restraints have the effect of distorting the price signals provided to customers when electing to use a payment method at the point of sale, and suppressing competition between Visa and MasterCard on a variety of levels. The Merchant Restraints preserve and enhance the Respondents' market power.

19. The elimination of the Merchant Restraints would unleash competitive forces that have been lacking in the market for Credit Card Network Services for years, by providing merchants with the ability to send the correct price signals to customers when electing to use a payment method, and enabling merchants to otherwise effectively steer transactions to lower-cost credit cards or other methods of payment.

20. As discussed below, the Respondents have advanced various argument relating to the interpretation of section 76 in support of their contention that the price maintenance provisions cannot (and should not) be applied to the Merchant Restraints. The Respondents have also attempted to "defend" the Merchant Restraints on the basis of a number of purported defences or justifications.

21. The interpretation of section 76 favoured by the Respondents, which would restrict the provision to circumstances where there is a resale of a product – *physically unchanged* – by a reseller – is at odds with the plain words of the provision, read in their grammatical and ordinary sense, as well as with the legislative evolution and history of the provision. The Respondents' interpretation would eviscerate the Tribunal's jurisdiction under section 76 and thereby undermine, rather than advance, the objects of section 76 and the *Competition Act*. The position of the Respondents in respect of the proper interpretation of

section 76 is not supported by the wording of that provision, by the legislative history of that provision or by authority. It should therefore be summarily rejected.

22. Apart from being irrelevant to the question of whether the Merchant Restraints contravene section 76 of the *Competition Act*, the Respondents' so-called "defences" and purported "justifications" of the Merchant Restraints are entirely without merit. In reality, they are little more than self-serving assertions that, as explained below, are unsupported by the evidence and in many cases, are fundamentally at odds with market realities.

23. For these reasons, and those set out below, the Commissioner respectfully requests that the Tribunal grant pursuant to section 76 an Order prohibiting each of the Respondents from implementing or enforcing their No Surcharge Rule, Honour All Cards and No Discrimination Rules, as discussed below, in the form set out in Appendix "A" or Appendix "B" to these Closing Submissions.

Industry Structure

24. Canada has a highly developed payment card infrastructure. Credit card products have been used to pay for goods and services in Canada since the late 1960s.[1] Since that time, the use of credit cards in Canada has continued to increase. Indeed, Canadian credit card use has grown faster than any other payment method over the past 10 years. Between 2001 and 2009, the number of annual credit card transactions per Canadian inhabitant grew from 42.5 to 79.3, an increase of 86.6%.[2]

25. A study by the Canadian Task Force for the Payments System Review (the "Payments Task Force"), published in September 2010, states that "[c]redit cards continue to be the fastest-growing payment method (both in terms of the number of transactions and volume), fueled by widespread acceptance, credit availability, high brand awareness and rewards programs."[3] The Payments Task Force also noted that the compound annual growth rate ("**CAGR**") of Canadian

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1 MasterCard commenced issuing and acquiring in Canada in 1973, while Visa started doing so under the Chargex name in 1968. [redacted]

2 See Expert Report of Mike McCormack ["**McCormack Report**"], Exhibit CA-33, para. 40.

3 See *Ibid*, para. 41.

credit card payment transaction volume from 2004 to 2010 was 8.2%, nearly double that of the next fastest growing payment method, debit cards, which had a CAGR of 4.2% over the same period.[4]

26. Visa and MasterCard operate the leading general purpose credit card payment networks in Canada, collectively processing approximately $286.95 billion in purchases in 2010 alone.[5]

27. The Respondents are the two dominant brands of general purpose credit cards available to consumers in Canada. As MasterCard has acknowledged in an internal document, "[t]he third (and indeed a distant third) brand of general purpose cards in Canada is American Express".[6]

28. A general purpose credit card is a credit card that is accepted as a form of payment at a large variety of merchant locations.[7] By contrast, proprietary cards (such as a Holt Renfrew card) typically can only be used at the locations of the merchants that issue those cards. There are two major types of general purpose credit cards. First, cards which require the balance to be paid off in full within a specified time period, often referred to as "charge cards" (such as certain American Express cards). Second, cards which require the cardholder to pay only a minimum portion of the balance on the account within a specified period of time and permit the cardholder to pay the remainder over time (such as Visa and MasterCard credit cards).[8] The Commissioner refers to general purpose credit cards and charge cards collectively as "credit cards".

29. In addition to the fact that they may be used to purchase goods and services from many unrelated merchants, general purpose credit cards have additional features that differentiate them from other payment methods, such as Interac debit cards, cash and cheques. For example, credit cards have the following features: an interest-free period from the time of purchase to the

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4 *Ibid*.

5 See The Nilson Report, Issue No. 967, Exhibit R-039.

6 MasterCard Canada, "Maintaining Competition in the Canadian Credit Card Industry", Exhibit A-117, pp.11-12.

7 See *Ibid*.

8 See McCormack Report, *supra*, para. 20.

end of the billing period; the provision of a form of unsecured and revolving credit; the ability to make purchases at any time, including online or over the telephone; protection of cardholders against liability for fraudulent transactions; and in certain circumstances, the provision of rewards or other benefits, such as air travel points, car insurance, damage and loss insurance and extended warranty programs.[9]

30. Contrary to the assertion of the Respondents, debit cards are not effective substitutes for credit cards. In fact, in their own documents as well as in their public statements and prior testimony, the Respondents have recognized repeatedly that credit cards and debit cards are distinct products, and not effective substitutes. For example, [redacted]

31. [redacted]

[redacted]

32. Don LeBeuf (Vice-President and Head, Customer Delivery, MasterCard Canada) also stated to the House of Commons Standing Committee on Industry, Science and Technology delivered only six months ago, in November 2011, that "debit and credit transactions are

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9 See, [redacted]

10 [redacted]

11 [redacted]

completely different, with a completely different risk profile, and the pricing for debit is substantially lower."[12]

33. Further, as asserted by Visa in a response to the European Commission's consultation on payment cards, credit cards "offer a different function to debit cards – namely the inherent feature of an unsecured extended credit facility and interest-free period…".[13] Visa's response to the Commission further explained that: "[d]ebit cards are provided as an ancillary part of a banking current account whereas credit cards are a standalone product."[14]

34. Consistent with the evidence, observations and comments from Visa and MasterCard referred to above, credit cards tend to be used for higher value purchases than debit cards, as reflected in the significantly different average transaction sizes for debit and credit cards. A 2008 study by [redacted] A similar conclusion was reached in the March 2011 Nilson Report [redacted] concluded that the average amounts of purchase transactions for American Express, Visa and MasterCard in 2010 were [redacted] and [redacted] respectively, whereas the average for Interac Debit was only $41.

35. The tendency to use credit cards for higher value purchases is also reflected at the level of individual merchants. For instance, for IKEA in 2011, the average transaction amount for a purchase made with a credit card was [redacted], compared to [redacted] for a purchase using Interac debit

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12 See House of Commons, Standing Committee on Industry, Science and Technology, *Evidence* (November 2, 2011), Exhibit A-454, p. 10.

13 "Visa Europe - Response to the Consultation on the European Commission's Interim Report I on Payment Cards", Exhibit A-129, p. 13.

14 *Ibid*.

15 See [redacted]

and [redacted] using cash.[16] Similarly, for Best Buy, the average ticket size of a purchase in 2011 was [redacted] for transactions using cash, [redacted] using Interac debit and [redacted] using a credit card.[17]

Participants in the Respondents' Credit Card Networks

36. Visa and MasterCard's credit card networks are commonly referred to as "four party" networks. In reality, however, there are five primary participants in the Respondents' respective credit card networks. Those participants are: (i) the credit card company (Visa or MasterCard); (ii) cardholders; (iii) merchants; (iv) financial institutions that issue credit cards to cardholders (known as "Issuers"); and (v) financial institutions that supply credit card network services to merchants (known as "Acquirers"). Each of these participants is described briefly below.

(a) Cardholders

37. A cardholder is a person that has been issued a credit card. Cardholders can be either consumers or businesses that use credit cards to purchase goods and services.

38. As of 2010, there were approximately [redacted] Visa and MasterCard credit cards in circulation in Canada.[18] A smaller number of these cards are considered to be actively in use by Visa and MasterCard. According to a MasterCard document produced in this proceeding, nearly [redacted] of Canadians are "non-revolving", meaning that generally they do not carry a credit card balance.[19]

39. In addition, many Canadians carry more than one type of credit card. A 2010 Visa Presentation notes that [redacted] of Canadian cardholders hold more than one type of credit card.[20]

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16 See Witness Statement of Charles Symons ["**Symons Statement**"], Exhibit A-087, para. 18.

17 See Witness Statement of Michael Shirley ["**Shirley Statement**"], Exhibit A-093, para. 15.

18 See [redacted]

19 [redacted]

20 See [redacted]

[redacted] Many people that hold credit cards also hold debit cards.

(b) Merchants

40. Merchants are sellers of goods or services. Hundreds of thousands of merchants in Canada accept credit cards as a form of payment. Evidence from the Respondents during the hearing demonstrates that a very large number of merchants in Canada accept Visa and MasterCard credit cards, and that the number of merchants who accept these credit cards has increased substantially in recent years. Hundreds of thousands of merchants in Canada that accept either or both Visa and MasterCard credit cards do not accept American Express cards.

41. Betty DeVita (President of MasterCard Canada) provided the following testimony regarding the significant expansion that has occurred in recent years in the number of merchant outlets accepting MasterCard:

> "MR. SIMPSON: Are you able to assist the Tribunal about the -- as to the growth, if any, of merchant locations of MasterCard over the last five years?
>
> MS DEVITA: Yes. In terms of the number of merchant locations, we've had significant growth. Obviously that started before I was there. We're at approximately 840,000 merchant locations today.
>
> MR. SIMPSON: Right. And with specific reference to paragraph 14 of your witness statement, Mrs. Devita *[sic]*, that is a growth to 839,000 from what number five years previously?
>
> MS DEVITA: 680,000"[22]

42. Similarly, William Sheedy (Group President, Americas of Visa Inc.), testified that [redacted]

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21 See [redacted]

22 See Transcript of May 30, 2012 (Volume 14), pp. 2469 (line 24) to 2470 (line 11).

23 See [redacted]

43. For many Canadian merchants, accepting Visa and MasterCard credit cards is a competitive necessity.[24] [redacted] Paul Jewer of Sobeys testified as follows:

> "MR. AKMAN: And can you please explain to the Tribunal your views as to whether it is a viable option for Sobeys and other grocers to refuse to accept all Visa and MasterCard credit cards?
>
> MR. JEWER: We believe it is not a viable option. Customers have come to expect that their credit cards will be able to be used in our stores. Credit card use is ubiquitous. All of our customers, excluding Costco, accept Visa and MasterCard.
>
> We think it is difficult to refuse a legitimate payment method that is chosen by our customers, particularly in the competitive environment in which we operate."[25]

44. Similarly, [redacted] testified as follows:

[redacted][26]

45. [redacted]

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24 See [redacted]

25 See Transcript of May 24, 2012 (Volume 10), pp. 1730 (line 22) to 1731 (line 10).

26 See [redacted]

[redacted]

46. Visa's own representative on discovery, [redacted], conceded during discovery that [redacted]

[redacted]

47. [redacted]

[redacted]

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27 [redacted]

28 [redacted]

[redacted][29]
[emphasis added]

48. As described in further detail below, despite substantial increases that have occurred in the period from 2008 onwards in the costs associated with accepting credit cards, very few Canadian merchants have stopped accepting Visa or MasterCard credit cards. Indeed, to the contrary, merchant acceptance has increased. [redacted] As acknowledged by one of MasterCard's witnesses during the hearing:

> "MR. AKMAN: Okay. You will agree with me that despite the introduction of higher-cost premium MasterCard credit cards, merchants have continued to accept MasterCard credit cards; is that right?
>
> MR. COHEN: Yes, they have."[30]

49. Similarly, throughout the period from 2008 onwards during which the cost of accepting credit cards has increased, the volume of transactions in Canada using Visa and MasterCard credit cards has continued to increase. According to *The Nilson Report* - a well-recognized industry source - the value of general purpose credit card purchases conducted using Canadian-issued Visa, MasterCard, American Express, and Diners Club credit cards increased 212.7% between 1998 and 2010, from CA$102.0 billion in 1998 to CA$319 billion in 2010.[31] In the same period, the number of Canadian general purpose credit card transactions rose from 1.1 billion (in 1998) to 3.0 billion (in 2010), an increase of 172.7%.[32]

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29 [redacted]

30 Transcript of June 6, 2012 (Volume 19), p. 3302 (lines 7-12).

31 See McCormack Report, *supra*, para. 45.

32 See *ibid.*

(c) Issuers

50. Visa and MasterCard do not supply credit cards directly to cardholders. Rather, Visa and MasterCard-branded credit cards are issued to cardholders by financial institutions known as Issuers.

51. An Issuer of Visa or MasterCard credit cards is a financial institution authorized by Visa or MasterCard to enter into agreements with cardholders in Canada for the use of credit cards bearing the Visa or MasterCard brand.[33] The vast majority of credit card transaction volume in Canada is attributable to Visa or MasterCard credit cards issued by Canada's largest banks, including RBC, BMO, TD, CIBC, BNS and National Bank.

52. Issuers earn significant revenues from credit card programs. [redacted]

53. [redacted]

[redacted]

[redacted]

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33 See Transcript of May 14, 2012 (Volume 4), pp. 575 (line 24) to 576 (line 3).

34 See [redacted]

35 See [redacted]

36 See *ibid.*

[redacted]

54. Each Issuer determines how to market its Visa and/or MasterCard-branded credit cards to consumers, subject to meeting certain requirements prescribed by Visa or MasterCard. An Issuer decides whether to offer a particular type of Visa or MasterCard credit card to a particular consumer and the terms upon which it will issue that card. For example, the Issuer will set the level of the annual fee payable by cardholders for the credit cards it issues, the interest rate to be paid by cardholders on any outstanding account balance, and the type and level of other charges associated with using the credit function of a given credit card.[40]

55. Issuers will also determine the level of any rewards or benefits that may be earned by a cardholder for using a particular credit card, [redacted] The evidence before the Tribunal disclosed that a significant number of cardholders do not receive <u>any</u> rewards on their credit cards. [redacted][42]

56. [redacted]

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37 See *ibid.*

38 [redacted]

39 See *ibid.*

40 See McCormack Report, *supra*, para. 16(i).

41 See [redacted]

42 *Ibid* [redacted]

[redacted][43].

(d) Acquirers

57. Visa and MasterCard do not supply directly to merchants in Canada the services that merchants require to be able to accept Visa- or MasterCard-branded credit cards for payment. Rather, Visa and MasterCard supply these services through financial institutions called "Acquirers".

58. [redacted]

59. The Code of Conduct for the Credit and Debit Card Industry in Canada (the "**Code of Conduct**"), promulgated by the Department of Finance in 2010, was the result of extensive consultation and deliberation over a lengthy period. Virtually every major participant in the credit card industry in Canada participated in that process, accepted the Code of Conduct and agreed to abide by its terms. These participants include Visa, MasterCard and the TD Bank. The Code of Conduct includes the following definition of Acquirers:

> Acquirers are entities that enable merchants to accept payments by credit or debit card, by providing merchants with access to a payment card network for the transmission or processing of payments.[46]

60. [redacted]

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43 See [redacted].

44 See [redacted]

45 [redacted]

46 See "Code of Conduct for the Credit and Debit Card Industry in Canada", Exhibit RM-8.

[redacted]

[emphasis added]

61. [redacted]

62. Similarly, Jordan Cohen, President of Global Payments Canada described the services that Global Payments provides to merchants as follows in his testimony before the Tribunal: "My company allows and facilitates merchant to accept payment cards."[49]

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47 [redacted]

48 [redacted]

49 Transcript of June 6, 2012 (Volume 19), p. 3283 (lines 9-10).

63. [redacted]

64. A merchant who wishes to accept a Visa- or MasterCard-branded credit card for payment must process all transactions using such cards through the credit card network associated with that brand. 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**").

65. 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.

66. Consistent with the foregoing, Kevin Stanton (the former President of MasterCard Canada) testified explained authorization, clearing and settlement as follows during his examination-in-chief:

> "MR. STANTON: … Authorization is the phase of a transaction where the merchant seeks approval from the issuer for the transaction that it will be valid. That happens through their acquirer.
>
> That transaction authorization may be at the level of the purchase or it may be something less or more than the level of purchase, and when it's less, for example, when you're getting gas at an unattended pump, or when you check into a hotel, they're getting an authorization for more than what they think you will spend.

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50 [redacted]

51 [redacted]

> Clearance is the process that reconciles the authorization against what you actually spent, and then settlement is the process through which the parties to the transaction are paid."[52]

67. Acquirers may also provide merchants with certain other ancillary services related to the acceptance of credit cards, such as point of sale terminal rentals and reporting services, in addition to the Credit Card Network Services described above. However, without the ability to access the Visa or MasterCard network, these ancillary services would be of little or no value.[53]

68. If Acquirers did not provide access to the networks of Visa or MasterCard, merchants would not be able to accept Visa or MasterCard credit cards as a form of payment and there would be no demand for the other ancillary services provided by Acquirers in respect of credit cards.[54] Access to the Respondents' networks is the central, fundamental and irreplaceable component of the services provided by Acquirers to their merchant customers.[55]

69. The fact that access is provided to merchants indirectly, through the processing systems of acquirers, rather than directly by Visa and MasterCard, is a classic "red herring" that has no bearing on the application of s. 76 of the Act to the facts and circumstances at issue, and is of no moment in this proceeding.

(e) Credit Card Networks

70. The final participant in the credit card networks is the credit card network itself.

71. Each of Visa and MasterCard has created and operates a payment network that permits the use of their own branded credit cards as a method of payment by consumers in their dealings with merchants in Canada.

72. Although Visa and MasterCard's operations are conducted primarily through their respective Issuers and Acquirers, each of the Respondents maintain control over essential terms

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52 Transcript of May 30, 2012 (Volume 14), p. 2449 (lines 4-18).

53 See McCormack Report, *supra*, para. 16(h); Reply Expert Report of Mike McCormack ["**McCormack Reply Report**"], Exhibit CA-36, pp. 14-15.

54 See *ibid*.

55 See *e.g*. McCormack Reply Report, *supra*, para. 37.

upon which Credit Card Network Services are supplied to merchants in Canada through the imposition of the Visa International Operating Regulations and the MasterCard Rules to which Issuers and Acquirers are required to adhere.[56]

73. The control exerted by the Respondents was described in this way by Mr. Cohen, in testimony before the Standing Senate Committee on Banking, Trade and Commerce in May 2011:

> "[i]t is important for you to understand that for a payments processor, **the networks are the judges and the juries. They set the regulations. They have the right to impose fines on us. They have a great deal of power over our activities.** We cannot participate in the system unless we are complying with the regulations of Visa, MasterCard, and Interac."[57]

Card Acceptance Fees

74. Each time a Visa or MasterCard credit card is presented for payment in Canada, a merchant must pay its Acquirer a fee for the Credit Card Network Services provided in connection with that transaction. This *ad valorem* fee, which is commonly referred to as a "Card Acceptance Fee", "Merchant Service Fee" or the "Merchant Discount Rate", is equal to a percentage of the purchase amount.

75. As will be described in greater detail below, Card Acceptance Fees paid by Canadian merchants range between approximately 1.5% and more than 4% of the purchase price of the good or service sold, depending upon (among other things) the type of credit card used, the type or size of merchant and the type of transaction. Each year, Canadian merchants pay more than $5 billion in Card Acceptance Fees.

76. The evidence before the Tribunal establishes that as a practical matter, Visa and MasterCard exert a substantial control over Card Acceptance Fees paid by merchants in Canada, and that Card Acceptance Fees are a significant cost to Canadian merchants. Indeed, in some

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[56] See Exhibit "D" to the Witness Statement of William Sheedy ["**Sheedy Statement**"], Exhibit CRV-418, and Exhibit "F" to the Witness Statement of Kevin Stanton ["**Stanton Statement**"], Exhibit CRM-444.

[57] "Minutes of Proceedings of the Standing Senate Committee on Banking, Trade and Commerce", Exhibit A-514, p. 18.

cases, Card Acceptance Fees will equal or exceed the entire profit margin of the merchant. For example, [redacted] testified that Canadian grocers [redacted] while the amount that [redacted] pays in Interchange Fees alone is now approximately [redacted] on Visa credit cards and [redacted] on MasterCard credit cards.[58]

77. The evidence also demonstrates that in recent years Card Acceptance Fees for merchants have increased substantially as a result of changes to Visa and MasterCard's respective Interchange Fees and Network Fees, and because of the introduction, and increasing penetration of, "premium" and "super premium" credit card products that carry substantially higher Interchange Fees.

78. Each of the merchants that testified before the Tribunal cited significant increases they have experienced in Card Acceptance Fees in recent years, including higher Card Acceptance Fees resulting from increases in Interchange Fees. For example, in his Witness Statement, Tim Broughton, co-owner of C'est What?, Inc. ("**C'est What**"), a restaurant in Toronto, testified that C'est What's effective cost of credit card acceptance increased from [redacted] in 2004 to [redacted] in 2011.[59] Mr. Broughton also commented on the significant and increased card acceptance costs imposed by the Respondents' premium credit cards on his small business (with "no additional value"):

> "The higher card acceptance costs associated with premium credit cards impose even more significant costs on C'est What, with very little advantage or benefit, if any, to C'est What. The average rate for each premium credit card transaction is [redacted] (the range is from [redacted] to [redacted]. Compared to the original [redacted] basic rate charged between 2004 and September 2008, this represents an increase of 62%, while yielding no additional value to C'est What. By December 2011, [redacted] of all transactions [redacted] of dollar volume) at C'est What occurred with a premium credit card."[60]

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58 See, Witness Statement of Paul Jewer ["**Jewer Statement**"], Exhibit CA-104, p. 5, para. 18.

59 See Witness Statement of Tim Broughton ["**Broughton Statement**"], Exhibit CA-13, paras 7 to 14. See also Witness Statement of Craig Daigle ["**Daigle Statement**"], Exhibit CA-16, para 26.

60 Broughton Statement, Exhibit CA-13, para. 15.

79. Craig Daigle of Shoppers Drug Mart testified that:

> "…Shoppers' Card Acceptance Fees for Visa and MasterCard increased from [redacted] million in 2007 to [redacted] million in 2011, an increase of [redacted]. Shoppers' average Card Acceptance Fee increased from [redacted] in 2007 to [redacted] in 2011 for Visa credit card transactions and from [redacted] in 2007 to [redacted] in 2011 for MasterCard credit card transactions."[61]

80. Marion van Impe of the University of Saskatchewan testified as follows regarding the rising Card Acceptance Fees paid by the University:

> "…in the ensuing 10 year period, the average Merchant Service Fee increased by about 20% from [redacted] to approximately [redacted] At the same time, the percentage of tuition paid by credit card increased to 42% in 2010. As a result of the increasing costs of credit card acceptance and increased use of credit cards, the overall cost to the University resulting from accepting credit cards for tuition payments rose from the original estimate of $140,000 in 2000 to $900,000 in the 2009-2010 academic year, an increase of over 600%. This increase made the costs of accepting credit cards for tuition payments unsustainable for the University."[62]

81. The principal components of the Card Acceptance Fees paid by Canadian merchants for Credit Card Network Services in connection with Visa and MasterCard credit card transactions are: (i) Network Fees that are established unilaterally by Visa or MasterCard and retained by them (ii) Interchange Fees that are established unilaterally by Visa and MasterCard and retained by Issuers; and (iii) Acquirer Service Fees retained by Acquirers.

82. Far and away the most significant component of the Card Acceptance Fees paid by merchants in Canada are the Interchange Fees determined unilaterally by Visa and MasterCard. The suggestion by Visa and MasterCard that they exert no control over or influence on Card Acceptance Fees paid by merchants in Canada, either directly or indirectly, is without merit.

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61 Daigle Statement, Exhibit CA-16, para. 26.

62 Witness Statement of Marion van Impe ["**van Impe Statement**"], Exhibit CA-97, para. 16.

83. Each of these components is discussed in turn below.

(a) Network Fees

84. Both Acquirers and Issuers pay Network Fees to Visa and MasterCard on each transaction processed through the Respondents' respective credit card networks. On a typical credit card transaction, the Issuer and Acquirer will each pay Network Fees of between [redacted] and [redacted] basis points, for total Network Fees of about [redacted] to [redacted] basis points, or [redacted]% to [redacted]% of the transaction value. [redacted][63]

85. Both Visa and MasterCard have increased their respective Network Fees in Canada during the last five years. By way of example, [redacted] That increase was significant and non-transitory in nature, did not give rise to any discernible shift to other forms of payment, and remains in effect.

86. [redacted][65]

87. The evidence establishes overwhelmingly that as a practical matter, increases in Network Fees are ultimately passed on to merchants in the form of higher Card Acceptance Fees. [redacted][66]

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63 See [redacted]

64 See [redacted]

65 See McCormack Report, *supra*, para. 104 and [redacted]

66 [redacted]

(b) Interchange Fees

88. By far, the largest component of Card Acceptance Fees paid by Canadian merchants are Interchange Fees that are determined unilaterally by Visa and MasterCard and paid to Issuers in Canada.

89. As Kevin Stanton (then President of MasterCard Canada) explained in a letter dated April 17, 2009, to the Honourable Michael A. Meighen, Chair, Senate Standing Committee on Banking, Trade, and Commerce, "Interchange is generally the largest component of the merchant discount rate paid by a merchant to its acquirer and, therefore, has a direct effect on a merchant's cost of card acceptance."[67]

90. On average, Interchange Fees constitute more than 80% of the total Card Acceptance Fees paid by merchants in Canada. For example, [redacted]

91. For larger merchants in Canada, Interchange Fees often represent more than [redacted] of their total Card Acceptance Fees. For example, Mario de Armas of Walmart testified that Interchange Fees and Network Fees represent approximately [redacted] of Walmart Canada's total Card Acceptance Fees:

[redacted]

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67 "Letter to Senator Michael Meighen from Kevin Stanton", Exhibit A-449, p. 8.

68 See [redacted]

[redacted]

92. Visa and MasterCard establish unilaterally so-called "default Interchange Fees" applicable to credit card transactions in Canada using their respective brands of credit cards. Although Visa and MasterCard both state that Issuers and Acquirers are free to negotiate bilateral agreements to set Interchange Fees that deviate from the level of default Interchange Fees, the evidence establishes [redacted]

93. [redacted]

94. The Respondents' control over the level of Interchange Fees in Canada, and therefore over Card Acceptance Fees paid by Canadian merchants, was also recognized in [redacted]

[redacted]

69 Witness Statement of Mario de Armas [**"de Armas Statement"**], Exhibit CA-2, para 38.

70 [redacted]

71 See [redacted]

72 [redacted]

[redacted]

95. Consistent with the evidence of Visa and MasterCard, [redacted]

96. Jeff van Duynhoven, the Senior Vice President of TD Merchant Services, also testified that there is no "economic justification" for deviating from the default Interchange Fees established by Visa and MasterCard. Mr. van Duynhoven claimed in his witness statement that such negotiations were difficult given "the challenging logistics of negotiation with thousands of issuers".[75] That claim, however, is at odds with the fact that a small number of Issuers in Canada represent the vast majority of credit card transactions that occur in this country. On cross-examination [redacted]

[redacted]

[redacted]

74 See [redacted]

75 See Witness Statement of Jeffrey van Duyhoven [**"van Duynhoven Statement"**], Exhibit CIT-457, para 28.

[redacted]

97. There can be no doubt that, as a practical matter, the default Interchange Fees set unilaterally by Visa and MasterCard establish a floor for Card Acceptance Fees paid by Canadian merchants. In this regard, [redacted]

98. While the Respondents (and Intervenors) have repeatedly described Interchange Fees as fees paid by Acquires to Issuers, the evidence before the Tribunal clearly shows that as a practical matter, in virtually all cases, Interchange Fees ultimately are paid by Canadian merchants, rather than by their Acquirers. Interchange Fees vary based on the characteristics of the merchants, not Acquirers. These include, among others, the industry in which the merchant participates (*e.g.*, grocery versus consumer electronics) and the size of the merchant's credit card purchase volume. If Interchange Fees were intended to be borne by Acquirers, one would expect to see the largest Acquirers in Canada or those with the lowest risk profiles paying less than others. But this is not the case. Instead, all Acquirers face the same set of Interchange Fees and have no ability to negotiate reduced Interchange Fees.

99. Although Interchange Fees are passed on to merchants as the largest component of the Card Acceptance Fees they are required to pay, the evidence establishes that with very few exceptions Interchange Fees cannot be negotiated by merchants, no matter how sizeable their operations in Canada may be. For example, Michael Shirley of Best Buy testified as follows:

> "MR. THOMSON: Are the interchange fees typically negotiated with Best Buy?
>
> MR. SHIRLEY: No.
>
> MR. THOMSON: Are the network fees ever negotiated with Best Buy?

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[76] See [redacted]

[77] *Ibid*., [redacted]

> MR. SHIRLEY: No. We are given very little room to manoeuvre. We've tried in the past, over the years, to challenge interchange and the other fees, and the only place where we have ever been successful is with the acquirer fees."[78]

Mario de Armas of WalMart testified to similar effect:

> "MR. SIMPSON: Right. And because, as the second largest retailer in Canada and one of the largest retailers in the world, you don't feel you have enough leverage doing hundreds of billions of dollars a year in business to try to get the card companies to the table to do something for you?
>
> MR. DE ARMAS: That is the correct -- as we are the largest retailer in the world, and we don't have significant leverage in order to get the card networks -- well, specifically to get Visa and MasterCard to the table to negotiate lower costs of acceptance. We have had success with other card networks."[79]

i. Increases in Interchange Fees

100. For many years, Visa and MasterCard each had a single Interchange Fee level. [redacted]

101. In 2006, MasterCard proceeded with an IPO and became a separate "for profit" publicly traded company. Visa followed suit in 2008. As both companies moved away from "membership" structured joint ventures, the need for the "non-duality regime" that had long characterized the credit card industry in Canada abated or disappeared. This was made clear in a letter of November 7, 2008 from Sheridan Scott, then the Commissioner of Competition, to a variety of industry participants, including Visa and MasterCard. In the non-duality world that had prevailed in Canada until 2008, issuers could issue Visa cards or MasterCard cards but not both. From 2008 onwards, however, issuers in Canada have been free to issue whatever credit cards they wish, and Visa and MasterCard have competed for their affections and attention

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78 See Transcript of May 23, 2012 (Volume 9), p. 1633 (lines 4-13).

79 See Transcript of May 9, 2012 (Volume 2), pp. 310 (line 17) to 311 (line 4).

80 See [redacted]

including by increasing the Interchange Fees received by issuers if credit cards are issued to Canadian cardholders.

102. In April 2008, Visa introduced premium "Infinite" credit card products with higher Interchange Fees that were payable in respect of its standard credit cards. The introduction of premium credit cards and other changes to Visa's pricing structure caused Visa's overall effective Interchange Rate to [redacted]% prior the introduction of premium cards in 2008 to [redacted]% in 2011, [redacted]%.[81]

103. In June 2008, MasterCard introduced a "high spend" program in Canada whereby substantially higher Interchange Fees became payable in respect of existing MasterCard credit cards if cardholders exceeded certain spending thresholds established by MasterCard. [redacted] Subsequently, in April 2009, MasterCard introduced "premium high spend" credit cards with Interchange Fees that are even higher than the Interchange Fees on Visa's premium "Infinite" credit card products and on MasterCard's own premium Interchange Fee category.[82] [redacted][83]

104. In her testimony before the Tribunal, Betty DeVita (President of MasterCard Canada) confirmed that the introduction by MasterCard of its high-spend program caused MasterCard's effective interchange rate to jump roughly [redacted] as compared to MasterCard's effective interchange rate in 2008. Ms DeVita also testified that the introduction of the MasterCard

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81 Se[redacted]

82 See[redacted]

83 [redacted]

premium high-spend credit card [redacted] MasterCard's effective interchange rate by roughly [redacted]% relative to MasterCard's effective interchange rate in 2008.[84]

105. As a result of the new rate structure and rate increases, MasterCard's overall average Canadian Interchange Fees and Acquirer Network Fee rate [redacted]% in 2007 to approximately [redacted]% by 2011, [redacted] approximately [redacted]%.[85]

106. The following chart, which appears in an internal MasterCard document produced in this litigation, [redacted]

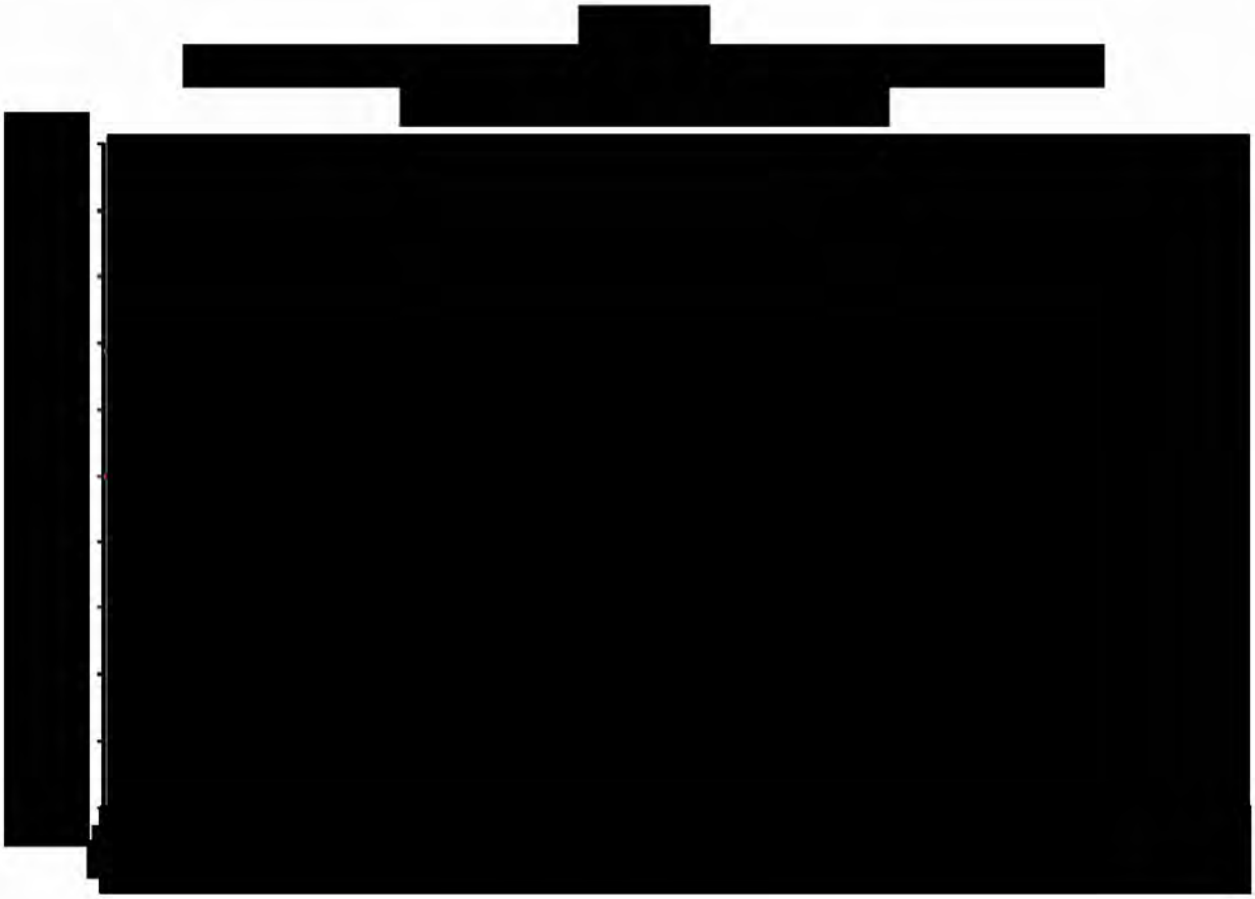
84 *Ibid.*

85 See [redacted]

[redacted]

[redacted]

[86] See [redacted]



107. As outlined in the tables below, MasterCard now has 30 different domestic Interchange Fee categories, with additional categories for international transactions. Similarly, Visa now has 24 different domestic Interchange Fee categories.

108. The Interchange Fees set by the Respondents vary depending on a number of factors, including the type of merchant (such as supermarket versus electronics retailer), the type of credit card presented for payment (such as a standard and premium credit card) and the type of transaction (standard versus electronic).[87]

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87 For example, Visa defines "Standard" transactions as "transactions where the card is not present or the magnetic stripe or chip is not read electronically, for example, online purchases, telephone order transactions, carbon paper card imprints" and "Electronic" transactions as "transactions that are fully authorized electronically, where the card is present and where the magnetic stripe or chip is read." (Exhibit "K" to the Witness Statement of Karen Leggett [**"Leggett Statement"**], Exhibit CI-472, p. 170) Similarly, MasterCard defines "electronically-captured" transactions as "a transaction authorized and settled electronically where full data from either the magnetic strip or the integrated circuit chip is read by a point-of-sale (POS) terminal and transmitted in its entirety to the issuer" and "All other MasterCard transactions" as "a transaction where full data from either the magnetic stripe or the integrated circuit chip

Visa Interchange Fees[88]

Fee Program	Classic/ Gold/ Platinum	Infinite	Commercial Credit
Industry Program – Grocery	1.36%	1.56%	1.85%
Industry Program - Gas	1.21%	1.41%	1.80%
Performance Program - Tier 1	1.40%	1.60%	1.80%
Performance Program - Tier 2	1.45%	1.65%	1.85%
Recurring Payments	1.40%	1.60%	1.85%
Emerging Segments	1.00%	1.20%	1.80%
Electronic	1.54%	1.74%	1.90%
Standard	1.65%	1.85%	2.00%

MasterCard Interchange Fees[89]

Fee Program	Consumer Core	Consumer High Spend	Consumer Premium High Spend	Commercial Core	Commercial Premium High Spend
Merchants with Annual MasterCard dollar volume in Canada in excess of $1 billion	1.40%	1.60%	2.00%	2.00%	2.00%
Merchants with Annual MasterCard dollar volume in Canada in excess of $400 million	1.45%	1.65%	2.00%	2.00%	2.00%

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is not read by a point-of-sale (POS) terminal and/or not transmitted in its entirety to the issuer, or a transaction where the card, the cardholder, and/or the merchant representative is not present at the time of the transaction. Mail order, telephone order and electronic commerce are examples of these transactions": "MasterCard Interchange Rate Overview", Exhibit RM-7, p. 4.

88 See Exhibit "K" to Leggett Statement, *supra*, p. 170.

89 See Witness Statement of Betty K. DeVita [**"DeVita Statement"**], Exhibit CRM-452, p. 35.

Petroleum merchants with Annual MasterCard dollar volume in Canada in excess of $400 million	1.21%	1.41%	2.00%	2.00%	2.00%
Supermarket merchants with Annual MasterCard dollar volume in Canada in excess of $400 million	1.36%	1.56%	2.00%	2.00%	2.00%
All other electronically-captured MasterCard card present tractions	1.59%	2.00%	2.25%	2.00%	2.25%
All other MasterCard transactions	1.72%	2.13%	2.65%	2.00%	2.65%

109. Given that Interchange Fees determined by Visa and MasterCard almost always constitute the largest component of Card Acceptance Fees paid by merchants in Canada, it is not surprising that there is a very high correlation between the level of Visa and MasterCard's respective default Interchange Fees and the level of Card Acceptance Fees paid by merchants when accepting credit cards of Visa and MasterCard for payment.

110. As [redacted] testified:

[redacted]

111. Similarly, [redacted]

[redacted]

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90 See [redacted]

[redacted]

112. An internal TD Bank document produced in this proceeding states (in relevant part) that [redacted] That document also contains the following statement: [redacted][93]

ii. The Interchange Fee "Gap" Between Visa and MasterCard

113. The launch by MasterCard in Canada of its high spend program in June 2008 and premium high spend cards in April 2009, both with substantially higher Interchange Fees than those applicable to Visa's core and Infinite premium cards, has resulted in a significant "interchange gap" between Visa and MasterCard in Canada. Remarkably, that interchange gap has persisted for several years. [redacted]

114. [redacted]

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91 See [redacted]

92 [redacted]

93 *Ibid.*

115. [redacted]

116. [redacted]

117. [redacted]

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94 [redacted]

95 [redacted]

[redacted]

118. [redacted]

119. [redacted]

120. [redacted]

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96 See [redacted]

97 [redacted]

98 [redacted]

99 See [redacted]

100 See [redacted]

[redacted]

121. [redacted]

122. [redacted]

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101 *Ibid.*, [redacted]

102 *Ibid.*, [redacted]

[redacted]

123. Critically, as discussed more fully in the portions of these submissions relating to the issues of market definition and market power there has, in fact, been no competitive response by Visa to the interchange gap, and the status quo has persisted. [redacted]

124. [redacted]

125. [redacted]

[redacted]

103 Se [redacted]

104 See [redacted]

105 [redacted]

[redacted] [emphasis added]

(c) Acquirer Service Fees

126. As a general matter, the smallest component of the Card Acceptance Fee is typically the portion retained by the Acquirer, known as the Acquirer Service Fee. This is also referred to, on occasion, as the Acquirer's margin.

127. Historically, Acquirers charged merchants a single percentage rate (*e.g.*, 2%) for each credit card brand, sometimes referred to as a "bundled rate". A bundled rate includes the Interchange Fee, the Network Fees and the Acquirer Service Fee.[107]

128. With the increase in the number of Interchange Fee categories in 2008, merchants sought increased transparency or visibility from Acquirers with respect to the components of the Card Acceptance Fees they were required to pay. [redacted] There are now hundreds of Interchange Plus arrangements in Canada, accounting for approximately [redacted] of the volume of credit card transactions in this country.

129. Under an "Interchange Plus" arrangement, merchants typically are responsible for the payment of all Interchange Fees paid to Issuers and Network Fees paid to Visa and MasterCard. All increases in those Fees are passed on directly to merchants, even though they play no role in the negotiation or determination of these Fees. Far and away the smallest component of the Card Acceptance Fees payable by merchants under interchange plus arrangements are the Service Fees paid by Acquirers. Those Fees are the only portion of Card Acceptance Fees that are truly negotiable by merchants in Canada.

130. The small size of the Acquirer Service Fee retained by Acquirers under Interchange Plus arrangements in Canada is illustrated by evidence from [redacted]

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106 [redacted]

107 See McCormack Report, *supra*, para. 124.

108 *Ibid*, para. 127.

[redacted]

131. [redacted]

132. [redacted]

133. The other primary pricing model used by Acquirers, [redacted] is known as "Interchange Differential Pricing". Under an Interchange Differential Pricing model, the merchant pays a "base" Interchange Fee, Network Fee and Acquirer Service Fee on all transactions for which a credit card is presented for payment. The merchant then pays the Acquirer an additional amount if the customer presents a premium credit card or the transaction otherwise attracts a higher Interchange Fee.[113]

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109 See [redacted]

110 [redacted]

111 See [redacted]

112 See [redacted]

113 [redacted]

134. The evidence before the Tribunal shows that Acquirers compete vigorously on the small portion of the Card Acceptance Fee that they retain. During this proceeding, [redacted] The strength of this competition is evident from the relatively small portion of Card Acceptance Fees that Acquirers retain. For example, [redacted]

135. All of the merchants that testified in this proceeding confirmed that there is significant competition among Acquirers and that the Service Fee retained by Acquirers is a very small portion of their total Card Acceptance Fees. For example, Pierre Houle of Air Canada testified as follows:

> "Under Air Canada's agreements with [redacted] the Acquirer Service Fee represents less than [redacted] of the total Merchant Service Fee paid by Air Canada. For example, of the average Merchant Service Fee of [redacted] for Visa and MasterCard transactions, less than [redacted] is retained by [redacted] as an Acquirer Service Fee".[117]

136. Similarly, Michael Shirley of Best Buy Canada gave the following evidence:

> "Best Buy Canada was able to secure competitive pricing from Global [Payments] with respect to the portion of the Card Acceptance Fees that is retained by Global, commonly referred to as an 'Acquirer Service Fee'. The Acquirer Service Fee paid by Best Buy Canada is currently [redacted] of the transaction price, which, as outlined below, accounts for only a very small

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114 See [redacted]

115 *Ibid*., [redacted]

116 *Ibid*., [redacted]

117 Witness Statement of Pierre Houle ["**Houle Statement**"], Exhibit CA-28, para 32.

> proportion of the overall Card Acceptance Fee paid by Best Buy Canada for credit card acceptance.

The most significant component of the Card Acceptance Fee paid by Best Buy Canada is the 'Interchange Fee', which is set by Visa and MasterCard and retained by the financial institution (the 'Issuer') that issues the credit card to the cardholders. The Interchange Fees paid by Best Buy Canada currently range from [redacted] to [redacted] of the transaction price, depending on the type of card used by a customer".[118]

137. Craig Daigle of Shoppers gave similar evidence before the Tribunal:

> "There is significant competition between Acquirers for the supply of credit card network services to merchants in Canada. As a result of this competition, Shoppers is able to secure competitive pricing from Moneris with respect to its activities as an Acquirer, for which it pays a separate fee per transaction (commonly referred to as an 'Acquirer Service Fee'). For Shoppers, the Acquirer Service Fee paid to Moneris is [redacted] per transaction."[119]

138. Merchants also testified that they would readily switch to a competing Acquirer in the event that the Acquirer Service Fee was not competitive. For example, Mario de Armas of Walmart testified as follows:

> "Walmart Canada would readily switch to a rival Acquirer in the event that the pricing offered by an Acquirer was not competitive. However, as outlined below, the portion of the fee retained by an Acquirer accounts for only a very small proportion of the overall Card Acceptance Fee paid by Walmart Canada for credit card acceptance. Irrespective of the Acquirer that Walmart Canada uses, all Acquirers face the same Interchange Fees and Network Fees as other Acquirers and are subject to the same restrictions that are imposed by Visa and MasterCard."[120]

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118 Shirley Statement, *supra*, paras. 20-21.

119 Daigle Statement, *supra*, para. 21. See also Jewer Statement, *supra*, para. 29.

120 de Armas Statement, *supra*, para. 36.

139. However, as indicated by Mr. de Armas, Acquirers are unable to control, or apparently even influence, Interchange Fees and Network Fees that make up virtually all of the Card Acceptance Fees paid by merchants in Canada.

140. The inability of Acquirers in Canada to negotiate or control Interchange Fees and Network Fees is demonstrated by the fact that all Acquirers are subject to the same Interchange Fees and Network Fees from Visa and MasterCard. They cannot compete by offering to merchants in Canada lower Interchange Fees or Network Fees. [redacted]

141. In this regard, [redacted]

The Merchant Restraints

142. In Canada, Issuers and Acquirers are required to comply with the Visa International Operating Regulations ("**Visa Rules**") and the MasterCard International Rules ("**MasterCard Rules**") as a condition of gaining access to the Visa and MasterCard payment networks, respectively.[122]

143. Under the Visa and MasterCard Rules, Acquirers are required to enter into agreements with their merchant customers pursuant to which those merchants agree to comply with all of

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121 [redacted]

122 See MasterCard International Rules, 7 December 2011 ["**MasterCard Rules**"], section 1.5.5, Exhibit CRM-444, p. 331; Visa International Operating Regulations – 15 October 2011 ["**Visa Rules**"], Core Principle 1.6, Exhibit CRV-418, p. 168; [redacted]

the Visa and MasterCard Rules, including the Merchants Restraints. [123] Acquirers are also required under the Visa and MasterCard Rules to ensure that their merchants customers abide by those Rules, including the Merchant Restraints.

144. For example, the Visa Rules state in Core Principle 6.4 that an Acquirer must "[e]nsure that its Merchant complies with the [Visa Rules] regarding payment acceptance" and "[e]nsure that required acceptance provisions are included in its Merchant Agreement or as a separate addendum".[124]

145. Similarly, MasterCard requires in Rule 5.1 of the MasterCard Rules that "[e]ach Member in its capacity as an Acquirer must directly enter into a written Merchant Agreement with each Merchant from which it acquires Transactions" and that "[e]ach Merchant Agreement must contain the substance of each of the [Merchant Restraints]".[125]

146. There are three categories of Visa and MasterCard Operating Rules that are at issue in this proceeding (previously defined as the "**Merchant Restraints**"):

(a) No-Surcharge Rules These rules prohibit merchants from adding any fee to a transaction amount when a customer uses a Visa or MasterCard-branded credit card for payment. For example, Rule 5.11.2 of the MasterCard Rules provides that merchants "must not directly or indirectly require any Cardholder to pay a surcharge or any part of any [Card Acceptance Fee] or any contemporaneous finance charge in connection with a Transaction."[126] Similarly, the Visa Rules state that merchants "must not add any surcharges to Transactions, unless local law expressly requires that a Merchant be permitted to impose a surcharge";[127]

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123 See MasterCard Rules, section 5.1.2 "Required Terms", Exhibit CRM 444, p. 394; Visa Rules, Core Principle Exhibit CRV 418, p. 652; [redacted]

124 See Visa Rules, Core principle 6.4, Exhibit CRV 418, p. 652.

125 See MasterCard Rules, section 5.1, "The Merchant Agreement", Exhibit CRM 444, p. 394.

126 *Ibid*, p. 412.

127 See Visa Rules, Card Acceptance Prohibitions, Exhibit CRV 418, p. 724.

(b) Honour All Cards Rules – These rules require merchants that accept any Visa or MasterCard-branded credit cards to accept all of that brand's credit cards, regardless of the Issuer or the type of the card. Rule 5.8.1 of the MasterCard Rules requires merchants to "honour all valid [MasterCard] Cards without discrimination when properly presented for payment."[128] The Visa Rules similarly state in Core Principle 6.2 that merchants "may not refuse to accept a Visa product that is properly presented for payment;"[129]

(c) No Discrimination Rule: The MasterCard's No Discrimination Rule prohibits merchants from offering incentives, giving preferences, or steering customers away from one brand or type of credit card.[130] That rule reads "[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".[131]

(a) Effect of the Merchant Restraints

147. The evidence before the Tribunal demonstrates that the Merchant Restraints established and enforced by Visa and MasterCard prevent Canadian merchants from effectively encouraging the use of lower cost payment methods, from discouraging the use of credit cards, including particularly high priced cards, and from recovering the additional cost associated with credit cards directly from those customers who elect to use these more expensive payment methods. For example, a merchant generally cannot charge customers that elect to use Visa or MasterCard credit cards a 1% fee, even though those credit cards impose significantly higher costs on the merchant than other methods of payment.[132]

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128 See MasterCard Rules, section 5.8.1., "Honour All Cards", Exhibit CRM-444, p. 409.

129 See Visa Rules, Core Principle 6.2, Exhibit CRV-418, p. 650.

130 See MasterCard Rules, section 5.11, "Prohibited Practices", Exhibit CRM-444, pp. 412 to 415 and Chapter 11, Canada Region Rules, section 5.11, "Prohibited Practices", Exhibit CRM-444 at p. 525.

131 MasterCard Rules, section 5.11.1, "Discrimination" Exhibit CRM-444, p. 412.

132 See, *e.g.*, Houle Statement, *supra*, p. 10; Daigle Statement, *supra*, p. 9; De Armas Statement, *supra*, p. 13; Li Statement, *supra*, p. 9; Symons Statement, *supra*, p. 11.

148. The practical effect of the Respondents' Honour All Cards Rules is that if a Canadian merchant accepts one type of Visa or MasterCard credit card, it must accept all types of Visa or MasterCard credit cards, respectively, including the Respondents' "premium" and "super premium" credit cards that have substantially higher Card Acceptance Fees than standard or "core" cards. For example, if a merchant accepts a MasterCard core credit card that may have a Card Acceptance Fee of 2%, that merchant does not have the option of declining to accept MasterCard's super premium high spend World Elite card, that may have a Card Acceptance Fee of 4%.

149. It was made clear in the evidence of Messrs. Sheedy and Weiner, and in the evidence of Doctors Carlton and Frankel, the Merchant Restraints also inhibit competition between Visa and MasterCard on a variety of different levels. They have the practical effect of turning the conventional competition world on its head. As matters now stand, the network stat sets the highest Interchange Fees, for instance, is the most competitive rather than the least. And because of the Honour All Cards Rule, Visa could not encourage merchants in Canada to reject the highest price "super premium" MasterCard credit cards if it wanted to. [redacted]

(b) Enforcement of the Merchant Restraints

150. Acquirers in Canada are required to enforce the Merchant Restraints in the event of non-compliance by the Acquirers' merchant customers.[133] As [redacted]

[133] See Visa Rules, "Merchant Agreement Requirements", Exhibit CRV-418, p. 652; MasterCard Rules, sections 5.2.1 "Acquiring Transactions" and section 5.2.2 "Merchant and Sub-merchant Compliance with the Standards", Exhibit CRM-444, p. 396.

[redacted]

151. [redacted]

[redacted]

152. [redacted]

(c) Merchant Restraints of One Network Often Apply to the Other

153. The evidence demonstrates that Acquirers in Canada frequently combine all of the requirements of the Rules of Visa and MasterCard in a single agreement that they expect their merchant customers to abide by. Conversely, those agreements do not have separate regimes that merchants must abide by when accepting Visa or MasterCard cards for payment. For this reason, merchants in Canada face a compounding effect, whereby they must comply with all of the restraints imposed by either Visa or MasterCard when accepting the credit cards of either network for payment in Canada. This is evident from even a cursory review of the various

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134 [redacted]

135 [redacted]

136 [redacted]

merchant agreements attached as Exhibits to the Witness Statements of the various merchants who testified as witnesses in this proceeding. For example, [redacted]

154. For example, Moneris' Merchant Operating Manual extends MasterCard's No-Discrimination Rule across all credit card brands accepted by Moneris' merchant customers. In relevant part, the Moneris Operating Manual provides that merchants "must not engage in any acceptance practice that discriminates against or discourages the use of a card in favor of any other particular card brand". The Moneris Operating Manual also applies the No Surcharge Rules across all brands, stating "You must not add any surcharges/convenience fees to any transaction".[137]

155. The result is that MasterCard's Rules are applied by Acquirers to limit competition with respect to Visa-branded credit cards. Specifically, MasterCard's No Discrimination Rule is applied by Acquirers to prevent merchants from engaging in practices that would favour other payment methods over Visa credit cards. In this way, each of the Respondent's respective Merchant Restraints reinforces and magnifies the effects of the others.

Relevant Market

156. As described above, each of the Respondents operates a network that provides infrastructure and services enabling merchants to obtain authorization, clearance and settlement of credit card transactions in Canada.

157. The relevant market for the purpose of assessing the competitive effects of the Merchant Restraints consists of Credit Card Network Services supplied in Canada in respect of general purpose credit card and charge cards. Participants in this relevant market include Visa, MasterCard and American Express.

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137 McCormack Report, *supra*, para. 157.

158. The Respondents seek to substantially expand the relevant product market beyond credit cards to include all forms of payment, such as cash, cheques, debit cards, wire transfers, money orders and payments made through text messaging. For example, Visa claims that:

> ". . . credit cards compete with all forms of payment including, but not limited to, card-based forms of payment, including credit cards, charge cards, debit cards, prepaid cards, merchant charge accounts and private label cards; paper based forms of payment, including cash, personal cheques, government cheques, travellers cheques, and money orders; mobile forms of payments, including payments through text messaging, mobile applications, and web browsers; and other electronic forms of payment not typically tied to a payment card or similar device, including online payment services, wire transfers and electronic benefits transfers".[138]

159. The Commissioner submits that the broad "all payments" market alleged by the Respondents should be rejected in favour of the market for Credit Card Network Services proposed by the Commissioner for many reasons, including the following:

(a) credit cards have features that clearly distinguish them from other methods of payment, such as interest free periods, the provision of an unsecured, revolving form of credit, the the ability to defer payment, the ability to make purchases remotely and protection against fraudulent transactions;

(b) merchants view accepting Visa and MasterCard credit cards as a necessity and do not view credit cards as substitutable with other methods of payment. If it were otherwise, merchants would not be expected to accept credit cards, given the substantially higher costs to merchants resulting from credit cards as compared with other forms of payment, such as Interac debit;

(c) the relevant market defined by the Commissioner is supported by the application of the well-established hypothetical monopolist test. The application of this test demonstrates that other methods of payment are not sufficiently close or sufficiently good substitutes for credit cards so as to constrain the price of Credit Card Network Services;

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[138] Response of Visa Canada Corporation, January 31, 2011 ["**Visa Response**"], para 12.

(d) despite significant increases in the Interchange Fees, Network Fees and the overall cost to merchants of accepting Visa and MasterCard credit cards, the uncontroverted evidence before the Tribunal is that virtually no merchants have responded to increasing Card Acceptance Fees in Canada by declining to accept Visa and MasterCard credit cards in favour of other (lower cost) methods of payment;

(e) apart from a number of bald and self-serving assertions in the witness statements filed by the Respondents, there is no evidence that Visa and MasterCard view other methods of payment as a constraint on the price of Credit Card Network Services. Indeed, as described below, the documents produced by the Respondents in this litigation flatly contradict those assertions; and

(f) the broad "all payments" market alleged by the Respondents has been consistently rejected by courts in other jurisdictions, such as the United States and the European Union, in favour of the market as defined by the Commissioner.

Each of these points is discussed further below, following a discussion of the general principles applicable to defining a relevant market.

160. Visa has conceded that the relevant geographic market is Canada.[139] And for good reason. This is so given that Visa and MasterCard each apply different rules for Canadian transactions, sets different prices for Canadian transactions and imposes significant limitations on the ability of merchants to purchase Credit Card Network Services from Acquirers outside of Canada. For example, while Card Acceptance Fees for merchants in Australia are substantially lower than in Canada, the rules of Visa and MasterCard prohibit merchants from purchasing Credit Card Network Services from Acquirers in Australia. Given that there appears to be no real controversy in this case that the relevant geographic market is Canada, this issue is not discussed further.

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139 Se [redacted]

(a) General Principles Applicable to Market Definition

161. In basic terms, the purpose of defining a relevant market is to identify "the competing products and geographic area in which competition occurs that determines the price for a given product".[140] The object of defining a relevant product market is to determine the set of products that provide an effective constraint on the pricing of the product in question.

162. To be considered within the same relevant product market, it is not sufficient that products can be substituted for each other in certain circumstances. Rather, the products must be sufficiently close substitutes such that an increase in the price of one of the products would be rendered unprofitable by customers switching to the other products. In this regard, pricing evidence is of primordial importance in defining relevant markets in a case of this nature. And uncorroborated, self-serving assertions concerning the competitive landscape such as those relied upon by Visa and MasterCard here are virtually irrelevant.

163. In *Canada (Director of Investigation and Research) v Southam Inc et al*,[141] the Tribunal found that Southam's daily newspapers were in a different product market than local community newspapers, even in the face of evidence that customers could advertise in either type of newspaper to reach a local audience and despite the fact that Southam's own representatives believed that they competed with community newspapers.[142] Indeed, Southam's entire acquisition and business strategy in British Columbia was predicated upon that belief.

164. On appeal, the Federal Court of Appeal disagreed with the Tribunal's conclusion on relevant market.[143] However, on further appeal, the Supreme Court of Canada affirmed the decision of the Tribunal, and its specific conclusion on the issue of relevant product market.[144]

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140 Dennis W Carlton and Jeffrey M Perloff, *Modern Industrial Organization*, 4th ed (2005) ["**Industrial Organization**"] at 783; Compendium of the Commissioner of Competition (Opening Argument), **Tab 7**.

141 (1992) CarswellNat 637 (Comp Trib) ["***Southam* (Comp Trib)**"], rev'd (1995), 127 DLR (4th) 263 (FCA) ["***Southam* (FCA)**"], aff'd [1997] 1 SCR 748 ["***Southam* (SCC)**"]; Commissioner's Closing Brief of Authorities, **Tab 1**.

142 *Southam* (Comp Trib), *supra*, para.. 385; Commissioner's Closing Brief of Authorities, **Tab 1**.

143 *Southam* (FCA), *supra*, para. 324; Commissioner's Closing Brief of Authorities, **Tab 1**.

144 *Southam* (SCC), *supra* paras. 76-81; Commissioner's Closing Brief of Authorities, **Tab 1**.

Mr. Justice Iacobucci, writing for a unanimous court, described the following approach to defining a relevant product market:

> "If the identification of an overarching, broad purpose that two kinds of products serve were sufficient to place those products in the same market, then all products could be placed in the same market, because all products serve the general purpose of satisfying consumers' needs. Certainly, following the Federal Court of Appeal's reasoning it would be possible to argue that broadcast media and print media are in the same market because both kinds of media serve advertisers. But it is not so, and the Federal Court of Appeal admitted at p. 636 that it is not so. The trick is to settle on the correct level of generality. Canadian courts have recognized as much in the past:
>
> . . . speaking generally, it is of importance to bear in mind that the term 'market' is a relative concept. In one sense, there is only one market in an economy since, to some extent, all products and services are substitutes for each other in competing for the customer's dollar.
>
> In another sense, almost every firm has its own market since, in most industries, each firm's product is differentiated, to some extent, from that of all other firms.
>
> Defining the relevant market in any particular case, therefore, requires a balanced consideration of a number of characteristics or dimensions to meet the analytical needs of the specific matter under consideration.
>
> *The Queen v. J. W. Mills & Son Ltd.*, [1968] 2 Ex. C.R. 275, at p. 305.
>
> What has to be kept in mind is that purposes are as various as markets, and both come in different sizes. Consequently it is unhelpful to suggest that once a purpose has been identified, all those products that serve that purpose should be considered to fall within a single market. It is the correct or relevant purpose that must be found, which is to say the broadest purpose that is consistent with a high cross-elasticity of demand...."[145] [emphasis added]

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[145] *Ibid.,* paras. 71-77.

165. Justice Iacobucci offered the following example to illustrate the principle that to be considered part of the same relevant product market, products must not just be substitutes, but must be *sufficiently close* substitutes:

> "… For example, cars and tanks both serve the general purpose of conveying people from place to place. But no one would suggest that cars and tanks are in the same market. The reason is that consumers do not modify their car-purchasing behaviour in response to slight changes in the price of tanks, and governments do not modify their tank-purchasing behaviour in response to slight changes in the price of cars. A person who is in the market for a station wagon does not shop with an eye on the price of armaments. Again, the Minister of National Defence does not check prices at local car dealerships before announcing an acquisition of new military hardware".[146]

166. The same approach to defining relevant markets has been applied by the Tribunal in non-merger cases. For example, in *Canada (Commissioner of Competition) v Canada Pipe*,[147] the Tribunal considered whether cast iron pipes and plastic pipes were in the same relevant product market. To determine this issue, the Tribunal considered whether cast iron pipes and plastic pipes were *sufficiently close* substitutes such that the existence of plastic pipes constrains the pricing of cast iron pipes:

> "In determining the relevant product market one considers substitutability – in other words, whether there exist sufficiently close substitutes to the product at issue, such that the market for that product includes those substitutes. In *Tele-Direct*, the Tribunal cites the market definition set out in *Canada (Director of Investigation and Research) v. Southam Inc.*, where the Federal Court of Appeal defines what is meant by substitutability:
> Products can be said to be in the same market if they are close substitutes. In turn, products are close substitutes if buyers are willing to switch from one product to another in response to a relative change in price, i.e. if there is buyer price sensitivity. Direct evidence of substitutability includes both statistical

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146 *Ibid.,* para 72.

147 2005 Comp Trib ["***Canada Pipe* (Comp Trib)**"], rev'd 2006 FCA 233 and 2006 FCA 236 [**"Canada Pipe (Cross-Appeal)"**]; Commissioner's Closing Brief of Authorities, **Tab 2**.

> evidence of buyer price sensitivity and anecdotal evidence, such as the testimony of buyers on past or hypothetical responses to price changes. However, since direct evidence may be difficult to obtain, it is also possible to measure substitutability and thereby infer price sensitivity through indirect means. Such indirect evidence focuses on certain practical indicia, such as functional interchangeability and industry views/behaviour, to show that products are close substitutes".[148] [emphasis added]

167. As described below, consideration of the attributes of credit cards as compared with other payment methods, the significant price differences between credit cards and other payments methods, the application of the well-established hypothetical monopolist test and the inability of merchants to effectively substitute credit cards with other methods of payment, all support the relevant market of Credit Card Network Services as defined by the Commissioner.

(b) Distinct Attributes of Credit Cards

168. Merchants accept credit cards because many of their customers prefer to use credit cards over other methods of payment. The evidence adduced in this proceeding demonstrates that merchants that accept MasterCard and Visa credit cards cannot effectively substitute acceptance of other payment methods for those credit cards, largely because credit cards have distinct attributes from the perspective of merchants' customers.

169. For example, as described in the preceding section, purchases are made on credit cards without accessing or reserving the cardholder's funds at the time of purchase.[149] In addition, credit cards provide access to a form of revolving credit that allows cardholders to pay outstanding balances over time, with interest.[150] In contrast, debit cards do not provide a credit function or an interest-free period following purchases, as charges are deducted directly from the debit cardholder's account at or about the time of the transaction.[151] In addition, debit cards

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148 *Canada Pipe* (Comp Trib), *supra*, para 68; Commissioner's Closing Brief of Authorities, **Tab 2**.

149 See Transcript of May 28, 2012 (Volume 12), pp. 2201 (line 25) to 2202 (line 7).

150 *Ibid*., p. 2209 (lines 5 to 24).

151 *Ibid*., pp. 307-308, [redacted]

often have lower daily spending limits.[152] Consequently, for large purchases that a customer wishes to finance over time, credit cards may be preferred by customers over other payment methods.

170. Unlike many other methods of payment, credit cards can be used in a wide variety of retail formats, including for purchases made remotely (such as by telephone or through online transactions).[153] Credit cards also provide protection against fraudulent transactions.[154] Finally, Issuers of credit cards commonly offer cardholders reward points and other benefits that are not generally offered by other methods of payment.[155]

171. In various internal documents and submissions, including submissions made in this proceeding,[156] MasterCard and Visa have emphasized the differences between credit cards and other methods of payment, including debit cards. For example, in a submission made in Australia, MasterCard warned against focusing "on credit and debit cards as alternatives" and noted that "credit cards have important functions that are different from debit cards".[157]

172. Similarly, in a document submitted to the European Commission, Visa claimed that "the structure and functionality of [credit cards and debit cards] are not the same and that they are based on totally different cost structures".[158] In the same document, Visa also stated that:

> "Credit cards, while to some extent competing with debit cards, offer a different function to debit cards – namely the inherent feature of an unsecured extended credit facility and interest-free period which incur additional cost. The credit facility offered by

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152 See [redacted]

153 See Transcript of May 28, 2012 (Volume 12), pp. 2216 (line 20) to 2217 (line 24).

154 *Ibid*., p. 2228 (lines 4-15).

155 See [redacted]

156 See *e.g.,* Witness Statement of Jordan Cohen ["**Cohen Statement**"], Exhibit CRM-512, para. 19; [redacted]

157 "MasterCard International Incorporated - Submission to Reserve Bank of Australia", Exhibit A-354, p. 23.

158 "Visa Europe - Response to the Consultation on the European Commission's - Interim Report I Payment Cards", Exhibit A-129, p. 13.

> credit cards is valued by merchants and cardholders alike and serves a different purpose to the payment service provided by a debit card".[159]

173. Visa also explained that:

> "Whereas a debit card transaction is dependent upon there being sufficient funds in the bank account (unless an overdraft facility has been agreed), a credit card transaction requires a detailed creditworthiness assessment and a cross-check as to the available credit limit. The costs of risk management and fraud checks are more expensive for credit cards which do not have the relative security of a deposit account".[160]

174. Visa also asserted that "credit cards and debit cards are different as regarding end-user demand and cost levels and structures" so that "there is no rationale for expecting their fees to be the same or similar."[161]

175. [redacted]

176. Similarly, [redacted]

159 *Ibid.*

160 *Ibid.*

161 *Ibid.* at p. 14.

162 [redacted]

[redacted]

177. In testimony before the Standing Senate Committee on Banking, Trade and Commerce, in April 2009, the Head of Visa Canada testified that "[w]e recognize that debit is a different market than credit."[164]

178. The Vice-President and Head of Customer Delivery for MasterCard Canada, Don Lebeuf, gave similar evidence in November 2011, in testimony before the House of Commons Standing Committee on Industry, Science and Technology. In particular, testified that "debit and credit transactions are completely different, with a completely different risk profile, and the pricing for debit is substantially lower".[165]

179. [redacted]

163 [redacted]

164 "Banking Trade and Commerce", Exhibit CA-402, p. 36.

165 "Standing Committee on Industry, Science and Technology -Evidence", Exhibit A-454, p. 3. See also [redacted]

166 [redacted]

180. Similarly, another document, [redacted]

[redacted] [underlining added]

(c) Merchants Continue to Accept Credit Cards, Despite Higher Costs

181. Credit cards provide a means of transacting with distinct attributes that, for many transactions, cannot be replicated by cash, debit or other payment methods. As a result, credit cards are widely accepted by merchants in Canada, despite the fact that credit cards are substantially more expensive that other methods of payment, such as debit cards.

182. The evidence given in this proceeding establishes that [redacted]

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167 [redacted]

168 See [redacted]

[redacted]

183. The substantial difference in the price to merchants of credit cards and debit cards provides further evidence demonstrating that these methods of payment are not in the same relevant market. Indeed, if debit cards and credit cards were functionally substitutable, as the Respondents contend in this proceeding, then the market could not sustain such a large price difference. Merchants would simply not accept credit cards as a form of payment given the significantly higher costs associated with credit cards, and would instead accept only other, lower cost payment methods, such as Interac debit cards.

184. In this regard, it is notable that virtually all Canadians who have a credit card also have a debit card. For example, [redacted]

185. Despite the significantly higher costs of credit cards, merchants continue to accept MasterCard and Visa credit cards. The evidence shows that once a merchant begins accepting credit cards, discontinuing acceptance is not an economically viable option given the risk of lost sales and profits.[171] [redacted] For example, [redacted]

[redacted]

169 See [redacted]

170 See [redacted]

171 Jewer Statement, *supra,* para. 26.

[redacted]

> Similarly, Mario de Armas of Walmart testified that: "[c]redit card acceptance, particularly acceptance of Visa and MasterCard credit cards, is critical for Walmart Canada's business, given that Walmart Canada's customers have become accustomed to paying by credit card and because credit cards represent a significant proportion of Walmart Canada's sales".[173]

(d) Application of the Hypothetical Monopolist Test

186. Experts for the Commissioner and the Respondents agree that the accepted methodology for defining a relevant market in a competition case is the hypothetical monopolist test.[174]

187. The hypothetical monopolist test begins with the smallest set of substitute products that includes the products at issue, and adds additional substitute products until a hypothetical single supplier – a "hypothetical monopolist" – of all of the products in the set could profitably impose a small but significant, non-transitory increase in price ("**SSNIP**") above the level that would exist in a competitive market. The SSNIP is commonly taken to be a price increase of 5% above competitive levels that is sustained over a period of at least one year.[175]

188. Dr. Carlton provided the following illustrative example of the hypothetical monopolist test in his expert report:

> "Suppose that the only two firms that manufacture product A propose to merge. If a hypothetical monopolist of product A would find it profitable to raise the price of product A by a small

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172 Shirley Statement, *supra*, para. 18.

173 De Armas Statement *supra*, para. 18.

174 See Expert Report of Dennis Carlton, Exhibit CA-67, ["**Carlton Report**"], para 30; Frankel Report, *supra*, para. 53; Expert Report of Ralph Winter, Exhibit CA-71, ["**Winter Report**"], para 45; Expert Report of Kenneth Elzinga, Exhibit CRV-479 ["**Elzinga Report**"], para 143; Expert Report of Jeffrey Church, Exhibit CRM-492 ["**Church Report**"], para. 60.

175 See Transcript of May 15, 2012 (Volume 5) pp. 853 (line 17) to 854 (line 6).

> yet significant amount – for example, five or ten percent – for a substantial period of time, then the availability of other products does not constrain the price of product A to its current level. In that case, product A is a market. If, instead, the hypothetical monopolist of product A would not be able to profitably increase price by a small yet significant amount for a substantial period of time – because, for example, so many consumers would switch to product B that the attempted price increase of product A is unprofitable – product A is not a market (i.e., the market includes at least products A and B)".[176]

189. As discussed in greater detail below, it is appropriate to apply the hypothetical monopolist test to the Credit Card Network Services supplied by the Respondents to Acquirers. To apply the test, one must assume that there is a single supplier of Credit Card Network Services in Canada (*e.g.*, assume a merger of Visa, MasterCard, American Express and any other credit card network operating in Canada). The issue to be determined under the test is whether the hypothetical monopolist supplier of Credit Card Network Services would be able to profitably increase prices to Acquirers by 5% above the competitive level.

190. In applying the hypothetical monopolist test, Dr. Winter used an average fee paid by Acquirers to Visa and MasterCard of approximately [redacted][177] Dr. Winter further stated that a 5% increase in this fee would be approximately [redacted] basis points, or an increase from [redacted] to [redacted].[178]

191. As with prior increases by Visa and MasterCard, Acquirers would pass on the [redacted] basis point increase to their merchant customers in the form of higher Card Acceptance Fees. For example, the Card Acceptance Fee to merchants may be increased from [redacted]% to [redacted]%. In applying the relevant test, it is relevant to examine the actual reaction of merchants in Canada to increases in Card Acceptance Fees they have been faced with from time-to-time. 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.

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176 Carlton Report *supra*, para. 31.

177 See [redacted]

178 See [redacted]

192. The relevant question to be asked under the hypothetical monopolist test, therefore, is whether so many merchants would decline to accept credit cards in response to an increase in Card Acceptance Fees from [redacted]% to [redacted]%, so as to render that price increase unprofitable. As described below, the evidence demonstrates beyond peradventure that very few merchants, if any, would choose to stop accepting all credit cards in response to a 10 basis point increase in Card Acceptance Fees. Reduced merchant acceptance would not therefore be sufficient to constrain a hypothetical monopolist of Credit Card Network Services from setting fees above the competitive level. In fact, despite much more significant increases in Card Acceptance Fees that have occurred in the period from 2008 onwards, there has been virtually no loss of acceptance in Canada of either Visa cards or MasterCard cards and no discernible shift to other forms of payment. [redacted]

193. Consistent with Dr. Winter's conclusions on the relevant market, Dr. Carlton testified as follows regarding his application of the hypothetical monopolist test in this case:

> So let me just consider the following numerical example. Consider a $10.00 retail purchase, and on that $10.00 retail purchase the merchant fee is 2 percent, 20 cents, and the interchange fee is 16 cents, 1.6 percent.
>
> I have chosen the 1.6 and the 2 percent to be roughly consistent with what I observed is in the market today. And for purposes of this example, I am going to ignore service fees, so let's assume that service fees are zero to keep it simple.
>
> So that after this $10.00 retail purchase, the merchant fee is 20 cents, the interchange fee is 16 cents. The acquirer is left with 4 cents out of which he has to pay his other costs.
>
> So now let's suppose that there is a 5 percent increase in the merchant fee from 20 cents to 21 cents. Well, then what will happen is that the net amount received by the acquirer would increase from four cents to 5 cents. That means the acquirer's profits are going to go up by at least 25 percent.

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179 See [redacted]

> So now you want to ask: Is the volume that the acquirer sees as a result of this price increase, this one-penny price increase, going to be so great that it would render the price increase unprofitable?
>
> And if you just do the mathematics, you can see that as long as the acquirer's volume doesn't fall by 20 percent or more, it will be profitable to impose this 5-cent increase.
>
> So you have to then ask yourself, Well, is such a large volume decrease likely if you increase the price by this one penny or this 5 percent?
>
> And I think it is pretty clear that the empirical evidence shows that there is really no basis to assume that such a 5 percent increase in price in the merchant fee would induce this very large decline in credit card payments to render the price increase unprofitable.
>
> And if you look at the empirical evidence in this case, it shows that Visa and MasterCard's actions have increased the merchant fees by more than 5 percent over the last few years, presumably because it was profitable to do so. And cash, cheques, debit cards were in existence, and that didn't prevent the actions of Visa and MasterCard, in raising service fees and merchant fees, from causing the merchant -- the merchant fee to go up. I said that -- let me restate that.
>
> Visa and MasterCard's actions in raising their service fees and interchange fee, which has led to increases in the merchant fee over time, has occurred despite the fact that cheques, cash, debit cards are in the market.
>
> So from my point of view, the -- looking at this evidence, it seems pretty clear to me that this test shows that credit card network services provided by acquirers to merchants is a relevant market.[180]

194. It is useful to consider what the Respondents would have to establish under the hypothetical monopolist test in order to support the broad "all payments" market that they contend constitutes the relevant market in this case. The Respondents would have to establish that a hypothetical monopolist supplier of Credit Card Network Services would not find it profitable to increase prices by 10 basis points, because so many merchants would discontinue

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[180] See Transcript of May 17, 2012 (Volume 7), pp. 1252 (line 24) to 1254 (line 7).

acceptance of credit cards in favour of other payment methods such as cheques, cash and wire transfers. Such a conclusion would require the finding that even if there were only one Acquirer in Canada to which merchants could turn to obtain Credit Card Network Services, that hypothetical monopolist Acquirer could not profitably increase prices for merchants.

195. MasterCard's and Visa's assertion that the relevant market consists of all payment methods means that a hypothetical merger between MasterCard, Visa and American Express would not result in higher prices for such services, nor cause any other harm to the Canadian public, due to the remaining competitive constraints posed by Interac debit cards, cash, cheques and wire transfers. This position is contradicted by the economic evidence and is, moreover, implausible on its face. Even the Respondents' own expert, Dr. Elzinga, conceded that such a merger would be a "concern".[181]

196. Dr. Church madeoon effort to respond in any way to the expert evidence of Dr. Frankel or Dr. Carlton. Instead, he confirmed his evidence to critiquing the first Report of Dr. Winter. In this regard, Dr. Church suggested that Dr. Winter had somehow erred in his application of the hypothetical monopolist test.[182] His criticisms focus upon two related issues from Dr. Winter's expert report: (i) the determination of the correct price to be used when applying the hypothetical monopolist test; and, (ii) whether the test should be applied to both sides of the credit card network (*i.e.*, both the Issuer and Acquirer sides of the platform). Each of these two issues is discussed below.

(e) The Correct Price for the Application of the SSNIP Test

197. In applying the SSNIP test, Dr. Winter used the current average price paid by Acquirers to Visa and MasterCard (approximately [redacted], which is comprised of the Interchange Fee (approximately [redacted]) and Acquirer Network Fees (approximately [redacted]).[183]

198. It is important to note that in applying the hypothetical monopolist test Dr. Winter adopted a highly conservative approach and used the current or prevailing price paid by

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181 See Transcript of June 4, 2012 (Volume 17), p. 2739 (lines 2-23).

182 See Church Report, *supra*, paras. 61 and 62.

183 See [redacted]

Acquirers in Canada even though that price is undoubtedly higher than it otherwise should be, and would be, in a more competitive market unburdened by the Merchant Restraints. The reference price for the application of the SSNIP under the hypothetical monopolist test is not the prevailing price, but the price that would exist in a competitive market. Use of the existing price by Dr. Winter in the application of the hypothetical monopolist test is favourable to the Respondents, as it can lead to a broader than appropriate definition of the product market, due to what economists have called the "cellophane fallacy". Because anticompetitive conduct may already have resulted in prices being elevated to a supra-competitive level, a hypothetical monopolist might not raise prices further even though the monopolist would be able to maintain prices well in excess of the competitive level. Put simply, the hypothetical monopolist test is a conservative test in the present case, because if the monopolist could increase prices beyond currently prevailing prices which are already higher than they should be, the monopolist could certainly raise prices profitably above substantially lower prices that would exist in a competitive market.

199. The issue of the "cellophane fallacy" was explained as follows by Dr. Carlton during his testimony:

> "Now, when I say "increase the merchant fee by 5 percent", what I really mean is increase the merchant fee by 5 percent above competitive levels.
>
> Well, you know, I don't know what the competitive level is, so in the example I am going to work through, I am going to use roughly the current level. Let me just indicate this is extremely conservative, because the current level may reflect market power already. So asking the question, 'Can I raise it further?', even if you answered that "no", there still might be a lot of market power.
>
> That's why this is a very conservative test that I am doing. In fact, because it leads many times to an observation that there is no market power from -- in the ability to raise price above current levels, people have criticized, and I have criticized, the use of this test because it can lead to not finding market power when, in fact, it exists. And that is called the "cellophane fallacy error".

> Nevertheless, the evidence in this case is sufficiently strong that it passes even this very conservative test."[184]

200. Nevertheless, even when the hypothetical monopolist test is applied based on currently prevailing prices in a manner most favourable to the Respondents, the test does not support the broad "all payments" market proposed by the Respondents.

201. Dr. Church contends that the hypothetical monopolist test should not have been applied by Dr. Winter to the total price paid by Acquirers (Interchange Fee and Acquirer Network Fee), but rather only to the Acquirer Network Fee (about [redacted] basis points). As Dr. Church stated in paragraph 77 of his report:

> "For the purposes of the hypothetical monopolist test, the relevant price is the net price received by the hypothetical monopolist, since this determines its profits and hence its behaviour. The appropriate price charged by a hypothetical monopolist of CCNS is the network acquirer fee not the interchange fee plus the network acquirer fee. The interchange fee is irrelevant to its profits (if revenues from acquirers are included in defining profits, so too should the payments to issuers be deducted) and hence not relevant to its determination of the profit maximizing price. Hence, the evidence on the effect on the interchange fee increase on MasterCard's acceptance is irrelevant for defining the relevant market". [emphasis added]

202. Dr. Church's assertion is unsupported by precedent or authority and, with great respect, is simply wrong. When examining an increase in prices for the purpose of applying the hypothetical monopolist test, the relevant price is the total price charged to Acquirers or to merchants, regardless of whether that price it may ultimately be divided into Interchange Fees or Network Fees. A hypothetical monopolist credit card network could elect to raise prices through an increase in Interchange Fees or an increase in Network Fees, or an increase in both. Indeed, as described above, Visa and MasterCard have significantly increased both their Interchange Fees and Network Fees, resulting in overall increases in Card Acceptance Fees for merchants.

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184 See Transcript of May 17, 2012 (Volume 7), p 1251 (lines 2-23).

203. A 2006 article entitled "Defining Relevant Product Markets in Electronic Payment Network Antitrust Cases" by Renata Hesse and Joshua Soven (both formerly with the Antitrust Division of the United States Department of Justice ("**U.S. DOJ**")) discusses the approach taken by the Antitrust Division of the U.S. DOJ in defining a relevant market for the consideration of an acquisition of a debit network. Consistent with the approach taken by Dr. Winter, the Antitrust Division applied the SSNIP to the total price paid by acquirers (Network Fees and Interchange Fees), as opposed to the network fee alone:

> "The Division also confronted the issue of which fee to use when it applied the hypothetical monopolist test - the switch fee [*i.e.*, Network 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).
>
> Consideration of the fee structure used by American Express further illustrates the error in defining relevant markets by using a SSNIP based only on the switch fees. American Express charges only a total fee, which is labelled in the industry as the merchant discount. It does not charge separate interchange and switch fees because, unlike most networks, it is a unitary system that provides both the payment network switching services and also functions as the issuer of its payment cards. American Express does not have to segment its fees into separate components for network switching and issuing services because it retains the entire total fee. Consequently, when American Express makes pricing decisions for merchants, it focuses on whether merchants are

> willing to pay a certain total fee, rather than only on merchants' responses to the portion of the fee that compensates it for providing either issuing or network switching services.
>
> An appropriate application of the hypothetical monopolist test thus requires examining the effect of a small but significant increase in the total price charged to both merchants and issuers, regardless of whether it is broken down into separate interchange and switch fees…".[185][emphasis added]

204. In any event, even if one were to follow the approach proposed by Dr. Church and apply the hypothetical monopolist test using only the Acquirer Network Fee, the result would actually *strengthen* the conclusion reached by Dr. Winter (and by Dr. Frankel and Dr. Carlton) that the relevant market is properly limited to Credit Card Network Services. Dr. Church estimated that the Acquirer Network Fee is approximately 5 basis points.[186] Applying a SSNIP of 5% on 5 basis points would increase the Acquirer Network Fee from approximately ¼ of a basis point from 5 basis points to 5.25 basis points. There is no basis whatsoever upon which this Tribunal could conclude that increasing the Network Fees of Acquirers in Canada by ¼ of one basis point would somehow lead to such a significant decline in acceptance of all credit cards by merchants in Canada as to render that increase unprofitable. Rather, all of the available evidence concerning the reaction of merchants in Canada to substantially more significant increases is to the contrary.

205. As with other aspects of the relevant market definition, Dr. Church admitted that he had not done no analysis to determine whether an increase of approximately ¼ of a basis point would be profitable.[187] Dr. Church conceded in cross-examination that applying the SSNIP to the Acquirer Network Fee alone would result in an increase for merchants in Card Acceptance Fees from 1.800% to 1.803%.[188] Such an increase is far smaller than the [redacted] basis points used by Dr. Winter in his application of the hypothetical monopolist test. In any event, it cannot credibly

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185 Renata Hesse and Joshua Soven, "Defining Relevant Product Markets in Electronic Payment Network Antitrust Cases" (2005-2006) 73 Antitrust Law Journal 709 ["**Hesse and Soven**"], pp. 728 to 730; Commissioner's Closing Brief of Authorities, **Tab 25**.

186 See Transcript of June 5, 2012 (Volume 18), p. 2954 (lines 11-22).

187 *Ibid*., pp. 2954-2955.

188 *Ibid*., p. 2955 (lines 4-7).

be suggested that merchants in Canada would decline to accept credit cards in favour of other payment methods as a result of such a small increase, or that the increase would be rendered unprofitable.

(f) Application of the SSNIP Test to Both Sides of the Market

206. Dr. Church also contends that instead of applying the SSNIP test on the fee paid by Acquirers, the test should be applied on the sum of the Network Fees paid on both sides of the credit card network. For example, Dr. Church states as follows at paragraph 68 of his expert report:

> "The theory of monopoly pricing by a two sided platform operator identifies that the relevant margin to assess the profitability of platform pricing is the sum of the network acquirer fee plus the network issuer fee (i.e., the fees actually charged by Visa and MasterCard, not the 'acquirer fee' constructed by Dr. Winter which includes interchange) less the marginal cost to complete a transaction. This marginal cost is the sum of the costs to provide the necessary services to the issuer and the acquirer. Moreover, it identifies that the relevant demand elasticity is the aggregate elasticity of demand, i.e., the sum of the demand elasticity on both sides of the platform, not just one side".

207. For the reasons set out in the section below discussing the two-sided market, Dr. Church's contention is, again, simply wrong, and has been rejected by the European Commission and General Court as frequently as late May 2012 during the course of these proceedings.

208. In any event, even if the sum of the Network Fees was used as the base price for the application of the SSNIP, the result of the hypothetical monopolist test would not change. The sum of the Issuer Network Fee and Acquirer Network Fee is approximately [redacted] basis points, much smaller than the [redacted] basis points used by Dr. Winter. A 5% increase in combined Network Fees of [redacted] basis points would be approximately [redacted] Dr. Church again admitted on cross-examination that he had not performed the hypothetical monopolist test using the sum of the Issuer Network Fee and Acquirer Network Fee.[189] There can be no doubt

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189 *Ibid*., pp. 2955 (line 18) to 2956 (line 3).

what the result would have been had Dr. Church completed the required analysis. In the circumstances, it cannot be credibly suggested that there would be any appreciable reduction in the volume processed by a hypothetical monopolist supplier of Credit Card Network Services resulting from a one-half of a basis point increase in Network Fees.

(g) Respondents Have Not Proffered Any Economic Evidence to Support Broad "All Payments" Market

209. While the Respondents' experts allege a number of errors in the approach taken by the Commissioner in defining the relevant market, it is significant that the Respondents' experts have undertaken no independent assessment or analysis of whether the broad "all payments" market contended for by the Respondents is appropriate.

210. In contrast to the approach taken by the Commissioner's experts to support their conclusions on relevant market, the Respondents' experts did not even attempt to justify their broad "all payments" market through an application of the well-established hypothetical monopolist test.

211. In this regard, Dr. Elzinga's report suffers from a number of very serious flaws, not the least of which include that his observations and conclusions are theoretical in nature and largely divorced from reality. The report of Dr. Church suffers from the same fundamental flaw. Indeed, Dr. Elzinga referred in his report to only four of the more than 90,000 productions of Visa and MasterCard in this case. And Dr. Church referred to none.

212. Moreover, in cross-examination, Dr. Church conceded that he had not applied the hypothetical monopolist test or conducted any analysis to support the relevant market alleged by the Respondents. Dr. Church also conceded that he was not even able to express an opinion as to whether the broad "all payments" market alleged by the Respondents was appropriate:

> "MR. FANAKI: … in fairness to you, sir, let me put it to you directly. You understand that the respondents have alleged in this case a relevant market that consists of all forms of payment, including cash, cheques, money orders, travellers' cheques, gift cards, wire transfers, Zoompass, Obopay, payments through text messages.

> So as an independent and impartial expert, is it your evidence to the Tribunal that the proper relevant market for considering the competitive effects of the merchant rules of Visa and MasterCard consists of all of these other forms of payment, including cheques, money orders and wire transfers?
>
> DR. CHURCH: Sorry, Mr. Fanaki, I was just trying to find a particular sentence that I can refer you to about my opinion on that issue. Anyhow, I think I actually do say something about this, but I can't find it off the top of my head, and I apologize.
>
> You are right I don't say exactly what I think the market is. That was not really part of my mandate. My mandate was to respond to Dr. Winter's analysis.
>
> I think that clearly a starting point is that the market should be defined around payment methods. What is included in that payment market with Visa and MasterCard I do not have an opinion on.
>
> MR. FANAKI: So, for example, you don't have an opinion on whether cheques, money order, wire transfers, payments through text messages, are part of the same relevant market?
>
> DR. CHURCH: I do not have an opinion on that. I haven't done the analysis.
>
> MR. FANAKI: I'm sorry?
> DR. CHURCH: I haven't done the analysis.
>
> MR. FANAKI: You haven't done the analysis to determine that issue?
>
> DR. CHURCH: That's right".[190]

213. The Tribunal can and should infer that the reason that the Respondents' own experts failed to conduct an economic analysis of the relevant market is because such an analysis would not support the broad "all payments" market alleged by the Respondents. This is why the Respondents' economic experts were instructed to deliver theoretical treatises in this case, rather than reliable economic evidence based on empirical or other analysis firmly rooted in the facts and evidence of this particular case.

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[190] *Ibid*., pp. 2907 (line 14) to 2909 (line 2).

214. Further, the Respondents' experts cannot properly express opinions regarding market definition, and related issues of market power and adverse effects on competition, without having undertaken the basic analysis necessary to assess the appropriate relevant market. Given the complete absence of any such analysis, the Tribunal is fully justified in giving no weight to the unsupported assertions of the Respondents' experts on the subjects of market definition, market power and adverse effects on competition.

(h) Merchants Continue to Accept Credit Cards Despite Significant Increases in Costs

215. As explained above, if the Respondents were correct in contending that the relevant market is broader than Credit Card Network Services, then as the price of those services rose, merchants would be expected to shift transaction volumes to other methods of payment.

216. However, despite significant increases in the Interchange Fees, Network Fees and overall Card Acceptance Fees paid by merchants in Canada for the acceptance of Visa and MasterCard credit cards, the uncontroverted evidence before the Tribunal is that virtually no merchants have declined to accept Visa and MasterCard credit cards.[191] Indeed, the evidence before the Tribunal is that even in the face of significant increases in the price of Credit Card Network Services, the number of merchants that accept the Respondents' credit cards has continued to increase.[192]

217. As illustrated in the figure below, there have been significant increases in MasterCard's weighted average Interchange Fees, particularly since the introduction of MasterCard's high spend (premium) credit card category in 2008. Specifically, MasterCard's weighted average Interchange Fee [redacted]

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[191] See Transcript of May 30, 2012 (Volume 14), pp. 2469 (line 24) to 2470 (line 11); [redacted]

[192] See Transcript of May 14, 2012 (Volume 4), pp. 574 (line 24) to 575 (line 3).

[redacted] In addition, Visa effective interchange fee went from [redacted]

[redacted]

[redacted]

218. The cost to merchants of accepting Visa and MasterCard credit cards has increased substantially as a result of increases in Interchange Fees and Network Fees, and the increasing penetration of premium credit cards. For example, Craig Daigle of Shoppers Drug Mart testified that:

> "…Shoppers' Card Acceptance Fees for Visa and MasterCard increased from [redacted] million in 2007 to [redacted] million in 2011, an increase of [redacted]. Shoppers' average Card Acceptance Fee increased from [redacted] in 2007 to [redacted] in 2011 for Visa credit card transactions and from [redacted] in 2007 to [redacted] in 2011 for MasterCard credit card transactions."[196]

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193 See [redacted]

194 See [redacted]

195 [redacted]

196 Daigle Statement, *supra*, para. 26.

219. Despite these substantial increases in the cost of credit card acceptance, almost no merchants have stopped accepting Visa or MasterCard credit cards. [redacted]

220. [redacted]

(i) No Evidence that the Price of Credit Card Network Services is Constrained by Other Payment Methods

221. Apart from a number of self-serving and unsupported assertions in the witness statements filed by the Respondents, there is no contemporaneous documentary or other evidence that Visa and MasterCard view other methods of payment as a constraint on the price of Credit Card Network Services. This fact alone is extraordinary in a case of this nature and, alone, is sufficient to defeat the position of Visa and MasterCard in respect of market definition. Indeed, as described below, the documents and information produced by the Respondents and the testimony of their witnesses in this proceeding flatly contradict such an assertion.

222. [redacted]

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197 [redacted]

198 [redacted]

199 [redacted]

[redacted]

223. [redacted]

224. [redacted]

(j) Alleged Inconsistency in Market Definition

225. In their pleadings and submissions to the Tribunal, the Respondents assert that, based on the Commissioner's definition of the relevant product market, allowing merchants to effectively encourage consumers to use lower-cost forms of payment, such as by surcharging higher-cost credit cards, "cannot constrain pricing for Credit Card Network Services" as these lower-cost forms of payment are outside of the relevant product market defined by the Commissioner.

226. More particularly, the Respondents argue that the Commissioner's position that consumers would switch to other methods of payment in response to surcharging is inconsistent with her position that these other methods of payment are not within the relevant product market. In paragraph 15 of its Concise Statement of Economic Theory, Visa goes so far as to

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200 [redacted]

201 [redacted]

202 [redacted]

describe the Commissioner's position on this issue as "nonsensical". Similarly, during his opening argument, counsel for MasterCard stated:

> We heard from my friend this morning about allegations of inconsistency on this side, but I suggest they're much stronger the other way.
>
> A corollary of the point I made a moment ago, that the remedies sought by the Commissioner are designed to make the output of credit card payments go down, is that they are reciprocally designed to shift demand to other sorts of payment mechanisms, debit, cash, cheques, preauthorized debit, other new payment technologies, et cetera.
>
> The Commissioner's remedy is designed to do that, which she paradoxically, but simultaneously, says are not in the same relevant market.
>
> We say, of course, that we absolutely do compete with these other payment methods every day, on every one of millions and millions of transactions.
>
> When consumers come to the checkout, they have payment options and we compete to be that chosen option. Every time consumers are asked, How do you want to pay for that, MasterCard struggles to be that answer.[203]

227. In making these assertions, the Respondents conflate the world as it currently exists with the Merchant Restraints in place with the world as it may exist in the absence of the Restraints.

228. Moreover, the Respondents wrongly equate the payment options available to consumers with the competitive alternatives available to merchants. As a result of the Respondents' No Surcharge Rule, customers using credit cards cannot see and do not face the costs to merchants resulting from the use of those cards, and may therefore regard credit cards as a substitute to other forms of payment, including those that impose lower costs on merchants. By contrast, merchants who bear the costs associated with different payment options, do not regard credit cards as substitutes for lower-cost payment options.

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[203] Transcript, May 8, 2012 (Volume 1), p. 197 (lines 2-23).

229. As matters now stand with the Merchant Restraints in place, merchants clearly do not regard other payment methods as effective substitutes for Credit Card Network Services. The fact that, in the future, if this Tribunal alters significantly the competitive landscape by prohibiting the Respondents from enforcing the Merchant Restraints, *consumers* may elect to use another method of payment in response to surcharges does not alter the fact that, even in the face of a significant increase in Card Acceptance Fees, *merchants* are unable to elect to accept other forms of payment while declining to accept Visa and MasterCard credit cards. As the U.S. District Court for the Eastern District of New York held in a 2003 decision issued against Visa and MasterCard in *In Re Visa Check/MasterMoney Antitrust Litigation*:

> " … That consumers might switch to another form of payment in the event of a surcharge on their credit card transactions does not alter the fact that there is no cross-elasticity of demand at the merchant level between defendants' products and all other forms of payment." [204] [emphasis added]

230. Further, the fact that other payment methods are outside of the relevant market should not be assumed to mean that there is no substitutability between such other payment methods and Credit Card Network Services. Rather, it means that these other payment methods are not *sufficiently close* substitutes to prevent suppliers of Credit Card Network Services from profitably maintaining supra-competitive prices for merchants over a sustained period of time.

231. Consistent with the above, MasterCard recognizes correctly in paragraph 47 of its Response that the focus of the inquiry in defining a relevant market should be on whether there is "sufficient" competition between Credit Card Network Services and other payment methods, as opposed to any competition. Having recognized this principle, the Respondents and their experts fail to apply it. The Respondents have not submitted evidence or conducted any analysis to demonstrate that sufficient competition exists between Credit Card Network Services and other payment methods to establish that these products are within the same relevant product market.

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[204] See *In Re Visa Check/Mastermoney Antitrust Litigation,* 2003-1 Trade Cas (CCH) P73,995 (EDNY 2003) [***"Visa Check/Mastermoney***"], p. 3; Commissioner's Closing Brief of Authorities, **Tab 8**.

(k) Respondents' "All Payments" Market Consistently Rejected

232. As discussed below, the Respondents have alleged a broad "all payments" market in numerous antitrust proceedings in various jurisdictions. However, as Mr. Sheedy conceded in cross-examination, the Respondents' "all payments" market has not been accepted by any court, tribunal or regulatory authority in any jurisdiction in the last 19 years:

> "MR. THOMSON: Now, while we're at it, again, you have testified at the outset of the cross-examination that you have been a witness in any number of cases that Visa has been involved in over your tenure at Visa, which goes back now 15 to 20 years?
>
> MR. SHEEDY: Nineteen years.
>
> MR. THOMSON: Nineteen years. Let's just deal with your tenure at Visa. Are you able to point to a single decision rendered by a court or a Tribunal or a Commission anywhere in the world, in the 19 years you have been with Visa, that has accepted Visa's contention of an all-form-of-payments market? If so, what court, what Tribunal, what Commission?
>
> MR. SHEEDY: I don't have any knowledge of a decision from a court or a Tribunal around a market definition that meets your question".[205]

233. In fact, as discussed below, the "all payments" market advocated by the Respondents has been consistently rejected in numerous decisions in the United States and elsewhere. In those decisions, courts have rejected the very same arguments that Visa and MasterCard are advancing in this Application to attempt to justify their broad "all payments" market.

234. The sole exception is an almost 30 year old decision in *National Bancard Corporation v Visa USA* ("*NaBanco*") involving an antitrust challenge to Visa's Interchange Fees, in which the U.S. District Court found for the Southern District of Florida that Visa credit cards competed, at

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[205] Transcript, May 31, 2012 (Volume 15), p. 2295 (lines 5-21).

that time, in a broad relevant "payment systems" market that included other forms of payment.[206]

235. The analysis of market definition in *NaBanco* was based on descriptions of substitutes available to consumers at the point of sale at that time, without regard to the principles of market definition that have consistently been applied in competition cases throughout the world for more than two decades. Rather, the analysis of the relevant market in *NaBanco* predated the introduction of the modern approach to market definition, including the application of the hypothetical monopolist test. As stated by Dr. Church in his text *Industrial Organization: A Strategic Approach*, the introduction by the U.S. DOJ of the merger guidelines created "[a] revolution in market definition". Moreover, many of the salient facts that underlay the Court's determinations of the relevant market in *NaBanco* have changed dramatically in the lengthy period since that case was decided. As a former Visa executive Broox Peterson candidly explained in a 2007 interview, "much of the rationale on which the court [in *NaBanco*] upheld the interchange fee in the 1980's is out-of-date in today's circumstances".[207]

236. The relevant jurisprudence since *NaBanco* is an unbroken line of authorities that consistently and repeatedly reject the Respondents' "all payments" market.

237. The first decision in that line of authorities is a 1994 decision of the U.S. Court of Appeals for the Tenth Circuit which arose from a dispute between Visa and the owner of Discover Card in the United States.[208] Specifically, the case concerned whether Visa's rules that precluded Visa Issuers from issuing competing credit cards, such as Discover or American Express, constituted a restraint of trade in violation of Section 1 of the *Sherman Act*. In that case, Visa agreed that the definition of the relevant product market was "the general purpose charge card market in the United States". The only participants in that market were Visa,

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206 *National Bancard Corporation v Visa USA*, 596 F Supp 1231)SD Fla 11984), p. 1257, aff'd 779 F 2d 592 (11th Cir 2986); Commissioner's Closing Brief of Authorities, **Tab 4**.

207 "Global Not-For-Profit Joint Ventures between Commercial Entities: An Interview with Broox W. Peterson former Senior Vice President and Assistant General Counsel Visa International and Visa U.S.A.", Exhibit A-396, p. 3.

208 *SCFC ILC, Inc v VISA USA, Inc, et al*, 36 F 3d 958, p. 966 (10th Cir 1994); Commissioner's Closing Brief of Authorities, **Tab 5**.

MasterCard, American Express, Citibank (Diners Club and Carte Blanche) and Sears (Discover Card).[209]

238. The next decision came in 2001, in a case brought by the U.S. DOJ against Visa and MasterCard.[210] After 34 days of trial, including extensive expert evidence, the U.S. District Court for the Southern District of New York, in a decision affirmed by the Court of Appeals for the Second Circuit, rejected expressly the Respondents' claim of a broad relevant market consisting of "all methods of payment including cash, checks and debit cards".[211] Instead, the court accepted the position of the U.S. DOJ that the relevant product market for antitrust analysis was "general purpose card network services".[212] The District Court based its decision, in part, on findings that in setting prices, Visa and MasterCard did not have regard to the price of cash, cheques, debit cards or other methods of payment:

> "[i]n setting interchange rates paid by merchants to issuers (through the merchants' acquiring banks), both Visa and MasterCard consider, and have considered, primarily each other's interchange rates, and secondarily the merchant discount rates charged by Discover and American Express … The costs to merchants of accepting cash, checks, debit, or proprietary cards were not a factor … And when tracking 'competitors', defendants look to the major general purpose card networks, not to other payment methods…
>
> Although the defendants seek here to define the market more broadly, large numbers of defendants' documents explicitly recognize the existence of a separate general purpose card market. […] Accordingly, because card consumers have very little sensitivity to price increases in the card market and because neither consumers nor the defendants view debit, cash and checks

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209 See *ibid.*

210 See *United States of America v Visa USA Inc, et al*, 163 F Supp 2d 322 (SDNY 2001) ["***USA v. Visa and Mastercard***"], aff'd 344 F 3d 229 (2d Cir 2003); Commissioner's Closing Brief of Authorities, **Tab 6**.

211 *Ibid,* pp. 330-31 and 336.

212 *Ibid*.

> as reasonably interchangeable with credit cards, general purpose cards constitute a product market".[213]

239. Approximately a year later, in July 2002, the European Commission issued a decision in a case referred to as *Visa International Multilateral Interchange Fee*.[214] The Commission found a payment card market that excluded cash and cheques, among other forms of payment.[215] The Commission expressly left open the prospect of finding a separate credit cards market.[216]

240. The next relevant decision followed in 2003 in *In Re Visa Check/MasterMoney Antitrust Litigation*, a class action brought by approximately 4 million U.S. merchants against Visa and MasterCard.[217] The Respondents again alleged that the relevant market included all forms of payment. Once again, this argument was rejected explicitly. The U.S. District Court adopted a relevant market consisting of general purpose credit and charge card services, consistent with the relevant market defined by the Commissioner in this matter. In fact, the District Court granted summary judgment against Visa and MasterCard on the basis that there was no genuine issue for trial with respect to the definition of the relevant market:

> "[t]here is no genuine issue of material fact requiring trial with respect to the fact that the relevant market, at its broadest, is the provision of general purpose credit and charge card services. The evidence establishes conclusively that merchants have not switched to other payment devices despite significant increases in the interchange fees on the defendants' credit cards. (In this respect, the evidence suggests an even narrower product market, i.e. general purpose [Credit Card Network Services] alone.) That consumers might switch to another form of payment in the event of a surcharge on their credit card transactions does not alter the fact that there is no cross-elasticity of demand at the merchant

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213 *Ibid,* p. 337.

214 Commission Decision of 24 July 2002, relating to a proceeding under Article 821 of the EC Treaty and Article 53 of the EEA Agreement (Case No COMP/29.373 – Visa International – Multilateral Interchange Fee) (notified under document number C(2002) 2698), (2002/914/EC); Commissioner's Closing Brief of Authorities, **Tab 7**.

215 *Ibid*, paras 51-52.

216 See *ibid*, para 52.

217 *Visa Check /Mastermoney, supra*; Commissioner's Closing Brief of Authorities, **Tab 8**.

> level between defendants' products and all other forms of payment".[218] [emphasis added]

241. The decision in *In Re Visa Check/MasterMoney Antitrust Litigation* was followed in 2007 by another decision of the European Commission in a case challenging MasterCard's Interchange Fees.[219] In that case, MasterCard alleged that it competed "with all other payment systems and forms of payment".[220] However, the Commission found that the evidence submitted by MasterCard was inconsistent with the broad relevant market alleged by MasterCard. For example, the Commission stated as follows when referring to one study submitted by MasterCard:

> In any event, the Dot Econ merchant benefits survey draws conclusions on cards characteristics that rather confirm that cards are not substitutable with cash and cheques from the merchants' perspective. … Dot Econ concludes that merchants place considerable value on payment instruments that offer a payment guarantee, rapid settlement, allegedly generate incremental spending, have reasonable level of penetration and are card-based rather than paper-based. At least these elements, which appear specific to payment cards, seem to confirm the analysis of cards as constituting distinct markets from cash and cheques from the perspective of merchants.
>
> …
>
> It cannot therefore be concluded that…Dot Econ's merchant benefits survey provides reliable evidence that payment card acceptance is substitutable to services related to cash and cheque. The study even tends to confirm that from the merchants' perspective payment card acceptance is not substitutable with the use of other payment methods.[221]

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218 *Ibid.*

219 *MasterCard, Inc et al v European Commission*, Judgment of the General Court (Seventh Chamber), 24 May 2012 ["**European General Court Decision**"], aff'g Provisional Non-Confidential Version, Commission Decision of 19/XII/2007 relating to a proceeding under Article 81 of the EC Treaty and Article 53 of the EEA Agreement (COMP/34.579 MasterCard COMP/36.518 EuroCommerce and COMP/38.580 Commercial Cards) To Be Notified to: MasterCard Europe S.p.r.l., MasterCard Incorporated and MasterCard International Incorporated ["**EC Decision**"]; Commissioner's Closing Brief of Authorities, **Tab 9**.

220 EC Decision, *supra*, para 253; Commissioner's Closing Brief of Authorities, **Tab 9**.

221 *Ibid*., paras. 295 to 296.

242. The Commission rejected the "all payments" market alleged by MasterCard and concluded on this issue as follows:

> The supply and demand side analyses show that card acquiring services are neither sufficiently substitutable with cash and cheque related services, nor with bank giro-, nor with direct debit services. The Commission therefore retains as relevant product market for assessing the MIF the market for acquiring payment card transactions. It can be left open whether this market can be further sub-divided into credit card acquiring and debit card acquiring or whether acquiring for MasterCard products is a product market on its own.[222]

243. Similarly, the Respondents' contention of an "all other forms of payment" market, based on, among other things, the "two-sided nature" of the market, was expressly rejected by the Commission.[223] On May 24, 2012, the European General Court affirmed the European Commission's decision, dismissing MasterCard's appeal.[224]

244. The next decision in the relevant jurisprudence is a 2008 decision of the U.S. District Court for the Eastern District of New York in another class action by merchants against Visa and MasterCard.[225] In relevant part, the District Court found "a market 'for Network services for General Purpose Payment Cards' (the 'General Purpose Market')",[226] concluding that:

> "There is no serious dispute, for purposes of this motion, that the General Purpose Market exists. *See United States v. Visa*, 344 F.3d 229, 239 (2d Cir. 2003) (affirming the district court's finding that 'there are no products reasonably interchangeable … with the network services provided by' Visa, MasterCard, Discover, and American Express)…".[227]

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222 *Ibid*., para. 307.

223 *Ibid.,* paras. 250 to 307.

224 European General Court Decision, *supra*, paras 21-23 and 168-182; Commissioner's Closing Brief of Authorities, **Tab 9**.

225 *In Re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation,* 562 F Supp 2d 392 (EDNY 2008); Commissioner's Closing Brief of Authorities, **Tab 10**.

226 *Ibid.,* 396.

227 *Ibid*., 400.

245. In sum, almost thirty years of case law has consistently rejected the broad "all payments" market advocated by the Respondents in the present matter. Remarkably, the Respondents have offered no credible evidence or any economic analysis to support their proposed market definition. Rather, it is evident that the relevant market does not include cheques, cash, money orders or any of the other payment methods alleged by the Respondents to be part of the relevant market.

246. On the basis of the consistent jurisprudence, the application of the well-established hypothetical monopolist test, the distinct attributes of credit cards as compared with other payment methods, the inability of merchants to effectively substitute other payments methods (even in the face of significant price increases), and Visa's and MasterCard's own internal documents and statements, the Commissioner submits that the inescapable conclusion that must be drawn in this case is that the appropriate relevant market in this matter is the supply of Credit Card Network Services in Canada.

Two Sided Market

(a) Overview

247. The Respondents have made a number of arguments to the effect that the Commissioner has failed to have appropriate regard for the "two-sided" nature of credit card networks. For example, the Respondents contend that the Commissioner "misconceives the nature of the market in issue" by allegedly failing to account for the fact that the market for credit cards is "two-sided". In fact, MasterCard goes so far as to allege that the two-sided nature of the credit card market is the "key economic fact in this case".[228]

248. Despite these assertions, the Respondents have failed to explain – let alone establish – how the two-sided nature of credit card networks should alter the Tribunal's assessment of the relevant market or its analysis concerning the impact that the Merchant Restraints have had upon prices for Credit Card Network Services and competition in Canada. As outlined below, accounting for the two-sided nature of credit card networks (as the Commissioner has in her

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[228] See MasterCard Concise Statement of Economic Theory, para. 4.

analysis), does not alter the analysis of the relevant issues in this case, including the definition of the appropriate relevant market.

(b) Credit Cards are Two-Sided

249. Credit cards are generally characterized as an example of a "two-sided" market, marketplace or platform. Such platforms allow two different types of customers to interact. In a two-sided market, the value of a platform to customers on one side is somewhat dependent on the quantity of customers using that platform on the other side. In this present case, the two sides of the platform are cardholders and merchants.

250. A standard example of a two-sided marketplace is a periodic publication, such as a newspaper. Newspapers typically have two different types of customers – readers, who buy the publication, and advertisers, who buy advertising space in the publication. The value to advertisers of a newspaper is dependent on the number of people who read the publication. Similarly, the value of a newspaper to readers is dependent, at least in part, on the quality of the advertising (*e.g.*, classified ads, weekly deals, etc.).

251. The customers on either side of the newspaper platform often pay different prices. Readers generally pay a low price, with advertisers paying a much higher price. Similarly, in the case of Visa and MasterCard, cardholders tend to pay a low price, such as a low annual fee, while the price charged to merchants, in the form of Card Acceptance Fees, is much higher.

252. In the absence of the Merchant Restraints, the different prices paid by merchants and cardholders would not necessarily be a cause for concern. Indeed, contrary to the allegations of the Respondents, the Commissioner is not challenging Interchange Fees or Card Acceptance Fees, *in and of themselves*. Rather, the Commissioner is challenging the Merchant Restraints as a form of vertical restraint that distorts and adversely affects the competitive process for establishing those fees.

(c) Applying the SSNIP to the Price on the Acquiring Side

253. Visa and MasterCard argue that in defining the relevant market, the Tribunal must focus on the prices paid on *both* sides of the credit card platform, as opposed to defining a relevant

market on only the merchant side of the platform.[229] For example, in his expert report, Dr. Church argues as follows:

> "In my view the relevant market cannot be the supply of CCNS by credit card networks to acquirers. The major reason for the difference in my assessment is that Dr. Winter's analysis of the relevant market ignores the implications of the fact that Visa and MasterCard are payment networks that compete with other payment methods. The theory of monopoly pricing by a two sided platform operator identifies the relevant margin to assess the profitability of platform pricing to be the sum of the network acquirer fee plus the network issuer fee (i.e., the fees actually charged by Visa and MasterCard, not the 'Acquirer Fee' constructed by Dr. Winter which includes interchange) less the marginal cost to complete a transaction. Moreover, it indicates the relevant demand elasticity to be the aggregate elasticity of demand, i.e., the sum of the demand elasticity on both sides of the platform, not just one side, and they should reflect network and feedback effects. In practice what this means is that the proper application of the hypothetical monopolist test to a payment platform should use the total transaction fee earned by the credit card platform and include both avenues of substitution, merchant substitution and cardholder substitution, as the price of a transaction on a payment platform rises. This is not the analysis done by Dr. Winter." [230] [emphasis added]

254. As set out below, the Respondents' argument is completely at odds with decisions of this Tribunal in prior cases involving two-sided platforms, of a number of U.S. courts that have defined markets in this very same industry and with the decision of the European Commission and General Court with respect to MasterCard. This approach is also contrary to that taken by the Antitrust Division of the U.S. DOJ in the very case relied upon by Visa in its opening submissions in this case, and by relevant academic commentary, including the approach described in Dr. Church's own text.

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229 See Church Report, *supra*, para 11.

230 *Ibid*.

255. In *Southam*,[231] the Tribunal examined whether a proposed acquisition of community newspapers and various other publications would substantially lessen competition. As the Respondents' expert, Dr. Church, confirmed on cross-examination,[232] the Tribunal in *Southam* defined a relevant market on one side of the two-sided newspaper market, namely the market for the supply of services to advertisers, and focused on the issue of whether the proposed transaction would substantially lessen competition in the supply of such services.[233] Contrary to the position of the Respondents in this proceeding, the Tribunal did not define the relevant market as a product that was supplied jointly to advertisers and readers. The approach taken by the Tribunal was affirmed and endorsed by the Supreme Court of Canada.

256. Similarly, in his text, *Industrial Organization: A Strategic Approach*, Dr. Church describes a number of radio station mergers to illustrate the standard approach to defining a relevant market.[234] Notably, however, as Dr. Church admitted during cross-examination, while radio stations are an example of a two-sided platform, that feature was given no weight or consideration in the discussion of market definition which appears in his text.[235] Consistent with the approach of the Tribunal in *Southam*, the relevant market in the radio station mergers described by Dr. Church in his text was the supply of services to advertisers, and not a joint product supplied to both listeners and advertisers.[236] As Dr. Church observes in his text: a "profit-maximizing monopolist in the average market in the U.S. for local radio advertising would increase price by more than 5%, providing evidence that local radio advertising markets are antitrust markets." [emphasis added] [237]

257. The Antitrust Division of the U.S. DOJ followed the same approach in reviewing the potential acquisition of a debit network, concluding that it was appropriate to apply the SSNIP

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231 *Southam* (Comp Trib), supra; Commissioner's Closing Brief of Authorities, **Tab 1.**

232 See Transcript of June 5, 2012 (Volume 18), pp. 2921 (line 17) to 2923 (line 6).

233 *Southam* (Comp Trib), *supra*, para 385; Commissioner's Closing Brief of Authorities, **Tab 1**.

234 See *Industrial Organization*, Exhibit A-494, pp. 13-14.

235 See Transcript of June 5, 2012 (Volume 18), pp. 2923 (line 7) to 2926 (line 2).

236 See *Industrial Organization*, Exhibit A-494, p. 14.

237 *Ibid.*

test to only one side of the market. The approach taken by the Antitrust Division is described as follows by two former Antitrust Division officials who were involved in the investigation of the proposed acquisition:

> "The harder problem was determining whether defining a relevant product market in the electronic payment network industry required applying the hypothetical monopolist test to both sides of the market. In particular, must a hypothetical monopolist be able to impose a SSNIP profitably on both merchants and issuers? As reflected in the complaint and pleadings, the Division determined that to define a market in the industry it was sufficient for a hypothetical monopolist to be able to impose a SSNIP profitably on one side of the market; it was not necessary for the hypothetical monopolist to be able to impose a SSNIP on both sides".[238] [emphasis added]

258. The Antitrust Division also explicitly rejected the argument that has been put forward in this case by the Respondents' experts; namely, that an inability to exercise market power on one side of the market (*i.e.*, the issuing side) would preclude a network from exercising market power on the other side of the market (*i.e.*, the acquiring side):

> "That merchants and card issuers are different classes of customers on opposite sides of a two-sided market does not alter the validity of the Merger Guidelines' analysis. There is no theoretical or factual reason why a dominant payment network's inability to exercise market power against one side of the market necessarily would preclude it from doing so against the other side. For example, if merchant demand for PIN debit network services is highly inelastic relative to card issuer demand, a dominant PIN debit network could charge supracompetitive prices to merchants while providing competitive rates to issuers. Consequently, when the Division evaluated the First Data/Concord acquisition, it sought to determine whether PIN debit networks constituted a relevant product market for either merchants or issuers, or both."[239]

259. Finally, consistent with the above practice and commentary, the European General Court recently affirmed a decision of the European Commission in a case against MasterCard, in

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238 Hesse and Soven, *supra,* pp. 726-727; Commissioner's Closing Brief of Authorities, **Tab 25.**

239 *Ibid*., p. 727; Commissioner's Closing Brief of Authorities, **Tab 25.**

which the Commission concluded that in examining the competitive effects of conduct by a credit card network, it is appropriate to define a separate relevant market for the supply of services on the Acquirer or merchant side of the market.[240] In its decision, the European Commission explicitly rejected MasterCard's argument that the two-sided nature of credit card networks meant that credit card network services should be viewed as a "joint" product supplied to both Issuers and Acquirers.[241]

260. As in the current case, MasterCard argued before both the European Commission and the European General Court that because of the "strict complementarity" between cardholders and merchants, the relevant market should be defined as a product that is supplied jointly to both sides of a credit card network, with the result that the SSNIP test should be applied to the "sum of the two prices charged" to both Issuers and Acquirers. The European Commission described MasterCard's argument on this issue as follows:

> "Cardholders and merchants should be seen as representing a 'joint demand'. 'Joint demand' is defined as '*strict complementarity*' of cardholder and merchant demand. As a consequence of its market definition, MasterCard requests the Commission to conduct a SSNIP test on the *sum of the two prices* charged to the two demand sides, that is to say cardholder fees and merchant fees. MasterCard submitted a study as evidence that a four party payment card system involves a joint service provided in response to a joint demand. The study argues in essence that the relevant product market must be '*the MasterCard service*' and the relevant product market is defined by determining which other payment systems compete with the MasterCard service".[242] [italics in original]

261. The European Commission rejected MasterCard's argument that the presence of two-sided demand (by both Issuers and Acquirers) means that, for the purpose of defining a relevant market, there is a single "joint" product that is supplied on both sides of the credit card network:

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240 European General Court Decision, *supra*; Commissioner's Closing Brief of Authorities, **Tab 9**; see also EC Decision, *supra*, paras. 250 to 277; Commissioner's Closing Brief of Authorities, **Tab 9.**

241 See EC Decision, *supra*, paras 250-277 (especially paras. 251, 257, 260-265 and 275); Commissioner's Closing Brief of Authorities, **Tab 9.**

242 *Ibid.,* para 252; Commissioner's Closing Brief of Authorities, **Tab 9.** See also European General Court Decision, *supra*, paras 174-178; Commissioner's Closing Brief of Authorities, **Tab 9.**

> "MasterCard's approach to defining markets in industries with two-sided demand cannot be accepted. Two-sided demand does not imply the existence of one single "joint product" supplied by a "joint venture".[243]

262. Further, the European Commission rejected MasterCard's argument (the very same argument being advanced by the Respondents in the present case) that the SSNIP test should be applied to the sum of the prices charged to merchants and cardholders:

> "Carrying out a SSNIP test on the sum of prices charged to cardholders implies that the distinct demand of cardholders for payment cards and the distinct demand of merchants for acquiring services are amalgamated into one single demand. This suggestion is conceptually unconvincing and also contradicts MasterCard's reasoning regarding Article 81 (3) of the Treaty where it justifies the very existence of an interchange fee in its system by relying on the different nature of demand of cardholders due to different price elasticities, which – in MasterCard's view – creates a need to 'balance' those different demands.
>
> For all of these reasons the concept of *joint demand* and MasterCard's suggestion to execute that single SSNIP test be executed [*sic*] on the *sum of charges* borne by cardholders and merchants does not appear appropriate for the purpose of defining product markets in the payment cards industry. The use of such a SSNIP test is inadequate for the purpose of assessing the potential effects of a MIF on competition *within* one of these schemes and in particular between acquiring banks as it ignores the different levels of interaction and supply and demand within such a scheme".[244] [italics in original]

263. Overall, the European Commission saw no basis for deviating from its long-standing practice of defining separate relevant markets on each side of a two-sided market:

> "MasterCard's concept of market definition is also inconsistent with the Commission's long standing case practice in defining product markets in industries with two-sided demand. The very examples MasterCard cited in reply to the Statement of

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243 EC Decision, *supra*, para 257; Commissioner's Closing Brief of Authorities, **Tab 9.**

244 *Ibid*., paras 264-265; Commissioner's Closing Brief of Authorities, **Tab 9.**

> Objections of 24 September 2003 in support of MasterCard's market definition show that its concept is contrary to consistent Community competition policy.
>
> MasterCard referred to the newspaper market as a 'two-sided market', because newspapers and magazines provide services to advertisers, as well as to readers. However, the Commission has always defined services to readers and services to advertisers as separate product markets despite interdependence of demand. As regards MasterCard's other example for 'two-sided markets', software platforms, the Commission reached the conclusion in its Microsoft decision that due to its specific characteristics and the lack of realistic substitutes, the market for streaming media players (a software application) constitutes a relevant product market that is distinct from the markets for client PC operating systems or work group server operating systems despite the fact that demand for these products is 'two-sided', that is to say interdependent".[245]

264. Consistent with the decisions and commentary described above, the Commissioner submits that, in examining the competitive effects of the Merchant Restraints, it is appropriate to define the relevant market on only one side of the credit card network, namely the Acquirer or merchant side, and to apply the SSNIP test to the prices charged to Acquirers or merchants for Credit Card Network Services.

265. In any event, even if the SSNIP test were applied to the sum of the prices charged on both sides of the credit card networks, it is clear, as explained below, that that the Respondents' broad "all payments" market would still not be the relevant market. Remarkably, as noted above, the Respondents' experts failed to apply the hypothetical monopolist test to what the Respondents contend is the appropriate price. This is not surprising when one considers that, despite the Respondents' strenuous arguments in favour of an "all payments" market, the analysis mandated by the hypothetical monopolist test simply does not support the conclusion that the alleged "all payments" market is the relevant market in the instant matter.

266. Using the sum of the Acquirer and Issuer Network Fees, as prescribed by Dr. Church, would yield a prevailing price of approximately [redacted] basis points.[246] A 5% increase in this price

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245 *Ibid*., paras 266-267; Commissioner's Closing Brief of Authorities, **Tab 9.**

246 See "Fee rates from 2006 to 2011", Exhibit CA-348.

would be approximately [redacted] basis points. It cannot credibly be suggested (and there is no evidence before the Tribunal) that an increase in Card Acceptance Fees from [redacted] to [redacted] would cause an appreciable number of merchants to decline to accept credit cards.

267. Similarly, even if it were assumed that Issuers bore the entire [redacted] basis point increase through higher Issuer Network Fees, it cannot credibly be suggested (and there is no evidence before the Tribunal) that Issuers would discontinue issuing credit cards in the face of such an increase.

268. Dr. Church also alleged that in applying the SSNIP test, it was necessary to account for "feedback" effects resulting from an increase in Card Acceptance Fees. By feedback effects, Dr. Church referred to the reaction of cardholders and Issuers on one side of the platform to changes to Card Acceptance Fees for merchants on the other side of the platform:

> "MR. FANAKI: I promised I would come back to you on this issue of feedback effects. By that, you mean the reaction of issuers to changes on the -- and prices on the acquiring or merchant side?
>
> DR. CHURCH: So feedback effect would be if I raise the price to merchants -- for instance, the price that merchants end up paying trickle down through acquirers, so there are fewer merchants accept the card -- then it may be that fewer cardholders would be interested in holding that card. That would be a feedback effect. That would be the first instance of it.
>
> Then if there are fewer cardholders going to hold it, it cycles back to maybe there are fewer merchants willing to accept it. You get then a second-order effect. Then you get a third-order effect.
>
> If the system is stable, eventually it will stop. If it is not stable, eventually the credit card network would disappear".[247]

269. As outlined above, given that no appreciable number of merchants would decline to accept Visa or MasterCard credit cards in response to an increase of 1/4 or 2/3 of a basis point, there are simply no "feedback" effects to be accounted for in the analysis. As Dr. Carlton explained during his cross-examination:

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247 Transcript of June 5, 2012 (Volume 18), p. 2956 (lines 4-23).

> "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".[248] [emphasis added]

270. In any event, as with his other conclusions on relevant market, Dr. Church failed to conduct any analysis of whether a small increase in the fees would result in any feedback effects:

> MR. FANAKI: I take it you will agree you haven't done an analysis to examine whether a one-third-of-a-basis-point increase is going to impact on the profitability of issuers?
>
> DR. CHURCH: I have not. I have not done any of this analysis except to put out what the framework should be.
>
> MR. FANAKI: And if we assume that there are no merchants that decline to accept credit cards in response to a one-third-of-a-basis-point increase, again, you haven't examined whether or not that is going to have any impact on the issuing side?
>
> DR. CHURCH: I have not.

271. Overall, irrespective of whether the SSNIP test is applied to the Acquirer Fee, the Acquirer Network Fee or the sum of the Network Fees paid by Issuers and Acquirers, the result

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[248] Transcript of May 17, 2012 (Volume 7), pp. 1291 (line 18) to 1292 (line 16).

is the same – other methods of payment are not sufficiently close substitutes so as to constrain an increase in these fees.

(d) Distortion of Competition on One Side of the Market

272. The Respondents contend – without any supporting evidence – that even if the Merchant Restraints suppress competition so that merchants pay higher Card Acceptance Fees on the Acquirer side of the platform, the increased profits to the credit card networks would be entirely "dissipated" away through fee reductions on the Issuer side of the platform.

273. As Dr. Church explained in his testimony in-chief, "any positive margin from competition suppression or cost externalization could be readily dissipated by competition on the issuer side of the platform".[249] Dr. Church confirmed his evidence in this regard in cross-examination:

> "MR. FANAKI: Let me try again. This morning you said, I believe, that a price increase caused by a suppression of competition on the acquiring side could be dissipated away through competition on the issuer side.
>
> DR. CHURCH: That's correct.
>
> MR. FANAKI: Right?
>
> DR. CHURCH: Yes."[250]

274. As discussed below, not only is this contention incorrect as a matter of both economics and law, [redacted][251] Similarly, the evidence demonstrates that the increased revenues from the suppression of competition for

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249 Transcript of June 5, 2012 (Volume 18), p. 2875, (lines 15-18).

250 *Ibid*., p. 2964 (lines 10-19).

251 [redacted]

Card Acceptance Fees have *not* been passed through, in whole, to cardholders in the form of increased benefits or rewards.

275. In any event, the Respondents are not entitled to defend their anti-competitive conduct on the basis that the increased prices paid by merchants may benefit Issuers or certain cardholders. By way of illustration, assume that there are several competing newspapers in a city, and those newspapers agree to raise the prices they will charge to advertisers for advertising space in their newspapers. The higher prices charged to advertisers may allow the newspapers to lower their prices for readers. However, it would never be appropriate to allow the newspapers to defend their price-fixing cartel on the basis that although the prices paid by advertisers on one side of the market are higher, the savings are being passed along to readers on the other side of the market. Rather, it is entirely appropriate to focus upon the impact of the cartel on the price of newspaper advertising (without reference to the price to readers) when assessing the competitive impacts of the conduct in question.

276. In determining whether conduct has an adverse effect on competition, it is sufficient to demonstrate that the conduct suppresses or distorts competition for certain customers. It is not necessary to establish that the conduct in question harms all customers or harms all customers equally. For example, in *Southam*, the Tribunal did not consider whether the increased prices for advertisers would result in lower prices for readers. Similarly, when examining the debit card network acquisition discussed above, the Antitrust Division of the U.S. DOJ found that it was sufficient to establish an antitrust violation if only certain customers were impacted, and that it was unnecessary to establish an anti-competitive effect on both cardholders and merchants:

> "… The Division based this conclusion on the established principle that a merger need not have an impact on every class or category of the parties' customers to violate the antitrust laws. The Antitrust Division and the Federal Trade Commission often challenge transactions that significantly reduce competition for a subset of the customers for a particular product-even though other subsets of customers for the same product are unlikely to experience any harm. The Merger Guidelines' provisions concerning price-discrimination markets state that a transaction can be anticompetitive if it will raise prices for a subset of

> customers of a product, even if it presents no competitive threat for other substantial groups of customers of the same product".[252]

277. For the same reasons, it would not be appropriate to allow a firm to defend anti-competitive conduct on the basis that the increased revenues associated with its anti-competitive conduct were paid to shareholders in the form of dividends or to employees in the form of higher wages.

278. It is not appropriate for the Tribunal to attempt to offset or "net out" the competitive effects on merchants and cardholders to determine whether conduct has an adverse effect on competition. As Dr. Winter explained in his Reply Report when commenting on Dr. Church's "offsetting effects" analysis:

> "Our key point of disagreement is whether the Tribunal must balance these allegedly 'offsetting effects' to determine the 'net' competitive impact of the Merchant Rules. The answer, in my view, is no. Neither from the perspective of competition policy generally, nor from the perspective of price maintenance specifically, is it necessary to attempt to 'net' out any increase in competition on the issuing side of the market from any decrease in competition on the acquiring/merchant side. It is appropriate, in assessing whether the conditions of section 76 are met in this case, to focus on the acquirer/merchant side of the market".[253]

279. As Dr. Winter explained in his Reply Report, the issue facing a credit card network in balancing between the Issuer and Acquirer sides of the market is the same problem that any firm faces in balancing between lower prices and higher non-price, demand-enhancing activities.[254] For example, a firm may decide to increase prices in order to spend more on service, promotions and advertising; or to decrease prices and spend less on these non-price strategies. Competition policy dictates that the appropriate combination of price and non-price strategies will be determined through unfettered competition. It is certainly not appropriate to allow a firm to defend conduct that increases prices and has an adverse effect on competition on the basis

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252 Hesse and Soven, *supra*, p. 727; Commissioner's Closing Brief of Authorities, **Tab 25.**

253 Reply Report of Ralph Winter, Exhibit CA-73 ["**Winter Reply Report**"], para 47.

254 *Ibid*., para. 48.

that some or all of these increased revenues will be spent on non-price strategies. As Dr. Winter explained:

> "Competition policy is based on the principle that markets *without anticompetitive activity* should be relied upon to yield the appropriate mix of price and non-price competition. This principle is as applicable to two-sided markets as it is to one-sided markets. Section 76 specifically, like competition law generally, does not involve a consideration of trade-offs with respect to non-price expenditures, such as issuing activities, but rather focuses on the anticompetitive conduct at issue. The two-sided versus one-sided aspect of the case is irrelevant to this conclusion".[255]

280. Further, when arguing that the increased revenues resulting from higher Card Acceptance Fees will be dissipated through competition for Issuers or cardholders, the Respondents fail to acknowledge that the higher cost of accepting credit cards, especially premium cards, results in higher prices to all *other* consumers, including those paying with cash or debit. Those consumers effectively subsidize part of the rewards on credit cards, and yet do not receive any of those rewards or any of the other benefits associated with credit cards.

281. Leaving that significant issue aside, it is not even factually accurate to allege that the increased revenues from higher Card Acceptance Fees are passed along to all credit card holders in the form of increased rewards. [redacted]

282. [redacted]

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255 *Ibid*., para. 52.

256 [redacted]

[redacted]

283. Further, there is no evidence that increases in Acquirer Network Fees were offset through reductions in Issuer Network Fees. [redacted]

284. Rather than analyzing this evidence, the Respondents' experts have merely assumed that higher Interchange Fees and higher Network Fees cannot cause harm because the incremental profits are certain to be dissipated entirely due to competition from rival networks or other "payment mechanisms". The evidence contradicts this significant assumption. As the evidence shows, only a portion of the increased revenues are "passed along" to cardholders in the form of greater rewards and benefits. Further, competition from other payment methods has not constrained Visa and MasterCard from implementing increases in Network Fees.

285. In summary, the two-sided nature of the market for credit cards does not affect or alter the Commissioner's conclusion that the relevant market, for the purposes of this proceeding, consists of Credit Card Network Services in Canada. Similarly, nothing in the two-sided nature of the credit card market alters the Commissioner's conclusion that the Merchant Restraints influence upwards Card Acceptance Fees and have adverse effects on competition, thereby contravening section 76 of the *Competition Act*.

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257 [redacted]

258 [redacted]

259 [redacted].

Market Power

286. As stated by this Tribunal in its recent decision in *Commissioner of Competition v CCS Corporation*,[260] "market power is 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".[261]

287. In examining whether a firm has market power, the Tribunal commonly considers various forms of direct evidence, such as evidence of an ability to profitably increase prices above the competitive level, as well as indirect evidence, such as market shares and barriers to entry. For example, in *Canada (Director of Investigation and Research) v NutraSweet Co.*,[262] the Tribunal stated as follows:

> "Market power is generally accepted to mean an ability to set prices above competitive levels for a considerable period. While this 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".[263]

288. The evidence before the Tribunal demonstrates that each of Visa and MasterCard exercises market power within the relevant market of Credit Card Network Services. Such evidence includes the following direct and indirect indicators of market power:

(i) 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;

(ii) 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;

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260 2012 Comp. Trib. 14, Registry Document No: 189 ["***CCS***"]; Commissioner's Closing Brief of Authorities, **Tab 41**.

261 *Ibid.*, at para. 371.

262 [1990] CCTD No 17 ["*Nutrasweet*"]; Commissioner's Closing Brief of Authorities, **Tab 13**.

263 *Ibid.*, p. 22.

(iii) 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;

(iv) [redacted]

(v) the market for the supply of Credit Card Network Services is highly concentrated and each of Visa and MasterCard holds a substantial market share;

(vi) the profit margins for Visa and MasterCard are very high; and

(vii) 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.

Each of these indicators of market power is discussed below.

(a) Visa and MasterCard Increase Prices Above Competitive Level

289. As noted above, market power is defined as the ability of a firm to sustain prices above competitive levels for a considerable period of time. In a competitive market, a supplier is unable to sustain a price increase above the competitive level, as the supplier would lose too many sales to rivals. The ability of Visa and MasterCard to profitably increase prices without any appreciable impact on credit card volumes is compelling evidence of their market power.

290. Visa and MasterCard have, in fact, increased substantially both Interchange Fees and Network Fees in the period since 2007, with the result that the Card Acceptance Fees paid by merchants in Canada have increased substantially during that period. There has, however, been no unprofitable loss to either Visa or MasterCard of transaction volumes.[264] [redacted]

[264] See Transcript of May 28, 2012 (Volume 12), pp. 2198 (line 25) to 3299 (line 16).

[redacted]

291. Increases in Interchange Fees and greater penetration of premium credit cards with higher Card Acceptance Fees have resulted in significant increases in Card Acceptance Fees for merchants. Each of the merchants that testified before the Tribunal cited significant increases in Card Acceptance Fees in recent years, due substantially to increases in their effective Interchange Fees. For example, in paragraphs 41 and 42 of his witness statement, Mario de Armas of Wal-Mart Stores, Inc. stated that:

> "Card Acceptance Fees for Walmart Canada have increased in recent years due to a number of factors, including increases in the level of Interchange Fees associated with credit cards and the introduction and increasing penetration of 'premium' credit cards that have higher Interchange Fees than standard credit cards.
>
> Comparing the fiscal year that ended on January 31, 2012, to the previous fiscal year, Walmart Canada's cost of accepting Visa and MasterCar [redacted]

292. Similarly, in paragraphs 25 to 27 of his witness statement, Michael Shirley of Best Buy Canada Inc. stated that:

> "Best Buy Canada's cost of credit card acceptance has increased in recent years due to changes made by Visa and MasterCard to the structure of Interchange Fees in 2008; particularly, the introduction and increased penetration of 'premium' credit cards that carry higher Interchange Fees than standard credit cards…
>
> Visa began assessing additional fees on all Visa credit card transactions in October 2007 and, in April 2008, introduced its 'premium' Visa Infinite credit card, with an Interchange Fee that was 12% higher than the Interchange Fee for a standard Visa credit card. Similarly, MasterCard began assessing additional fees on all MasterCard credit card transactions in April 2008 and, in July 2008, introduced the 'MasterCard High Spend Program' with

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265 [redacted]

266 deArmas Statement, *supra*, paras. 41-42.

> a 26% higher Interchange Fee than the standard MasterCard credit card. MasterCard automatically switched cardholders with a minimum card spend of $24,000 per year to this program without issuing cardholders new credit cards.
>
> A few months later, in November 2008, MasterCard launched a 'premium' credit card, with Interchange Fees 42% higher than those associated with a standard MasterCard credit card. These rate increases were non-negotiable and the networks offered no off-setting Interchange Fee decreases for non-premium credit cards."[267]

293. Tim Broughton, the owner of C'est What? restaurant in Toronto, also described the significant increase in his company's effective cost of credit card acceptance between 2008 and 2011:

> "Factoring in all of the fees paid to Global Payments, C'est What's effective cost of credit card acceptance has steadily increased from [redacted] for each credit card transaction in December 2008 to [redacted] in December 2011. That is an increase of 25.5% over three years".[268]

294. Each of the other merchants with operations in Canada gave evidence of similar increases in Card Acceptance Fees.[269]

295. Increases in the price charged for Credit Card Network Services have not occurred exclusively through increases in the Interchange Fees set by the Respondents, but also through increases in the Network Fees charged by Visa and MasterCard to their respective Acquirers. As described above, these Network Fees ultimately are passed on to merchants through higher Card Acceptance Fees. For example, [redacted]

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267 Shirley Statement, *supra*, paras. 25-27.

268 See Broughton Statement, *supra*, para. 13.

269 See Houle Statement, *supra*, paras. 34 and 35. See also Symons Statement, *supra*, para. 40; Daigle Statement, *supra*, paras. 25 and 26; Jewer Statement, *supra*, para. 37; van Impe Statement, *supra*, paras. 15 and 16; Li Statement, *supra*, para. 25.

[redacted]

296. [redacted]

297. Indeed, as previously stated, the number of Canadian merchants that accept Visa and MasterCard credit cards has increased during the same period that Card Acceptance Fees have increased.[274]

298. [redacted]

270 [redacted]

271 [redacted]

272 [redacted]

273 [redacted]

274 See Transcript of May 28, 2012 (Volume 12), pp. 2164 (line 24) to 2165 (line 3).

[redacted]

[redacted]

299. [redacted]

300. The experience in Canada, as described above, is consistent with the experience in the United States. In its decision in *United States of America v. Visa U.S.A. Inc. et al.*,[277] the U.S. District Court for the Southern District of New York found that "both Visa and MasterCard have recently raised interchange rates charged to merchants a number of times, without losing a single merchant customer as a result".[278]

(b) Prices are Unrelated to Costs

301. [redacted]

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275 [redacted]

276 [redacted].

277 *USA v. Visa and MasterCard, supra*; Commissioner's Closing Brief of Authorities, **Tab 6**.

278 *Ibid.*, p. 340.

279 [redacted]

302. [redacted]

303. [redacted]

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280 [redacted]

281 [redacted]

282 [redacted]

283 [redacted] see also McCormack Report, *supra*, para. 117.

[redacted]

304. The 2007 decision of the European Commission referred to above also describes MasterCard's position that Interchange Fees are set to extract as much of a merchant's "willingness to pay" as MasterCard can without causing the merchant to decline acceptance of its cards, offer discounts or surcharge on these credit cards (as MasterCard permits surcharging of credit cards in Europe):

> [MasterCard attempts to determine] [h]ow high could interchange fees go before we would start having either serious acceptance problems, where merchants say: we don't want this product anymore, or by merchants trying to discourage the use of the card either by surcharging or discounting for cash".[285]

305. The former Senior Vice President and Assistant General Counsel for Visa International and Visa USA, Broox Peterson has confirmed that Visa takes a similar approach in setting Interchange Fees:

> "As more and more of merchants' sales are paid for with cards, the merchants have come to resent the fees they pay for that privilege. This resentment has been stoked over the years by a creep upwards in those fees, due to increases in the amount of the interchange reimbursement fee paid by Acquirers to Issuers for every transaction, which the Acquirer passes along to the merchant.
>
> Due to mergers and consolidation of banks worldwide in the past 20 years, it came to be that a small number of very large banks controlled the card associations. Since these member banks were also very large Issuers, they began to view the interchange reimbursement fee not as a revenue reallocation mechanism to ensure success of the system, but as a demand-driven pricing

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284 [redacted]

285 EC Decision, *supra*, para. 175; see also European General Court Decision, *supra*, para. 158; Commissioner's Closing Brief of Authorities, **Tab 9**.

> scheme to collect as much revenue from merchants as the market would bear".[286] [emphasis added]

306. Pricing to collect "as much revenue from merchants as the market [will] bear" is a direct and compelling indication that Visa and MasterCard each possess and exercise market power in the relevant market.

(c) Visa and MasterCard Engage in Price Discrimination

307. The Tribunal has accepted that price discrimination by a firm is – in combination with evidence of other conduct – "compelling" evidence of market power. For example, in *Canada (Competition Act, Director of Investigation and Research) v Tele-Direct (Publications)*,[287] the Tribunal stated:

> "In addition to the evidence of profitability advanced by the Director, the Tribunal is of the view that Tele-Direct's approach to setting prices supports the conclusion that Tele-Direct is behaving more like a firm with a comfortable margin of market power than a firm facing close substitutes. We note Dr. Wilig's point that evidence of price discrimination, in isolation, would not reliably indicate market power. In combination with other evidence it is, however, compelling…".[288]

308. Price discrimination occurs when different customers pay different prices unrelated to any differential costs of serving those customers. Successful price discrimination requires, among other things, at least some degree of market power, because pricing is not related strictly to costs.[289]

309. The evidence establishes that MasterCard and Visa engage in extensive price discrimination. Most obviously, the Interchange Fees established by Visa and MasterCard are expressed as a percentage of the transaction amounts (such as [redacted] of the transaction value), as opposed to being a fixed fee (such as the fixed fee applicable to Interac debit transactions).

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286 "Global Not-For-Profit Joint Ventures between Commercial Entities: An Interview with Broox W. Peterson former Senior Vice President and Assistant General Counsel Visa International and Visa U.S.A", Exhibit A-396, p. 3.

287 [1997] CCTD No 8 ["***Tele-Direct***"]; Commissioner's Closing Brief of Authorities, **Tab 14**.

288 *Ibid.,* para 288.

289 See Frankel Report, *supra*, p. 56.

This automatically results in higher fees for larger value transactions, and increases in fees over time as average transaction amounts increase.

310. For example, as described above, the Interchange Fee set by MasterCard for using a MasterCard World Elite credit card in a standard transaction is 2.25%.[290] For a $100 transaction, the Interchange Fee component of the fee paid by the merchant is $2.25. However, on a $200 transaction, the Interchange Fee is doubled to $4.50.

311. Similarly, most of Visa and MasterCard's Network Fees are also determined as a percentage of transaction value, even though the same authorization, clearing and settlement process is applied regardless of the transaction size.

312. The substantially higher Interchange Fees and Network Fees for larger transactions cannot be justified on the basis of increased costs for such transactions. It cannot credibly be claimed (and no evidence has been adduced to support such a claim) that a $200 transaction costs Visa, MasterCard or their Issuers twice as much to process as a $100 transaction.

313. Evidence of price discrimination is also apparent from the substantial differences among Interchange Fees applied by Visa and MasterCard across various customer segments and transaction types. Visa and MasterCard each organize Interchange Fees by category, based on (among other things) the type of card used in the transaction (*e.g.*, standard or premium), the type of merchant (*e.g.*, bricks-and-mortar or online only), the merchant's annual volume of Visa or MasterCard credit card transactions (*e.g.*, in the case of MasterCard, merchants with annual MasterCard dollar volume in Canada in excess of $400 million), and the type of transaction (*e.g.*, card-present or card-not-present).[291] [redacted]

290 Devita Statement, *supra*, p. 35.

291 Leggett Statement*, supra,* p. 170.

[redacted]

314. As discussed above, for many years, Visa and MasterCard each had a single Interchange Fee level. For MasterCard, it was 1.00% of the value of the transaction, while for Visa, it was 1.75% minus 25 cents.[293] Today, MasterCard has 30 different domestic Interchange Fee categories and Visa has 24 different domestic Interchange Fee categories.

315. The differences in Interchange Fees between merchant categories are significant. For example, a merchant in MasterCard's petroleum category will pay an Interchange Fee of between 1.21% (when a core MasterCard credit card is used) and 2.00% (when a MasterCard premium high spend card is used), as compared with merchants falling in the "all other MasterCard transactions" category, who pay an Interchange Fee of between 1.72% (when a core MasterCard credit card is used) and 2.65% (when a MasterCard premium high spend credit card is used). The highest Interchange Fees are at least twice the level of the lowest Interchange Fees.

316. Again, there is no evidence that the significant differences in Interchange Fee categories are based on the costs of providing services to these different categories of merchants. The ability of Visa and MasterCard to engage in such price discrimination provides compelling evidence of their market power.

(d) Primary Constraint on Price is Threat of Regulation

317. As described above, the evidence before the Tribunal demonstrates that the primary constraint on the prices charged by Visa and MasterCard is not competition or reduced merchant acceptance, [redacted]

[redacted]

293 See "Maintaining Competition in the Canadian Credit Card Industry", Exhibit A-117, p. 30.

(e) Visa and MasterCard Earn Supra-Competitive Margins in Canada

318. [redacted]

319. In *Canada (Director of Investigation and Research) v.Tele-Direct (Publications Inc. and Tele-Direct (Services) Inc. ("Tele-Direct")*, the Tribunal found that accounting profits of over 40% were a sufficient indicator of market power.[296] Similarly, in *Canada (Commissioner of Competition) v. Canada Pipe Co.*,[297] the Federal Court of Appeal affirmed the Tribunal's conclusion that Canada Pipe had market power based, in part, on the Tribunal's conclusion that Canada Pipe had "hefty margins".[298] The Court of Appeal concluded that such margins were an indication of supra-competitive pricing and that it was open to the Tribunal to conclude that Canada Pipe had market power.

320. The Commissioner submits that the evidence on the record before the Tribunal in this case, [redacted] Additionally, Mr. Sheedy testified that the operating margin for Visa Inc. for 2010 was 57%.[301]

321. The "hefty" margins of Visa and MasterCard are a further indication of the market power of the Respondents.

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294 [redacted]

295 [redacted]

296 *Tele-Direct*, *supra*, pp. 131 and 138; Commissioner's Closing Brief of Authorities, **Tab 14**.

297 *Canada Pipe* (Cross-appeal)[2006] FCA 236; Commissioner's Closing Brief of Authorities, **Tab 2**.

298 *Ibid,* para. 51; Commissioner's Closing Brief of Authorities, **Tab 2**.

299 [redacted]

300 [redacted]

301 Transcript of May 28, 2012 (Volume 12), p. 2199 (line 25) to 2200 (line 3).

(f) Relevant Market is Highly Concentrated

322. The Tribunal has affirmed in a number of decisions that a high market share is *prima facie* evidence of the existence of market power. For example, as the Tribunal stated in *Canada (Competition Act, Director of Investigation and Research) v The D & B Companies of Canada Ltd*:[302]

> "As stated in Laidlaw, a prima facie determination of whether a firm likely has market power can be made by considering its market share. If the share is very large, the firm will likely have market power although, of course, other considerations must be taken into account. In the Laidlaw case, these included the number of competitors in the market and their market share, any excess capacity and how easily a new firm could establish itself as a competitor. …".[303]

323. [redacted]

324. The Competition Bureau's *Merger Enforcement Guidelines* identify a market as highly concentrated where the combined market share of the four largest firms (the "CR4") exceeds 65%.[305] In the case of Credit Card Network Services in Canada, the CR4 is 100% and has always been 100%.

325. Competition authorities in the United States use a slightly different measure to examine the levels of concentration in a market - referred to as the Herfindahl-Hirschman Index or "HHI". Under the U.S. *Horizontal Merger Guidelines*, a market is considered to be highly

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302 [1995] CCTD No 20 ["***Nielsen***"]; Commissioner's Closing Brief of Authorities, **Tab 12**.

303 *Ibid.*, p. 33.

304 [redacted]

305 See Excerpt from Competition Bureau, "Merger Enforcement Guidelines" (October 6, 2011); Commissioner's Closing Brief of Authorities, **Tab 39**.

concentrated where the HHI exceeds 2,500.[306] In this market, the HHI is approximately 4,746.[307]

326. Evidence from *The Nilson Report* shows that, based on the number of transactions, Visa's market share in 2010 was 58.1% and MasterCard's market share was 36%, for a combined total of 94.2%.[308] Calculated based on the dollar volume of transactions, in 2010**,** Visa's market share was approximately 61.5% and MasterCard's share was 30.2%, for a combined total of approximately 92%.[309] Under either measure, Visa and MasterCard each holds a substantial share of a highly concentrated market.

327. The evidence clearly demonstrates that the relevant market is highly concentrated and that Visa and MasterCard are effectively a duopoly. Consistent with the Tribunal's decisions in *Nielsen*, the significant share of the relevant market held by each of Visa and MasterCard is *prima facie* evidence of market power.

(g) Barriers to Entry are High

328. In addition to levels of concentration, in prior cases the Tribunal has also considered whether the threat of potential entry into the relevant market would be likely to prevent the exercise of market power.

329. For example, in *Commissioner of Competition v Superior Propane*,[310] the Tribunal considered the relationship between barriers to entry and the exercise of market power (at paras 127 to 128):

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306 See Excerpt from U.S. Department of Justice and Federal Trade Commission, "Horizontal Merger Guidelines" (August 19, 2010); Commissioner's Closing Brief of Authorities, **Tab 40**.

307 For example, a market consisting of four firms with market shares of 30%, 30%, 20%, and 20% has an HHI of 2600 ($30^2 + 30^2 + 20^2 + 20^2 = 2{,}600$). In this market, with market shares of approximately 61%, 31% and 8%, the HHI equals approximately 4,746 ($61^2 + 31^2 + 8^2 = 4{,}746$).

308 See " The Nilson Report issue #967", Exhibit RV-39, p. 7.

309 *Ibid.*

310 2000 Comp Trib 15; Commissioner's Closing Brief of Authorities, **Tab 3**.

"As stated by the Tribunal in Director of Investigation and Research v. Hillsdown Holdings (Canada) Limited (1992), 41 C.P.R. (3d) 289 at 324, [1992] C.C.T.D. No. 4 (QL):

> In the absence of significant entry barriers it is unlikely that a merged firm, regardless of market share or concentration, could maintain supra-competitive pricing for any length of time. An attempt to do so would cause competitors to enter the market and the additional supplies created in that manner would drive prices back to the competitive level.

This statement emphasises the economic effect of entry. Evidence of commencement of operations, per se, is insufficient to establish the competitive restraint on a supra-competitive price or a likely exercise of market power".

330. [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

311 [redacted]

[redacted]

331. In addition to the considerable investment in the infrastructure and systems necessary to operate a credit card payment system, a new entrant would also have to solve the "chicken and egg" problem of simultaneously attracting a significant volume of merchants to accept its credit cards as a form of payment, and also attracting a significant volume of cardholders to hold and use those cards. Moreover, this would have to be accomplished in the face of three entrenched incumbents.[313]

332. The significance of these barriers to entry is confirmed by the fact that there has not been a new credit card network in Canada for at least 25 years. Even the Discover Card network, which has operated in the United States since 1986, has not been able to penetrate the Canadian market to any significant extent.

[redacted]

312 [redacted]

313 See [redacted] and "Maintaining Competition in the Canadian Credit Card Industry", Exhibit A-117, p. 30.

[redacted]

334. In the present matter, the evidence shows that barriers to entry for a new credit card network are very high. Above and beyond the high technical barriers to establishing and operating a credit card network, the two-sided nature of credit card networks makes entry by new networks even more costly and difficult. Consequently, entry is not sufficiently likely to prevent the exercise of market power.[317]

335. In summary, the direct and indirect evidence demonstrates that Visa and MasterCard each possess substantial market power in the market for Credit Card Network Services. The ability of Visa and MasterCard to significantly increase Interchange Fees and Network Fees, without suffering any appreciable loss of volume, and to price to extract as much of a merchant's "willingness to pay" as possible, are direct demonstrations of the Respondents' market power. Visa's and MasterCard's market power is also clearly evident from their combined 92% share of the market for Credit Card Network Services, their supra-competitive margins and the substantial barriers to entry into the relevant market.

Interpretation of Section 76 of the *Competition Act*

336. As set out above, the Commissioner brings this Application under section 76 of the Competition Act for an Order prohibiting each of the Respondents from continuing to enforce the Merchant Restraints, which influence upwards and discourage the reduction of the Card Acceptance Fees paid by merchants.

337. The purpose of the *Competition Act*, as set out in Part I of the Act, is as follows:

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314 [redacted]

315 [redacted].

316 [redacted]

317 See Carlton Report, *supra*, p. 20 and Frankel Report, *supra*, p. 49.

"**1.1 Purpose of Act** – The purpose of this Act is to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy, in order to expand opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada, in order to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy and in order to provide consumers with competitive prices and product choices."

338. Section 76 reads, in relevant part, as follows:

"PRICE MAINTENANCE

76. (1) **Price maintenance** – 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

(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

*(*b*)* the conduct has had, is having or is likely to have an adverse effect on competition in a market"

(2) **Order** – 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.

(3) **Persons subject to order** – An order may be made under subsection (2) against a person who

(a) is engaged in the business of producing or supplying a product;

> *(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, trademark, copyright, registered industrial design or registered integrated circuit topography".[318]

339. To secure a remedy under section 76, the Commissioner must satisfy the following five elements:

- the Respondents must fall within one of the defined class of persons to which the price maintenance provision applies, such as a person that supplies a product, a person that holds exclusive intellectual property rights, or a person that is engaged in a business relating to credit cards;
- the challenged conduct must be implemented, directly or indirectly, through an agreement, threat, promise or any like means;
- the challenged conduct must influence upward or discourage the reduction of a price;
- the price influenced upward must be the price at which a Respondent's customer, or any other person to whom the article or service comes for resale, supplies or offers to supply or advertises a product within Canada; and
- finally, the challenged conduct must have had, be having or be likely to have an adverse effect on competition.

(a) There is No Dispute with Respect to the Interpretation or the Application of the First Two Elements of Section 76

340. On the first element set out above, there is no dispute that Visa and MasterCard fall within the group of persons that may the subject of an order under section 76. For example, Visa and MasterCard each supply a service and they each hold exclusive rights under trademarks. In addition, as highlighted above, section 76(3) explicitly states that an order may be made under section 76 against a person who is engaged in a business relating to credit cards.

341. In fact, credit card businesses are the only type of business explicitly identified in section 76. In the Commissioner's submission, this demonstrates that credit card companies, such as Visa and MasterCard, were clearly intended to fall within the scope of the price maintenance provision.

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318 *Competition Act*, RSC 1985, c C-34, s 76 ["***Competition Act***"]; Commissioner's Closing Brief of Authorities, **Tab 33**.

342. There can be no debate (and there is, in fact, no debate) that the first element of section 76 is satisfied in this case.

343. With respect to the second element of section 76, the price maintenance provision is concerned with of the influencing upwards of prices "by agreement, threat, promise or any like means".

344. As with the first element, there can be no question that the rules at issue in this Application – the Merchant Restraints – are implemented "by agreement". As discussed above, in order to access the Visa and MasterCard networks, Acquirers must agree to include the Merchant Restraints in each and every one of their agreements with merchants. The Respondents explicitly require that each Acquirer have written agreements with their merchants and that those written agreement incorporate the Merchant Restraints. The evidence demonstrates that Acquirers in Canada have, in fact, implemented the Merchant Restraints by imposing largely non-negotiable agreements upon merchants in Canada that wish to accept credit cards for payment. As a consequence, the Merchant Restraints are clearly implemented "by agreement", and there is no debate that the second element of section 76 has been met in this case.

(b) The Last Three Elements of Section 76 also Clearly Apply to the Present Case

345. The last three elements of section 76 – influencing upward, vertical relationship and adverse effect on competition – are where the Commissioner has joined issue with the Respondents with respect to both the proper interpretation and application of section 76.

346. As set out below, the Respondents advance several arguments why the price maintenance provision in section 76 (and, in particular, the last three elements of that provision) cannot properly be interpreted as applying to the Merchant Restraints. As will be explained, those arguments rest on an overly narrow interpretation of section 76 that is contrary both to the principles of interpretation mandated by the *Interpretation Act* and the relevant jurisprudence, including decisions of the Supreme Court of Canada.

347. Section 12 of the *Interpretation Act* provides that "every enactment is deemed remedial, and shall be given such fair, large and liberal construction and interpretation as best ensures the attainment of its objects."

348. The Supreme Court's mandated approach to the construction of statutory provisions has been frequently stated: the proper construction of a statutory provision flows from reading the words of the provision in their grammatical and ordinary sense and in their entire context, harmoniously with the scheme of the statute as a whole, the purpose of the statute, and the intention of Parliament.[319]

349. For the reasons set out below, the Commissioner submits that the Respondents' narrow and confining interpretation of section 76 is at odds with the plain words of the provision, read in their grammatical and ordinary sense, as well as with the legislative evolution and history of the provision. The Respondents' interpretation undermines rather than advances the purposes of the *Competition Act*. It should therefore be rejected.

350. In the instant matter, the evolution of the price maintenance provision and the history preceding and circumstances leading to the enactment of section 76 are germane to several of the arguments advanced by the Respondents and, as will be seen, are significant in discerning Parliament's intention with respect to the scope and application of section 76. The evolution and history of section 76 are reviewed below prior to addressing each of the Respondents' arguments on statutory construction. This review shows that Parliament has chosen through a series of amendments, to make it unmistakably clear that the price maintenance provisions apply in the very circumstances presented in this case, where vertical restraints have the purpose or effect of harming competition. The Commissioner submits that section 76, in its present form, should be interpreted in that light.

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[319] See *Rizzo & Rizzo Shoes Ltd. (Re)*, [1998] 1 SCR 27 ["***Rizzo & Rizzo Shoes***"], paras 20-22; Commissioner's Closing Brief of Authorities, **Tab 15**; *AUPE v Lethbridge Community College*, 2004 SCC 28 ["***AUPE***"], pp. 25-26; Commissioner's Closing Brief of Authorities, **Tab 16**; *Bell ExpressVu Ltd Partnership v Rex*, 2002 SCC 42, paras. 26-27; Commissioner's Closing Brief of Authorities, **Tab 17**. See also Ruth Sullivan, *Sullivan on the Construction of Statutes*, 5th ed (2008) ["**Sullivan**"], pp. 352-58; Commissioner's Closing Brief of Authorities, **Tab 31**.

Legislative Evolution and History of the Price Maintenance Provision

351. It is well-settled that the history and evolution of a provision, as well as the circumstances of its enactment, are often important parts of the context to be examined in interpreting a statutory provision.[320] As Dr. Sullivan observes in her leading text *Sullivan on the Construction of Statutes*, one of the most effective ways of establishing legislative purpose "is to trace the evolution of legislation from its inception, through successive amendments, to its current formulation".[321] Such tracing "may reveal past decisions by the legislature to adopt a new policy or strike out in a new direction; it may reveal a gradual trend or evolution in legislative policy; or it may reveal the original purpose of legislation and show that this purpose has remained constant through successive amendments to the present".

352. In this regard, as Dr. Sullivan explains, the setting or circumstances in which a legislative provision was originally enacted and has evolved over time are important: "[t]he key assumption here is that legislation is not an academic exercise. It is a response to circumstances in the real world and it necessarily operates within an evolving set of institutions, material circumstances and cultural assumptions".[322] For purposes of this Application, the relevant evolution and history (including the circumstances and setting of amendments) of the price maintenance provision are as follows.

(a) The Original Provision

353. A "resale price maintenance" provision first appeared in the *Combines Investigation Act* (the predecessor to the *Competition Act*) in 1951, as section 37A. In relevant part, that provision read:

> "**37A.** (1) In this section 'dealer' means a person engaged in the business of manufacturing or supplying or selling any article or commodity.

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320 See *Canada (Attorney General) v Mowat*, 2011 SCC 53, para. 43; Commissioner's Closing Brief of Authorities, **Tab 6**; Sullivan, *supra*, pp. 280-81 and 577-82; Commissioner's Closing Brief of Authorities, **Tab 31**.

321 Sullivan, *supra*, p. 280; Commissioner's Closing Brief of Authorities, **Tab 31**.

322 *Ibid*., p. 355.

> (2) No dealer shall directly or indirectly by agreement, threat, promise or any other means whatsoever, require or induce or attempt to require or induce any other person to resell an article or commodity
>
> (a) at a price specified by the dealer or established by agreement,
>
> (b) at a price not less than a minimum price specified by the dealer or established by agreement,
>
> (c) at a markup or discount specified by the dealer or established by agreement,
>
> (d) at a markup not less than a minimum markup specified by the dealer or established by agreement, or
>
> (e) at a discount not greater than a maximum discount specified by the dealer or established by agreement,
>
> whether such markup or discount or minimum markup or maximum discount is expressed as a percentage or otherwise".[323] [emphasis added]

354. Four aspects of section 37A are noteworthy for present purposes, and illustrate the originally quite limited scope of the provision:

- **Resale Required:** as section 37A(2) makes clear, the provision was expressly directed at the resale of an article or commodity. Subsection 37A(2) states that "No dealer shall directly or indirectly by agreement, threat, promise or any other means whatsoever, require or induce or attempt to require or induce any other person to resell an article or commodity". [emphasis added] Further, consistent with the provision's focus on "resale", subsection 37A(2) was entitled "Resale price maintenance";
- **Articles and Commodities Only:** by virtue of subsection 37A(1), the provision was limited to resale price maintenance in respect of articles and commodities only. Services (and resale price maintenance in respect of services) were outside the scope of the provision;

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[323] *An Act to amend the Combines Investigation Act*, SC 1951, c 30, s 1; Commissioner's Closing Brief of Authorities, **Tab 34**.

- **Price Floors and Minimum Prices Only:** as subsection 37A(2) makes clear, the provision was expressly directed at specific price floors or minimum prices as specified by the supplier or, to use the language of the provision, the "dealer". For example, subsection 37A(2) prohibited the supplier from requiring the reseller to resell an article "at a price specified by the dealer or established by agreement" or "at a price not less than a minimum price specified by the dealer or established by agreement". The 1951 version of the provision was therefore clearly limited to circumstances where the supplier specified a minimum price floor; and
- **Criminal Offence:** as enacted in 1951, resale price maintenance was a criminal offence under the Combines *Investigation Act*, punishable by a fine of up to $10,000 or two years imprisonment in the case of an individual, and a fine of up to $25,000 in the case of a corporation.

355. While the provision underwent certain minor amendments between 1951 and 1976, it remained limited to circumstances where a supplier set a specific price floor in respect of the resale of articles and commodities.[324]

(b) 1976 Amendments

356. In 1976, the *Combines Investigation Act* was significantly reformed as part of the so-called Stage 1 amendments to the *Combines Investigation Act*,[325] including substantial amendments to the price maintenance provision to address what were believed to be a number of deficiencies with the then existing provision.[326] Those amendments significantly broadened the scope of the proscribed conduct.

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[324] See *Combines Investigation Act,* RSC 1952, c 314, s 34 and *Combines Investigation Act,* RSC 1970, c C-23, s 38; Commissioner's Closing Brief of Authorities, **Tab 35**.

[325] See *An Act to Amend the Combines Investigation Act and the Bank Act and to repeal an Act to amend an Act to amend the Combines Investigation Act and the Criminal Code*, SC 1974-75-76, c 76 ["**1976 Amendments**"], s 18; Commissioner's Closing Brief of Authorities, **Tab 36**.

[326] See Bureau of Competition Policy, *Background Papers: Stage 1 Competition Policy* (1976) ["**Background Papers**"] at 38 and 54-55; Commissioner's Closing Brief of Authorities, **Tab 32**.

357. The amended provision was found in section 38 of *Combines Investigation Act*. The modified provision read, in relevant part, 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,
>
> (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;"[327]

358. For present purposes, the key features of the 1976 amendments were as follows:

- **Resale Requirement Eliminated:** the requirement for a "resale" was removed from the provision. Specifically, the amended provision was broadened to include any "agreement, threat, promise or any like means … to influence upward or discourage the reduction of, the price at which any other person engaged in business in Canada supplies or offers to supply or advertise a product within Canada". The provision also covered any attempt to influence upward the prices charged for a product by any other person – without requiring any form of resale or, for that matter, any relationship between the other person and the seller. Consistent with the foregoing, the provision was renamed "price maintenance", instead of "resale price maintenance";
- **Price Floor/Minimum Price Requirement Eliminated:** the 1976 amendments also removed any requirement that there be a minimum price floor or specific price. The amendments substantially broadened the provision to capture any conduct that directly or indirectly influences prices upward or discourages the reductions of prices. As set out above, in pertinent part, section 38 stated that: "No person … shall, directly or indirectly … attempt to influence upward, or to discourage the reduction of, the price at which any other person engaged in

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[327] 1976 Amendments, *supra*., s 18; Commissioner's Closing Brief of Authorities, **Tab 9**.

business in Canada supplies or offers to supply or advertises a product within Canada";

- **Express Broadening of the Provision to Include Services:** whereas the provision had historically been confined to "articles and commodities", the amended provision was expressly broadened to apply to price maintenance in respect of services. To this end, the phrase "article or commodity" was replaced in section 38 by the word "product", defined (for the first time) in section 2 of the *Combines Investigation Act* as "includ[ing] an article and service". The 1976 amendments also added to section 2 a definition of the term "service", being "a service of any description whether industrial, trade, professional or otherwise";[328] and
- **Express Broadening of the Class of Persons Potentially Subject to Prosecution, including to Persons "Engaged in a Business that Relates to Credit Cards"**: the class of persons who could be subject to prosecution under the provision was also broadened through the 1976 amendments. Until 1976, the *Combines Investigation Act* had applied to a "dealer", defined as "a person engaged in the business of manufacturing or supplying or selling any article or commodity". However, the amended section 38 applied to "a 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, trademark, copyright or registered industrial design". Clearly, this was a broad definition intended to capture a wide range of Canadian businesses. Notably for present purposes, there is only one type of business in Canada that was explicitly mentioned in the provision – that is a business relating to credit cards.[329]

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328 *Ibid*, s 1.

329 As counsel for Visa observed in opening argument, as part of the 1976 amendments the phrase "agreement, threat, promise or any other means whatsoever" was replaced with the words "agreement, threat, promise or any like means". [emphasis added] The Respondents rely (see Transcript of Opening Submissions dated May 8, 2012 ["**Opening Submissions**"] at 139) on this change as evidence that Parliament intended to limit the conduct captured by the price maintenance provision. Assuming for the sake of argument only that this is correct, that change has no bearing on the present matter as the Commissioner places no reliance on the words "or any like means". As set out above, it is the Commissioner's position that the Merchant Restraints are implemented "by agreement".

359. As *Background Papers* published by the Bureau of Competition Policy in respect of the 1976 amendments to the *Combines Investigation Act* make clear,[330] the broadening of the provision to move beyond traditional supplier and reseller relationships and to apply to conduct beyond minimum price floors was not an accident, but rather (as previously noted) was intended to address a number of deficiencies in the section.[331]

360. In this regard, the Bureau commented as follows regarding the 1976 amendments:

> "The amendments to the resale price maintenance provisions have attempted to remove certain deficiencies in the former provisions in relation to resale at a specified price. The former provisions had been part of the Combines Investigation Act since 1951 and had contributed to the overall purpose of the Act of maintaining competition not only among retailers but also among the manufacturers and wholesalers who supply them.
>
> The new provisions now relate to price maintenance and suggested retail prices and have removed the requirement to prove a specified price".[332] [emphasis added]

361. Further, in a section of the *Background Papers* entitled "Broadening the Resale Price Maintenance Provision", the Bureau stated as follows:

> "The former provision relating to resale price maintenance was found through the experience gained in its administration to contain certain deficiencies, one of the most notable of which related to requiring resale at a specified price. It has been shown that it was possible to circumvent the provision if a supplier required that resale take place at a higher price than the price at which an article was currently being sold but did not specify the required higher resale price. In such circumstances no prosecution could have succeeded because it would have been necessary to show, as one of the elements of the offence, that a certain price had been specified by the supplier. In order to

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330 It is well established that administrative interpretation, including background papers, may be accorded significant weight by the courts in determining the meaning or effect of legislation: see Sullivan, *supra* at 624 and 626; Commissioner's Closing Brief of Authorities, **Tab 31**.

331 *Background Papers*, *supra,* pp. 38-39 and 54-55; Commissioner's Closing Brief of Authorities, **Tab 32**.

332 *Ibid.*, pp. 38-39.

> correct this deficiency, the new provision prohibits both 'influencing upward' the price at which goods are sold and attempting to discourage the reduction of any such price. The provisions no longer refer to requiring or inducing a person to sell at a specified price. …"[333]

362. In respect of the change to broaden the class of persons subject to prosecution, the Bureau stated:

> "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."[334] [emphasis added]

363. In summary, the provision was explicitly amended to apply to persons engaged in a business relating to credit cards, such as the Respondents in this case. Further, the provision was explicitly amended to apply to circumstances beyond a traditional supplier-reseller arrangement. In fact, as the *Background Papers* recognize, the provision was broadened to apply to conduct by a supplier that would influence upwards the price of *any* person, even if there was no supply relationship between the supplier and the person being influenced. As stated in the passage quoted above from the *Background Papers*, the amended provision could even apply to conduct by a supplier that sought to influence upwards the sale price of a competing product – such as an agreement between two competitors to fix prices.

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333 *Ibid.,* p. 54.

334 *Ibid.,* p. 55.

364. The breadth of the new section 38 was well-recognized by commentators at the time of the amendment. For example, Michael Flavell in his text *Canadian Competition Law: A Business Guide* explained the implications of the 1976 amendments, and the resulting breadth of the new provision in these terms:

> "As we shall see below, the word 'resale' disappeared from the Canadian competition law vocabulary in 1976, with the advent of the Stage I amendments and the broadening of the provision to cover price maintenance in situations other than sale and resale.
>
> …
>
> The behaviour proscribed is:
>
> i. to directly or indirectly, 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 in Canada supplies or offers or advertises *any* product in Canada; thus the persons involved need not be in a sale and resale situation (though normally they will) nor need the price influence be on a product actually supplied by the person exerting the influence (though normally it will); furthermore, it is not now necessary to show an attempt to specify a particular price or a minimum price, since what is proscribed is any influence upward or discouragement of reduction".[335] [italics in original]

365. When the *Competition Act* was enacted in 1986 (replacing the *Combines Investigation Act*), section 38 was carried over into the new statute, renumbered as section 61, without any material changes.

(c) Criticisms of the Price Maintenance Provision

366. The price maintenance provision remained unchanged until 2009, but this was not because it was viewed as an ideal provision. On the contrary, it was subject to significant and on-going criticism. There were two principal criticisms of the price maintenance provision found in section 61 of the *Competition Act*.

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335 C.J. Michael Flavell, *Canadian Competition Law: A Business Guide* (1979) 288-89 and 294; Commissioner's Closing Brief of Authorities, **Tab 24**. As Professor Sullivan observes, "scholarly opinion [such as the Flavell text] has become an authoritative source in the interpretation of statutes". These materials are "often relied upon as authoritative evidence of legislative purpose or the meaning of legislative provisions", and are also admitted as evidence of external context and historical circumstances behind the enactment of the provision being interpreted: see Sullivan, *supra*, 618-20; Commissioner's Closing Brief of Authorities, **Tab 31**.

367. First, because the requirement that there be a resale was removed, the provision could be applied to agreements where there was no vertical relationship between the parties. For example, as recognized in the *Background Papers*, the provision could be applied to an agreement between competitors – parties in a horizontal relationship – such as an agreement between competitors to fix prices.

368. This created a peculiar (and, to many, a troubling) situation where the price maintenance provision could be applied to purely horizontal cartel agreements, such an agreement between competitors to fix prices, that ought properly to have been subject to prosecution under the conspiracy provision in section 45. This was viewed as problematic because, at that time, the price maintenance provision was a *per se* offence that did not require proof of any adverse effect on competition, whereas the section 45 conspiracy provision required proof of an undue lessening of competition. Further, the maximum fine under the conspiracy provision was $10 million, whereas there was no limit on the fines that could be imposed pursuant to the price maintenance provision. Use of section 61 to deal with horizontal arrangements was criticized as "clearly an attempt to circumvent proceedings that are suited for [the conspiracy provision] in [section] 45".[336]

369. The second criticism of the former section 61 was that it was simply not appropriate to treat price maintenance as criminal conduct and evaluate it under a *per se* prohibition without any consideration of whether the conduct in issue had an adverse effect on competition.[337]

(d) 2009 Amendments

370. Parliament sought to address these criticisms of section 61 through amendments to the *Competition Act* in 2009. While much of the language and structure of the former section 61, including the heading "Price Maintenance", were preserved, two important changes were made.

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336 Lawson AW Hunter, "Pricing Practices: The VanDuzer Report" (paper delivered at the Insight Conference Roundtable on *Competition Act* Amendments, 25 May 2000), [unpublished]; Commissioner's Closing Brief of Authorities, **Tab 24**. See also Report of the Standing Committee on Industry, Science and Technology, *A Plan to Modernize Canada's Competition Regime* (April 2002) at p. 75; Brief of Authorities of the Respondent Visa Canada Corporation, **Tab 49**.

337 See, *e.g.*, Thomas W Ross, "Introduction: The Evolution of Competition Law in Canada" (1998) 13 Review of Industrial Organization 1, p. 97; Commissioner's Closing Brief of Authorities, **Tab 29**. See also *A Plan to Modernize Canada's Competition Regime*, *supra*, pp. 75-76; Brief of Authorities of the Respondent Visa Canada Corporation, **Tab 49**.

First, Parliament decriminalized price maintenance, making it a reviewable practice, and also required that the conduct have an adverse effect on competition in a market before a remedy may be issued. The move to the civil provisions of the *Competition Act* also removed price maintenance cases from the rigid framework of criminal proceedings before the courts to the more flexible, remedial setting of the Tribunal. This move from criminal to civil also favours a broader or more liberal interpretation of the current section 76, as compared with the predecessor criminal provision.

371. Second, Parliament prescribed that there be some form of vertical relationship between the supplier and the person whose prices are being influenced upwards, thereby restricting the new provision to vertical relationships and precluding use of the price maintenance provision as a tool to get at horizontal conspiracies, which are now dealt with under reformed conspiracy provisions found in sections 45 and the provision dealing with agreements between competitors found in section 90.1 of the Act. As discussed more fully below, this was accomplished by replacing the words "the price at which any other person engaged in business in Canada" (which appeared in section 61) with the phrase "the price at which the person's customer or any other person to whom the product comes for resale" [emphasis added] (which now appears in section 76). The following side-by-side comparison of the relevant portions of the two provisions highlights the change:

Section 61 of *Competition Act*	**Section 76 of *Competition Act***
"… 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."	"… 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."

The Respondents' Statutory Construction Arguments Should be Rejected

372. As noted above, the Respondents advance several arguments why the price maintenance provision in section 76 (and, in particular, the last three elements of that provision) cannot

properly be interpreted as applying to the Merchant Restraints. Those arguments may be summarized as follows:

(i) the Merchant Restraints cannot fall under section 76 because the Merchant Restraints do not set a minimum price or price floor as allegedly required by the third element of the provision (which mandates that the challenged conduct – the Merchant Restraints in this case – influence upward or discourage the reduction of the price at which an article or service is supplied);

(ii) section 76 is inapplicable as there is no "resale" of a product, as allegedly required by the fourth element of the provision (which mandates that the person engaged in the impugned conduct (Visa and MasterCard, in this case) and the person's whose price is being influenced upwards (Acquirers, in this case) be in a vertical relationship);

(iii) the Merchant Restraints do not meet the "typical" definition of price maintenance;

(iv) the Commissioner's application of section 76 to the Merchant Restraints employs an alleged improper "reverse causality" (by examining whether the adverse effect on competition influences prices upwards, instead of demonstrating that the adverse competitive impact follows from an upward influence on prices); and

(v) the Commissioner's interpretation of section 76 is undesirable from the perspective of competition policy as it would capture all or almost all cases in which the price of an input is influenced upward due to conduct that adversely affects competition in the market for the input.

Each of these arguments will be discussed in turn.

(a) Section 76 does Not Require a Minimum Price or Price Floor

373. With respect to the third element in section 76 – the requirement that the challenged conduct (in this case, the Merchant Restraints) influences upward or discourages the reduction of the price at which an article or service is supplied – the Respondents contend that that the Merchant Restraints cannot fall under section 76 because the Merchant Restraints do not set a minimum price or price floor. In other words, the Respondents claim that because Visa and MasterCard do not explicitly set a minimum price for Acquirers to charge merchants, unlike the case of the hypothetical jean supplier that tells a retailer "you must price my jeans for no less than $50", there is no price maintenance within the meaning of section 76.

374. The Respondents' position is at odds with both the grammatical and ordinary meaning of the words of section 76 and the legislative evolution of the price maintenance provision.

375. The Respondents' argument would require this Tribunal to ignore the clear and unambiguous language of section 76, which nowhere mentions (much less requires) minimum prices or price floors, and to (improperly) read into or graft onto the provision additional words which are plainly not found in the language of section 76. In effect, the Respondents argue that the Tribunal should proceed as if the law had not been changed in 1976 to remove the price floor/minimum price requirement from the price maintenance provision. Of course, the role of the Tribunal is to interpret, not to enact. It is trite law that courts and administrative tribunals must give effect to the words chosen by Parliament to express its intention.

376. On its face, the current provision (like its predecessors after 1976) is clearly not confined to circumstances involving specific minimum prices or a price floor. Rather, section 76 uses broad language, particularly in the description of the "price maintenance" aspect of the provision. For example, subsection 76(1)(a) includes the phrase "directly or indirectly", as opposed to being confined to "direct" forms of price maintenance. In addition, subsection 76(1)(a) refers to conduct that "has influenced upward" prices, as opposed to confining the section to direct means of setting specific minimum prices or price floors. As the legislative evolution discussed above makes clear, had Parliament intended to restrict the application of section 76 in the manner suggested by the Respondents, it could easily have said so (using language similar to that which appeared in predecessors provisions prior to 1976).

377. There is nothing in the context in which section 76 was enacted, including the legislative history of the provision, that supports the Respondents' claim that Parliament somehow intended as part of the 2009 amendments to reintroduce the minimum price/price floor requirement that was removed more than thirty years ago, as part of the 1976 amendments.

(b) Section 76 does Not Require a Resale

378. The fourth element in section 76 requires that the person engaged in the impugned conduct (Visa and MasterCard, in this case) and the person's whose price is being influenced upwards (Acquirers, in this case) be in a vertical relationship, such as a supplier and customer relationship. This was conceded by Visa in its opening argument. Referring to the 2009

amendments, counsel for Visa stated "[s]pecifically, section 76 was expressly limited to vertical arrangements. This was achieved by including in subsection 76(1)(a) the words …, 'the price at which the person's customer or any other person to whom the product comes for resale'."[338]

379. However, the Respondents maintain that in addition to requiring a vertical relationship, Parliament's intention in re-inserting the word "resale" in the last portion of s. 76(1)(a) was to limit the entire provision to "resale" price maintenance exclusively.[339] They say that as a result of this change section 76 has no application unless there is a "resale" of a product. The Respondents go further and argue that section 76 should be read as being limited to circumstances where there is a resale of a product – *physically unchanged* – by a reseller.[340] To put that argument into the context of this case, the Respondents contend that what Visa and MasterCard sell to their customers, Acquirers, is different from what those Acquirers supply to retailers and, as a consequence, the Tribunal does not have any jurisdiction under section 76 to issue a remedy.

380. The Commissioner submits that the argument of Visa and MasterCard is entirely without merit. Among other things, it ignores the plain wording of s. 76, and is unsupported by the "legislative history" surrounding the enactment of this provision or by authority. It was clearly not Parliament's intention to dramatically narrow the application of the price maintenance provision in this way. The Respondents' interpretation of the fourth element of section 76 fails to read the words of the provision grammatically and their ordinary sense, in accordance with the structure of the provision. Moreover, it is contradicted by the context in which section 76 was enacted, and undermines the objects of both section 76 and the *Competition Act*.

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338 Opening Submissions, *supra*, p. 141.

339 See Opening Submissions, *supra*, p. 142.

340 See Church Report, *supra*, para. 23.

381. It is clear, by virtue of Parliament's use of the word "or" in subsection 76(1)(a)(i), that subsection 76(1)(a)(i) consists of two prohibitions.[341] For ease of reference, subsection 76(1)(a)(i) is reproduced again immediately below:

> **76.** (1) **Price maintenance –** 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," [emphasis added]

382. Section 2 of the *Competition Act* defines the terms "article", "product" and "service" as follows:

> **"2. (1) Definitions** – In this Act,
>
> "**article**" means real and personal property of every description including
>
> (a) money
>
> (b) deeds and instruments relating to or evidencing the title or right to property or an interest, immediate, contingent or otherwise, in a corporation or in any assets of a corporation;
>
> (c) deeds and instruments giving a right to recover or receive property;
>
> (d) tickets or like evidence or right to be in attendance at a particular place at a particular time or times or of a right to transportation; and
>
> (e) energy, however generated;
>
> …
>
> "**product**" includes an article and a service;

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341 *Nadeau Poultry Farm Ltd v Groupe Westco Inc*, 2009 ["***Nadeau***"] Comp Trib 6, paras 127-30, aff'd 2011 FCA 188; Commissioner's Closing Brief of Authorities, **Tab 22**.

…

"**service**" means a service of any description whether industrial, trade, professional or otherwise."

383. 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". [emphasis added] As explained during the Commissioner's opening submissions, subsection 76(1)(a)(i) consists, in effect, of two halves, separated by the word "or". Interposing the relevant definitions and removing certain words which are not relevant for present purposes, the two halves read as follows:

First Half of Section 76

76. (1) **Price maintenance** – On application by the Commissioner, the Tribunal may make an order if the Tribunal finds that

(*a*) a person who is engaged in the business of producing or supplying a product, or is engaged in a business that relates to credit cards, directly or indirectly:

(i) by agreement has influenced upward, or has discouraged the reduction of, the price at which the person's customer supplies or offers to supply *a* product within Canada, and

(*b*) the conduct has had, is having or is likely to have an adverse effect on competition in a market.

Second Half of Section 76

76. (1) **Price Maintenance** – On application by the Commissioner, the Tribunal may make an order if the Tribunal finds that

(*a*) a person who is engaged in the business of producing or supplying a product, or is engaged in a business that relates to credit cards, directly or indirectly:

> (i) by agreement has influenced upward, or has discouraged 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, and
>
> (*b*) the conduct has had, is having or is likely to have an adverse effect on competition in a market.

384. Looking at the explicit language of the first half of the provision (before the "or"), section 76 applies to an agreement (or other prescribed conduct) by a supplier or articles or services that influences upward or discourages the reduction of the price at which that supplier's "customer" supplies or offers to supply articles or services 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 customer sells ***a*** product. "A" is an indefinite article, defined as "one, some, any".[342] Parliament's usage of the indefinite article here confirms the object of the interdiction. 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. In other words, section 76 is applicable to agreements where suppliers influence upwards the prices charged by their customers. Proving that Acquirers are customers of Visa and MasterCard is sufficient to bring this relationship into the scope of section 76 – it is clearly a vertical relationship.

385. As discussed above, as a result of the 1976 amendments, the provision was renamed "price maintenance" (whereas it had previously been named "resale price maintenance") and, through (among other things) removal of the requirement that the dealer/supplier require or induce "any other person to *resell* an article or commodity", significantly broadened to cover price maintenance in situations other than sale and resale. To accept the Respondents contention that section 76 requires a resale would require the Tribunal to ignore the amendments to and evolution of the provision since 1951, in addition to the clear and unambiguous words of the first half of the provision.

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342 *Canadian Oxford Dictionary*, 2d ed (2004) at 1; Commissioner's Closing Brief of Authorities, **Tab 30**.

386. The Respondents' contention is also at odds with the fact that when Parliament enacted section 76 the heading of the provision was not changed from "Price Maintenance" back to "Resale Price Maintenance", despite the re-insertion in the last portion of s. 76(1)(a) of the word "resale". It is now well established that headings should be considered part of the legislation and should be read and relied on like any other contextual feature.

387. The relevant jurisprudence, including recent judgments of the Supreme Court of Canada, make it clear that headings are a valid indicator of legislative meaning and may be taken into account in interpretation.[343] Parliament's decision not to revert to the heading "Resale Price Maintenance" (which appeared in the *Combines Investigation Act* for more than 20 years when the provision was, in fact, confined to situations of sale and resale), provides an additional compelling basis for rejecting the Respondents' highly restrictive interpretation of section 76 as applying to "resale" (of precisely the same product) price maintenance only.

388. 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 the product comes for resale supplies or offers to supply or advertises a product within Canada" [emphasis added], as opposed to "the product", "that product" or "the 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. Pursuant to the presumption of consistent expression, Parliament is presumed to use language carefully and consistently so that within a statute the same words have the same meaning and different words have different meanings.[344] Parliament's choice to use the definite article "the" to describe the product coming for resale and the indefinite article

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343 See Sullivan, *supra,* pp. 393-94; Commissioner's Closing Brief of Authorities, **Tab 31**.

344 See Sullivan, *supra*, pp. 214-15; Commissioner's Closing Brief of Authorities, **Tab 31**.

"a" to describe the product being resold must be considered deliberate and indicative of a change in meaning or a different meaning.[345]

389. As the legislative evolution outlined above makes clear, the changes made to the price maintenance provision in 2009 were directed at the specific problem discussed above; namely, to prevent the application of the price maintenance provision to purely horizontal agreements between competitors, as opposed to parties in a vertical relationship. The Commissioner submits that the new language and, in particular, the addition of the words "customer" and "resale", were intended to limit the application of section 76 to vertical relationships, such as between suppliers and customers, or between suppliers and firms further downstream. Conversely, they were not intended to render the price maintenance provisions essentially meaningless by confining their application to the narrowest possible circumstances.

390. As a matter of competition policy, it would severely undermine the effectiveness of section 76, and by necessary implication the purpose of the *Competition Act*, if (as the Respondents urge) the provision was limited to only those cases where a customer resells precisely the same set of services or articles, without modification, that he receives from the supplier. On this basis, a manufacturer of cars could require dealers to sell at a minimum price, but avoid the application of section 76 because dealers add floor mats and license plate holders to vehicles before their final sale. Under the Respondents' overly narrow interpretation of the section, the price maintenance provision would also not apply to any circumstance wherein a reseller individually packages products that are shipped in bulk by the supplier because the individually packaged product sold by the reseller is not precisely the same as the bulk product supplied by the supplier.

391. There is nothing in the legislative history surrounding the enactment of section 76 to suggest that Parliament somehow intended that the jurisdiction it conferred on this Tribunal through section 76 would be narrowly circumscribed and anemic in nature, as the Respondents would have it.

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345 *Ibid.*, p. 216.

392. Contrary to section 12 of the *Interpretation Act*, the Respondents' construction of section 76 is not fair, large or liberal. Nor does their preferred construction of the section 76 best ensure the attainment of its objects. The consequences that result from the Respondents' interpretation of section 76 are, in fact, incompatible with the objects of the *Competition Act*,[346] and with the objects of the price maintenance provision itself. It is a well established principle of statutory interpretation that Parliament does not intend to produce absurd consequences and that an interpretation that is incompatible with the objects of the legislation or the provision in issue is absurd and should be rejected.[347]

393. The Respondents' narrow interpretation is particularly inappropriate in this case, as it relates to the supply of Credit Card Network Services. Subsection 76(3) states explicitly that the provision applies to any person who "extends credit by way of credit cards or is otherwise engaged in a business that relates to credit cards". Notably, suppliers engaged in the business of credit cards are the only type of suppliers expressly identified in section 76.

394. In summary, a "resale" is not required under section 76 of the *Competition Act*. Rather, section 76 applies to vertical restraints where the supplier is influencing upwards the price at which a customer sells *a* product and where this conduct has an adverse effect on competition.

395. In any event, Visa and MasterCard do, in fact, supply Credit Card Network Services to be "resold" by Acquirers to merchants. This is not like the case of a supplier providing one hidden input, such as electricity, into the manufacture of a product. Rather, the Credit Card Network Services supplied by Visa and MasterCard are the main, primary and critical input supplied to Acquirers.

396. This conclusion is supported by 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. As discussed above, for many of the merchant

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346 See section 1.1 of the *Competition Act*; *supra.*

347 See *Rizzo & Rizzo Shoes*, *supra*, para.s 27-29; Commissioner's Closing Brief of Authorities, **Tab 15**; *AUPE*, *supra,* paras. 46-47; Commissioner's Closing Brief of Authorities, **Tab 16**.

witnesses who testified in this proceeding, the portion of Card Acceptance Fees attributable to Acquirers is between [redacted] and [redacted] of the total Card Acceptance Fee.

(c) This is not an "Atypical" or "Unusual" Price Maintenance Case

397. The Respondents' arguments that the Merchant Restraints are outside the scope of section 76 because the Merchant Restraints do not explicitly establish a specific price floor and because there is allegedly no "resale" of a product are variants on a broader argument by the Respondents that the Tribunal does not have the jurisdiction to issue a remedy because the Commissioner's case does not fit the mould of a "traditional resale price maintenance case".

398. This argument is without merit. Legal novelty is not the test.

399. While this case is novel in comparison with, and more complex than, a case involving a supplier selling a pair of jeans to a retailer and telling that retailer that the jeans must not be sold for less than $50 a pair, for the reasons set out herein, the Merchant Restraints implemented by Visa and MasterCard are as much a form of price maintenance as the price floor set by the hypothetical supplier of jeans, just more cleverly constructed and disguised.

400. It must also be said that the Respondents' suggestion that the Tribunal should decline to grant a remedy on the basis that this case is not like the "usual" or an "ordinary" price maintenance case is a very "unusual" argument to make before this Tribunal. The cases before this Tribunal are each unique in their own way. The challenge to exclusive dealing in the *NutraSweet* case[348] was unusual at the time given that the Tribunal had not dealt with an exclusive dealing case prior to that decision. That did not deter the Tribunal from granting relief in respect of the obvious anti-competitive effects of the conduct in issue.

401. The Respondents' argument is all the more dubious and untenable given that section 76 is a new provision in the *Competition Act*, having been enacted only in 2009, and one that has not previously been interpreted or applied by the Tribunal. It is peculiar, to say the least, to suggest that a case is unusual when it is the first case dealing with a recently enacted provision

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348 *Nutrasweet, supra*.

of the *Competition Act* the boundaries of which have yet to be defined by the specialized adjudicative body charged with its interpretation and application.

402. It also bears noting that other competition enforcement agencies and academics have also recognized that the Merchant Restraints are a form of price maintenance.

403. For example, in its 2009 complaint against Visa and MasterCard, the New Zealand Commerce Commission identified the following as among the anticompetitive effects of provisions virtually identical to the Merchant Restraints:

> "The Visa MIF [Multilateral Interchange Fee] provisions either alone or together with the other Visa Rules…have the purpose, effect or likely effect of controlling or maintaining, or providing for the controlling or maintaining of, the [Card Acceptance Fees] charged by acquirers for the supply of merchant acquiring services in the Relevant Acquiring Market.
>
> …
>
> The Visa Rules prevent or hinder competition in the Relevant Acquiring Market by (inter alia): (a) establishing a 'floor price' for the [Card Acceptance Fees] charged by Visa Banks as acquirers;…"[349]

404. Moreover, in 2008 article, Dr. Adam Levitin described the effects of the Merchant Restraints as follows:

> "Vertical price-fixing typically involves a wholesaler and a retailer fixing the price of their own product at resale. Vertical resale price fixing of both maximums and minimums is reviewed under the rule of reason standard; it is not a per se violation. ….
>
> No-surcharge rules have aspects of both maximum and minimum vertical price-fixing. If merchants are seen as retailers of [Credit Card Network Services] to cardholders, then no-surcharge rules are imposing a maximum price level for credit cards—that of competing payment systems No-surcharge rules are also imposing a minimum price *on other payment systems.* Typically, vertical price-fixing involves a manufacturer setting an absolute resale price for its own product. Here, though, merchant restraints link

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[349] See Excerpt from Third Amended Statement of Claim of the New Zealand Commerce Commission (September 2, 2009); Commissioner's Closing Brief of Authorities, **Tab 11.**

> the resale price of a network's card product to that of a competitors' product.
>
> Nondifferentiation rules do the same in terms of fixing the price of higher interchange rate cards and lower interchange rate cards—the maximum retail price for the high interchange rate cards is constrained to being the retail price of the low interchange rate cards, and the minimum retail price of the low interchange cards is the retail price of the high interchange cards."

405. [redacted]

406. In sum, although the present matter is more complex than the typical case of price maintenance for several reasons, including the nature of the product at issue and the absence of an explicit minimum price floor, the Merchant Restraints do fit the mould of price maintenance for the purposes of section 76 of the *Competition Act*.

407. In any event, the preferable approach under competition policy is to allow the matter to be resolved based upon an assessment of the economic impact of the Merchant Restraints, as opposed to seeking to shield conduct with adverse competitive effects from scrutiny on the basis that the conduct is allegedly unlike that which is seen in a "typical" price maintenance case.

(d) There is No Improper "Reverse Causality"

408. With respect to the fifth element of section 76, namely whether the conduct has had, is having or is likely to have an adverse effect on competition, to the Commissioner's knowledge

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350 [redacted]

the parties' disagreement centres on the Respondents' claim that the Commissioner's application of section 76 is incorrect as it "has a reverse order of causality".[351]

409. This argument was put forward most clearly in the expert report submitted by Dr. Church on behalf of Respondents. In his report, Dr. Church states that based on his "understanding" of section 76, the Tribunal may only intervene where a "party engages in price maintenance that has had…an adverse effect on competition". [emphasis added] Dr. Church goes on to state that "the causality in the economics and competition policy literature goes from the conduct to an effect on competition: first establishing price maintenance and second an effect on competition from the price maintenance". [emphasis added]

410. It is notable that the Respondents have not provided a single citation to the "economics and competition policy literature" they allege support either Dr. Church's contention or their arguments regarding the direction of causality. It is also notable that in making this assertion Dr. Church elected to add an additional term ("that") to a paraphrased version of section 76, as opposed to quoting directly from the section itself. Section 76 explicitly states that the Tribunal may issue a remedy where the following two conditions, among others, are satisfied:

(a) a person "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"; and

(b) "the conduct has had, is having or is likely to have an adverse effect on competition in a market".

411. Section 76 specifies no particular "order of causality" between these two conditions that must be established before the Tribunal may grant a remedy.

412. In the present matter, it is clear that the conduct at issue is the implementation and enforcement by Visa and MasterCard of the Merchant Restraints through agreements with Acquirers. The issues are whether the Merchant Restraints ha[ve] influenced upward, or ha[ve]

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[351] See Opening Submissions, *supra*, pp. 144-47.

discouraged the reduction of, the prices of customers of Visa or MasterCard, "or any other person to whom the product comes for resale" and whether the Merchant Restraints have had, are having or are likely to have "an adverse effect on competition in a market". Contrary to what the Respondents' claim, section 76 does not require any specific direction of causality between the upward-influence condition and the adverse-competition condition. The conditions for the Tribunal to implement a remedy are established if the two conditions are met, irrespective of the direction of causality.

413. One implication of the Respondents' interpretation of section 76, if accepted, is that the Tribunal could consider only those adverse effects on competition that are caused by an upward influence in prices, as opposed to considering the broader range of anti-competitive effects that may result from the impugned conduct. Such an interpretation is at odds with the Tribunal's own decisions regarding what constitutes an "adverse effect" on competition.

414. Subsection 76(1)(b) directs the Tribunal to consider whether the conduct at issue "has had, is having or is likely to have an adverse effect on competition in a market". There are no decisions that have considered section 76 – given that the provision was enacted only in 2009. However, the Tribunal has considered what is meant by an "adverse effect on competition in a market" in the context of two refusal to deal cases determined under section 75 of the *Competition Act*: the 2006 decision in *B-Filer Inc et al v The Bank of Nova Scotia*[352] and the 2009 decision in *Nadeau Poultry Farm v Groupe Westco*.[353]

415. In *B-Filer*, the Tribunal noted that "[a]dverse 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."[354] These manifestations of adverse effects are

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352 2006 Comp Trib 42 ["***B-Filer***"]; Commissioner's Closing Brief of Authorities, **Tab 21**.

353 *Nadeau*, *supra*; Commissioner's Closing Brief of Authorities, **Tab 22**.

354 *B-Filer, supra*, para. 206; Commissioner's Closing Brief of Authorities, **Tab 21**.

all symptoms of "created, enhanced or preserved market power" and are not limited to price increases.[355]

416. The Tribunal in *B-Filer* found that determining whether the refusal to deal had an adverse effect on competition "demands a relative and comparative assessment in the market with the refusal to deal and that same market without the refusal to deal". The Tribunal adopted the reasoning of the Federal Court of Appeal in the *Canada Pipe* case that comparative analysis in regard to competition in a market requires consideration of relative competitiveness. At paragraph 198, the Tribunal quoted the following statement from *Canada Pipe*:

> " … the Tribunal must compare the level of competiveness in the presence of the impugned practice with that which would exist in the absence of the practice". To the same effect, at paragraph 199, the Tribunal also adopted the following statement from its decision in the *Laidlaw* case: "the substantial lessening which is to be assessed need not necessarily be proved by weighing the competitiveness of the market in the past with its competitiveness at present. Substantial lessening can also be assessed by reference to the competitiveness of the market in the presence of the anti-competitive acts and its likely competitiveness in their absence".[356]

417. Following *B-Filer*, and consistent with earlier decisions of the Tribunal, such as *Laidlaw*, determining whether a practice has an adverse effect on competition requires an assessment of the level of competitiveness in the presence of the practice and in the absence of the practice. In this case, the appropriate consideration is whether the market for Credit Card Network Services would be more competitive in the absence of the Merchant Restraints than it is with the Merchant Restraints in place.

418. That raises the issue of what is meant by more or less "competitive". In essence, the Tribunal has determined that examining whether conduct has an adverse effect on competition requires an assessment of whether the conduct is likely to preserve or enhance the market power of the respondents. In *B-Filer*, the Tribunal stated as follows:

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355 *Ibid*., para. 208.

356 *Ibid*., para. 198.

> "The 'competitiveness' of a market under both the abuse and merger provisions of the Act refers to the degree of market power that prevails in that market. In *NutraSweet,* cited above, the Tribunal wrote, in the context of a section 79 matter, (at page 47) that: '[tlhe factors to be considered in deciding whether competition has been or is likely to be substantially lessened are similar to those that were discussed in concluding that [Nutrasweet] has market power. In essence, the question to be decided is whether the anti-competitive acts engaged in by [Nutrasweet] preserve or add to [Nutrasweet's] market power.'"[357]

419. As to how such adverse effects on competition are likely to be manifested in the market, the Tribunal in *B-Filer* found that: "[a]dverse 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.[358]"

420. On this issue, the Tribunal concluded that "for a refusal to deal to have an adverse effect on a market, the remaining market participants must be placed in a position, as a result of the refusal, of created, enhanced or preserved market power".[359]

421. Finally, section 75 of the *Competition Act*, like section 76, requires only that there be an "adverse effect" on competition, as opposed to the "substantial lessening" of competition standard used in other provisions of the Act. In *B-Filer*, the Tribunal confirmed that: "[f]rom the plain meaning of the words used by Parliament, we find that 'adverse' is a lower threshold than 'substantial'".[360]

422. In summary, there are three points to be taken from the Tribunal's decision in *B-Filer*:

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357 *B-Filer, supra,* para. 201.

358 *Ibid*., para. 206.

359 *Ibid*., para. 208.

360 *Ibid*., para. 211.

- first, determining whether conduct has an adverse effect on competition requires an assessment or comparison of the level of competitiveness in the presence of the impugned conduct and in the absence of that conduct;
- second, examining whether conduct has an adverse effect on competition requires an assessment of whether the conduct is likely to create, preserve or enhance market power of the market participants; and
- third, "adverse effect" on competition is a much lower threshold than the "substantial lessening" of competition test normally applicable in competition cases.

423. As discussed below, the evidence clearly demonstrates that the market for the supply of Credit Card Network Services would be more competitive in the absence of the Merchant Restraints and that the Merchant Restraints preserve and enhance Visa and MasterCard's market power.

(e) The Commissioner's Interpretation of Section 76 is Not Overly Broad

424. The Respondents argue that the present matter cannot be distinguished from any case where a supplier increases prices of an input to a reseller, such as a supplier of electricity or a supplier of flour to a baker.[361] As set out in the expert report of Dr. Church, the Respondents argue that if Merchant Restraints are found to constitute price maintenance within the meaning of section 76 then "any conduct that adversely affects competition in a market for an input could be prohibited as price maintenance, provided the adverse effect causes a higher input price and there is some pass through of the higher input price to the price of the downstream product".[362] This is a considerable overstatement, and again, entirely without merit.

425. As the evidence discussed herein makes clear, there is no question that the increases in Interchange Fees and Network Fees implemented by Visa and MasterCard have the effect of increasing the Card Acceptance Fees charged by Acquirers to merchants in Canada. In this way only, the present matter is similar to increases in prices of the supplier of electricity or flour. However, in making the argument outlined above, the Respondents fail to recognize an important distinction between the present matter and the other scenarios they cite, all of which merely involve a supplier increasing the cost of an input to a downstream firm.

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361 See Opening Submissions, *supra*, pp. 172-73; Church Report, *supra*, para. 23; Elzinga Report, *supra*, para. 26.

362 See also Opening Submissions, *supra*, pp. 143-44.

426. Through the Merchant Restraints and their other respective operating regulations, Visa and MasterCard dictate key terms upon which Acquirers may supply Credit Card Network Services to merchants. Unlike the flour supplier or the electricity supplier that impose no restraints on the terms upon which downstream customers supply products, Visa and MasterCard have retained control over the terms upon which Acquirers supply services to merchants. Visa and MasterCard require Acquirers to implement and enforce the Merchant Restraints in agreements between Acquirers and merchants. In this regard, the Respondents ignore the fact that the Merchant Rules are a form of "vertical restraint" that is applied by Visa and MasterCard through agreements with Acquirers.

427. In making the argument that if the Commissioner's approach to section 76 is accepted "any conduct that adversely affects competition in a market for an input could be prohibited as price maintenance" provided there is pass-through of a higher price, the Respondents also ignore an important fact. The upward influence on prices and the adverse effects on competition in this case result not merely from conduct that adversely affects competition for an input, but are the results of vertical restraints imposed on merchants by Visa and MasterCard through agreements with Acquirers.

428. In any event, the Respondents fail to offer any explanation as to why it is allegedly preferable or appropriate, as a matter of competition policy, to permit vertical restraints (such as the Merchant Restraints) that increase prices and adversely effect competition to avoid scrutiny by the Tribunal because conduct that adversely affects competition in a market for an input may potentially be captured within the scope of section 76.

429. In contrast, there are obvious competition policy concerns resulting from the narrow interpretation of price maintenance advocated by the Respondents. As set out herein, the Merchant Restraints result in higher prices and a suppression of competition between Visa and MasterCard, which makes the Merchant Restraints exactly the type of conduct that competition policy is intended to proscribe.

430. The Respondents advance a further argument that any anticompetitive conduct in an upstream market could, as a matter of law, be prohibited under section 76. This is nothing more than in terrorem reasoning. The Respondents' argument assumes (without any basis or

foundation) that the Tribunal's decision in this matter would create precedent applicable to cases that do not involve a vertical restraint. The Respondents provides no example of a pro-competitive or competitively neutral arrangement that would be improperly captured by the broader interpretation of price maintenance they criticize. Indeed, they cannot provide such an example because even under the broader interpretation of price maintenance, to which they object, there remains the requirement that the vertical restraint have an adverse effect on competition.

431. The Respondents also argue that the Commissioner's interpretation of section 76 would capture any form of vertical restraint that results in higher prices by downstream customers, such as franchise agreements that require franchisees to sell only higher quality (and more expensive) products. Again, this argument is based on faulty reasoning and speculation by the Respondents and not on the facts of the present matter, which clearly do not involve a franchise agreement or similar arrangement. Further, in making this argument, the Respondents disregard the fact that to be prohibited under section 76, the conduct must also result in an adverse effect on competition.

432. The Respondents' example of a franchise agreement also disregards the fact that the Merchant Restraints at issue in this proceeding restrict the pricing behaviour of merchants, as opposed to simply requiring merchants to incur certain costs. Dr. Carlton explained the relevant distinction during his cross-examination:

> "MR. KENT: Okay. I've got a -- so it's -- I think you would agree with me then, to kind of tie some of these things together, that it is not unusual in markets for someone upstream in a relationship to impose requirements on somebody downstream that cause that person downstream to take on costs they might not have taken on if left to their own devices.
>
> I am thinking of -- franchise agreements are a common example, where franchisees are obliged often to purchase their ingredients or various other inputs from captive -- sources captive to the franchisor and not in the open marketplace. You are familiar with those sorts of arrangements?
>
> DR. CARLTON: Yes.

> MR. KENT: And would you say that all those sorts of arrangements are also examples of where the lack of unleashed competitive forces have caused some sort of failure along these lines?
>
> DR. CARLTON: Not necessarily, because that example differs from this one, from the case we're in, because the example you gave me is say a manufacturer imposes conditions on his distributor, but to incur certain costs.
>
> But in this case, it's not just that you have to incur certain costs. It is that I am constraining your pricing behaviour at the -- I'm constraining the merchant's pricing behaviour".[363]

433. Further, the Respondents example of a franchise agreement also ignores the fact that the Merchant Restraints not only result in higher Card Acceptance Fees, but also suppress competition between Visa and MasterCard. Again, the relevant distinction was explained by Dr. Carlton in cross-examination:

> "MR. KENT: …But if you've got a franchisor with a bunch of independent franchisees, each of whom is constrained, in the sense that they must provide parking and they cannot charge for it...
>
> DR. CARLTON: Yes, but this is -- I mean, I am just trying to relate it to this case, but I don't necessarily have an objection if a franchisor wishes to tell its franchisees how to -- what the product is. I mean, that is part of what is being sold.
>
> And, you know, I have no complaints if Visa wanted to tell, you know, its people who take a Visa card that, you know, they have to do certain things. Depending on what those things are, I would have no complaint.
>
> What I do have a complaint about is that you're telling the merchant, You cannot surcharge in your own independent judgment my card relative to, you know, some other card in order to sway consumers to use that other card.
>
> That is the competitive restriction. I agree with you a franchisor could say, you know, Carlton, you want my doughnut shop? You can make doughnuts this way. Otherwise, you know, you can't be

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[363] Transcript of May 17, 2012 (Volume 7), pp. 1386 (line 23) to 1387 (line 25).

> -- call yourself my doughnut shop. I agree. I am not saying any restriction is anticompetitive. It depends.
>
> MR. KENT: And that is even though, by buying your doughnut dough from the captive supplier, you may be paying a price higher than you could pay if you went out into the open market to buy it?
>
> DR. CARLTON: That may be. I'm agreeing to that, and that is different than in this case where it is not just the cost that the merchant is incurring, but he's incurring this restriction that says, I don't want you to charge a fee depending upon the medium people are using. If you accept this card, you have to charge the same fee for the use of this card as you charge for any other card.
>
> That is what is constraining the competition in my examples".[364] [emphasis added]

Upward Influence on Prices

(a) Overview

434. As described above, each Respondent requires its Acquirers to impose the Merchant Restraints on merchants as a condition of providing Credit Card Network Services to merchants. The Merchant Restraints are vertical restraints that prohibit merchants who accept Visa and MasterCard credit cards from, among other things, declining to accept particular credit cards (such as premium credit cards), applying a surcharge for those customers that elect to pay with credit cards, or engaging in other forms of discrimination that discourage the use of credit cards.

435. Through the Merchant Restraints, Visa and MasterCard dictate key terms upon which Acquirers may supply Credit Card Network Services to merchants, including the relative prices that may be charged by merchants for those services. By requiring Acquirers to implement the Merchant Restraints, the Respondents have influenced upward, and do influence upward, the price for Credit Card Network Services.

436. The Merchant Restraints influence upward and discourage the reduction of the Card Acceptance Fees paid by merchants. In the absence of the Merchant Restraints, merchants could constrain Card Acceptance Fees through the most effective and straightforward means

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[364] *Ibid*., pp. 1389 (line 10) to 1390 (line 25).

available; namely, by surcharging or threatening to surcharge certain credit cards or declining to accept higher-cost credit cards.

437. The Commissioner has illustrated the effect of the Merchant Restraints on Card Acceptance Fees by providing expert evidence and evidence from other jurisdictions relating to the "but for" world that would exist without the Merchant Restraints. In the absence of the Merchant Restraints, a merchant could effectively respond to higher Card Acceptance Fees for a particular credit card by attempting to steer consumers to a different and less expensive credit card or method of payment. As will be explained in further detail below, alternative methods of steering, such as discounting, are simply not effective substitutes for surcharging or refusing certain cards.

438. Because the Merchant Restraints prevent merchants from effectively encouraging customers to use lower-cost payment methods, the Merchant Restraints remove or reduce any incentive on the part of Visa and MasterCard to compete through lower fees to merchants. The Merchant Restraints allow Visa and MasterCard to maintain higher prices for their services, without facing meaningful countervailing pressure from merchants or otherwise suffering any loss in volume, as would normally occur when a firm charges higher prices in a competitive market. In fact, with the Merchant Restraints in place, the Respondents "compete" primarily over which network can offer Issuers the opportunity to collect the *highest* fee revenues from merchants.

439. The evidence before the Tribunal establishes the following points:

(a) surcharging or declining to accept certain credit cards is effective at steering transactions to lower cost methods of payment;
(b) the ability of merchants to surcharge or threaten to surcharge on credit cards constrains the level of Card Acceptance Fees; and
(c) the Honour All Cards Rule influences Card Acceptance Fees upward.

Each of these points is discussed below.

(b) Surcharging is Effective at Steering Customers

440. The evidence before the Tribunal confirms the logical and expected result that when merchants surcharge on higher-cost credit cards, customers tend to react by significantly reducing their use of the surcharged credit cards.

441. The evidence from Australia shows that surcharges have been effective in steering customers to lower-cost payment methods. In a 2010 study, the RBA found that approximately 30% of merchants surcharge at least one brand of credit card. This may be compared with 2007 where approximately 8% of merchants surcharged on one brand of credit card. However, the proportion of Australians that actually pay a surcharge has remained the same between 2007 and 2010, despite the increased number of merchants who surcharge. Specifically, in both 2007 and 2010, only 5% of customers reported actually paying a surcharge.[365]

442. The RBA noted that these data confirm the expected result that when merchants surcharge on credit cards, customers respond by choosing a different payment method in order to avoid the surcharge:

> "As noted above, there has been a clear shift towards consumers using debit cards in preference to credit cards between 2007 and 2010. A number of factors may have contributed to this slowdown in the use of credit cards. First is the increased prevalence of surcharging on credit card transactions since the first study was undertaken. In December 2010, almost 30 percent of merchants surcharged at least one of the credit cards they accepted, compared with just over 8 percent in June 2007. However, consumers appear to have become more sensitive to surcharges, or better at avoiding them; the proportion of credit card transactions where a surcharge was actually paid by the consumer was virtually unchanged between 2007 and 2010, at around 5 per cent."[366]

443. Similarly, the Tribunal heard testimony from Charles Symons regarding IKEA's experience with respect to surcharging on credit cards in the United Kingdom. In the period from 2004 to 2010, the IKEA Group applied a 70 pence (approximately CDN $1.10) surcharge

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365 "Strategic Review of Innovation in the Payments System: Results of the Reserve Bank of Australia's 2010 Consumer Payments Use Study", Exhibit A-374, p. 18.

366 *Ibid.*

to all credit card transactions at its retail operations in the United Kingdom. Mr. Symons testified as follows regarding the impact of surcharging:

> "The surcharges instituted by the IKEA Group created an effective pricing signal that encouraged consumers to use lower-cost methods of payments, such as debit cards, instead of higher-cost credit cards. In particular, as indicated in the presentation attached as Exhibit "D", the volume of credit card transactions at the IKEA Group's retail stores in the United Kingdom in 2005 was reduced by 37% through surcharges. Customers previously paying with credit cards switched to lower-cost debit cards. The number of debit transactions in 2005 increased by 16%. Cash sales were not affected and stayed at approximately 19% following the implementation of the surcharge.
>
> When surcharges on credit cards were removed in 2010, the number of transactions using credit cards increased by [redacted] During this same period, the number of debit transactions decreased by [redacted].[367]

444. [redacted]

445. The effectiveness of surcharging was also confirmed by TD Bank's expert, Balaji Jairam. Under cross-examination, Mr. Jairam made the following admissions:

> "MR. FANAKI: Now, would you agree with me that one of reasons a merchant may surcharge on credit cards is to encourage customers to choose a method of payment that is cheaper for the merchant?
>
> MR. JAIRAM: Sure.

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367 Symons Statement, *supra*, paras. 57-58.

368 [redacted]

> MR. FANAKI: And would you agree with me that when merchants surcharge on particular types of credit cards, that one likely reaction by cardholders will be to switch to a credit card that does not attract surcharges?
>
> MR. JAIRAM: One of the likely, yes, absolutely".[369]

446. Also, Marion van Impe from the University of Saskatchewan provided testimony that the application of a 1% surcharge (in the form of a convenience fee) on MasterCard credit card transactions substantially reduced the volume of credit card transactions at the University of Saskatchewan:

> "MR. FANAKI: And if we could go, please, back, Mr. LaRose, to page 10 of the PDF, paragraph 35?
>
> There you describe what the effect is of the surcharge on the level of credit card payments. Can you explain this for the Tribunal, please?
>
> MS VAN IMPE: Yes. In 2009-2010, the percentage of payments that were received by credit card was approximately 42 percent. That declined to less than 20 percent the following year. And in this last fiscal year, which we're just completing, it is down to around 13-1/2 percent.
>
> MR. FANAKI: So, overall, following the application of the additional fee, the use of credit cards has fallen from 42 to, did you say, 13 percent?
>
> MS VAN IMPE: Thirteen percent, yes".[370]

447. In her witness statement, Ms Van Impe testified that the "majority of students who formerly paid by credit card appear to have changed to online banking, which results in very low fees for the University".[371]

448. When merchants surcharge on credit cards, customers tend to react by switching to other payment methods or otherwise reducing their use of the surcharged credit cards. The risk of lost

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369 Transcript of June 7, 2012 (Volume 20), p. 3406 (lines 8-19).

370 Transcript of May 23, 2012 (Volume 9), p. 1684 (lines 5-20).

371 Van Impe Statement, *supra*, para. 35.

volume on credit card networks is a powerful incentive for Visa and MasterCard to lower their fees in response to surcharging or a threat of surcharging – an incentive entirely absent because of the No Surcharge Rule.

(c) Surcharging or the Threat of Surcharges Are Effective Constraints on Card Acceptance Fees

449. The Respondents have argued that their experience with surcharging in Australia does not support the Commissioner's submission that the ability to surcharge or to threaten to surcharge has constrained Card Acceptance Fees. For example, counsel for Visa stated the following during opening argument:

> "To the contrary, it suggests that surcharging has nothing whatsoever to do with reducing interchange, because in Australia interchange has been dramatically reduced, and yet merchants still surcharge".[372]

450. However, the evidence before the Tribunal shows that surcharges, or the threat of surcharges, have been effective at securing reductions in Card Acceptance Fees in Australia and elsewhere. The Respondents have a strong economic incentive to reduce or not increase Card Acceptance Fees when merchants have the ability to surcharge on credit cards. For example, if merchants began to surcharge on MasterCard credit cards, the number of transactions using those cards would be expected to fall. To avoid potential reductions in the number of transactions over its network, MasterCard has an economic incentive to take actions that would reduce the likelihood or level of surcharging by lowering Card Acceptance Fees through the reduction of Interchange Fees or Network Fees.

451. [redacted]

[redacted]

[redacted]

452. [redacted]

[redacted]

[redacted]

[redacted]

453. [redacted]

[redacted]

[redacted]

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373 [redacted]

374 [redacted]

375 [redacted]

454. [redacted]

455. [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

376 [redacted]

377 [redacted]

[redacted]

456. [redacted]

457. [redacted]

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378 [redacted]

379 [redacted]

380 [redacted]

458. In addition, Australian merchants have affirmed that the threat of surcharging has been effective in securing reductions in Card Acceptance Fees. [redacted]

[redacted]

459. Similarly, Douglas Swansson, a representative of a major Australian merchant named Coles, testified [redacted]

[redacted]

381 [redacted]

[redacted]

Similarly, on one occasion, Coles elected to apply a surcharge to transactions using certain brands of fuel cards accepted at Coles Express for which it was incurring higher card acceptance fees. Surcharging allowed Coles to recover the higher costs that Coles Express was incurring in accepting those cards. [redacted]

460. [redacted]

461. [redacted]

462. [redacted]

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382 Witness Statement of Douglas Swansson ["**Swansson Statement**"], Exhibit CA-76, p. 7.

383 [redacted]

[redacted]

463. [redacted]

(d) Honour All Cards Rule Influences Prices Upward

464. The Honour-All-Cards Rules have two main aspects: an "all products" aspect that prohibits a merchant from accepting some types of Visa or MasterCard credit cards but not others (*e.g.*, accepting standard or core credit cards, but not premium credit cards); and, an "all issuers" aspect that prohibits a merchant from accepting some credit cards, but not others, based on the identity of the Issuer (*e.g.*, accepting a CIBC Visa Infinite, but not an RBC Visa Infinite).

465. By eliminating an option for merchants to selectively accept only some of each Respondent's credit cards, the Honour All Cards Rule allows the Respondents to maintain higher Card Acceptance Fees than they otherwise could. Eliminating the Honour All Cards Rule provides merchants with another competitive means of constraining Card Acceptance Fees. 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 carrying a very high Interchange Fee, based on the merchant's own evaluation of the costs and benefits of accepting those particular cards. With the Honour All Cards Rule in place, however,

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384 [redacted]

385 (Group President, Asia-Pacific, Central Europe, Middle East and Africa, Visa Inc.).

386 [redacted]

a merchant must weigh the added cost of the premium card against the potential loss of declining to accept all MasterCard credit cards.

466. The Tribunal heard evidence that the RBA has considered removing the Honour All Cards Rule as an alternative to continuing to regulate the level of Interchange Fees in Australia. In a 2008 report, the RBA discussed the potential of "stepping back" from the regulation of Interchange Fees "if the industry is able to address a number of issues that would promote competition and efficiency in a timely fashion". Among the issues required to be addressed was the removal of the Honour All Cards Rule:

> "Another issue that would need to be addressed is the honour-all-cards rule. If the Board is to remove the existing interchange regulation, its view is that further steps would need to be taken to improve the ability of merchants to put downward pressure on interchange fees. Accordingly, in addition to the modifications to the honour-all-cards rule discussed in Section 5, the Board sees it as important that payment schemes allow merchants to make independent acceptance decisions for each type of card for which a separate interchange fee applies. This would allow a merchant to refuse acceptance of, say, premium cards if it thought the cost of acceptance was too high relative to the benefit gained. Ideally, such a change would be made voluntarily by the schemes, although the Board would consider imposing this requirement through regulation if the schemes did not change their rules and it was deemed appropriate to step back."[387]

467. In addition to enabling merchants to make separate acceptance decisions based on each particular product of MasterCard or Visa card, and the associated Interchange Fees, eliminating the Honour All Cards Rule would make possible the development of intrabrand price competition between Issuers. 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.

468. However, as a result of the Honour All Cards Rule, Issuers do not consider selective acceptance by merchants to be a constraint on Interchange Fees. This creates an incentive for Issuers to press for higher Interchange Fees in order to increase their own revenues and promote

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[387] Exhibit "I" to Buse Statement, *supra*, p. 190.

greater issuance of credit cards, without concern that merchants may decline to accept those cards. As Balaji Jairam, the expert for TD Bank, stated during cross-examination:

> "MR. FANAKI: Then if we look at paragraph 120, you say that:
>
> 'The honour-all-cards rule guarantees that any issuer's card will be accepted...'
>
> I really want to focus you on the last sentence -- sorry, I will give you the whole paragraph:
>
> '... will be accepted at any merchant that accepts that brand of card (Visa, MasterCard or American Express). This certainty allows the issuers to focus on attracting consumers rather than spending time and money on ensuring a sufficient merchant footprint. This has been essential in facilitating consumer-focused competition among issuers, which has led to an expanded product offering designed to meet the needs of various customer segments. Without the honour-all-cards [rule] issuers will need to divert their attention and resources to ensuring that merchants accept their cards rather than focusing on product innovation.' [As read]
>
> I want to ask you some questions on innovation shortly, but here what you're talking about is that, in the presence of the honour-all-cards rule, the issuers can focus on attracting further cardholders, correct?
>
> MR. JAIRAM: Right, right.
>
> MR. FANAKI: And that if the honour-all-cards rule is removed, then issuers will need to divert their attention away from cardholder-focused competition to ensuring merchants accept their cards?
>
> MR. JAIRAM: Right".[388] [emphasis added]

469. As Mr. Jairam states, the removal of the Honour All Cards Rule will require Issuers to also concern themselves with the cost to merchants of increases in Interchange Fees. It follows that in the absence of the Honour All Cards Rule, Issuers and the Respondents would have an incentive to reduce Interchange Fees and Network Fees, resulting in lower Card Acceptance Fees for merchants.

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[388] Transcript of June 7, 2012 (Volume 20), pp. 3409 (line 12) to 3411 (line 1).

(e) Requiring all Customers to Bear the Higher Costs of Credit Cards

470. The evidence demonstrates that merchants typically pass some or all of the increased costs resulting from high Card Acceptance Fees onto *all* their customers equally in the form of higher retail prices for goods and services. The No Surcharge Rule restricts the pricing freedom of merchants, by preventing them from charging an additional fee (or a higher price) to *only* those customers that elect to cause merchants to incur Card Acceptance Fees through the use of a credit card.

471. Because of the No Surcharge Rule, the increased costs of credit card acceptance are borne by all customers of a merchant, including those that use other methods of payment, such as cash, debit cards or even basic credit cards with lower Card Acceptance Fees. In this way, customers using other payment methods are in effect providing a subsidy to credit card users by paying a portion of their credit card acceptance fees. As stated by Visa in opening argument, "Just as acquirers can reasonably be expected to pass on their costs to their merchant customers, merchant can reasonably be expected to pass on their card acceptance costs to their customers."[389]

472. [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

389 Transcript of May 8, 2012 (Volume 1), p. 157 (lines 1-5).

[redacted]

473. The Respondents have argued that the Tribunal should not be concerned with the fact that the higher costs of credit cards are subsidized by customers paying with lower-cost methods of payment. For example, Dr. Church states the following in his expert report:

> "The 'cost externalization' hypothesis links the reduction in incentives to reduce Acquirer Fees to a sharing of the burden of Acquirer Fees with other forms of payment. According to Dr. Winter non credit card users 'subsidize' credit card users. In this context what is important to remember, as with the issue of the distributional effects of RPM, is that the distributional effects of conduct – without something more – does not make conduct an issue for competition policy (even if the Rules were price maintenance, which they are not)."[391]

474. However, the issues at hand are not confined to whether it is fair for customers using lower-cost methods of payment to bear the higher prices resulting from the use of credit cards. Rather, the central issue is the impact on competition and on the incentives of the Respondents to raise Card Acceptance Fees, given their knowledge that credit cards users bear only a portion of the cost of any price increases.

475. The Tribunal heard expert testimony from Dr. Winter that where a portion of a cost increase is borne by customers outside of the suppliers' supply chain, this incentivizes those suppliers to set higher prices than they otherwise would. As Dr. Winter states in his expert report: "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

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390 [redacted]

391 Church Report, *supra*, para. 59.

monopoly supplier of coffee beans has an incentive to set a higher price."[392] Dr. Winter explained this simple example further in his Reply Report:

> "… To illustrate this effect with a simple example, consider a firm supplying coffee beans to coffee houses. Suppose the coffee houses also sell tea to an equal number of tea drinkers. Suppose further that the supplier of coffee has market power, but that the tea is supplied by a competitive market and is less costly. Now suppose that, like the No-Surcharge Rule in this matter, the coffee supplier imposes a restraint on the downstream coffee houses dictating that its product, once brewed, shall not be sold at a greater price than tea. The result is an immediate upwards influence on the price of tea, as the price of both tea and coffee must now reflect the average cost of inputs for the two drinks.
>
> A second upwards influence on prices follows from the fact that the demand facing the upstream coffee supplier becomes less sensitive to price as a result of the restraint. Where there is an equal number of tea and coffee drinkers, downstream coffee drinkers bear only half the cost of a $1 per pound increase in the price of coffee, and tea drinkers bear the remaining cost. The sensitivity, or elasticity, of demand is cut in half. Like any firm facing a less elastic demand, the coffee producer will increase its price".[393]

476. The principle that a supplier will raise the price of its product, when buyers of other products bear a portion of the price increase, applies directly to the case of credit cards. When the Respondents raise prices in the presence of a No Surcharge Rule, some of the resulting increases in Card Acceptance Fees are borne by customers that use other methods of payment, such as those using debit or cash. Because of the Merchant Restraints, merchants cannot raise prices only for credit card users through the application of surcharges on credit cards. Merchants therefore raise prices to all consumers to cover the costs of higher Card Acceptance Fees, including those customers that purchase using other methods of payment. As Dr. Winter explains, the No Surcharge Rule removes an important constraint on the level of Card Acceptance Fees and clearly influences prices upwards:

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[392] Winter Report, *supra*, para 89.

[393] Winter Reply Report, *supra*, paras. 53-54.

> "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".[394]

477. It is clear from the evidence that the Merchant Restraints influence upward and discourage the reduction of the Card Acceptance Fees paid by merchants. In the absence of the Merchant Restraints, Card Acceptance Fees would, over time, decline. Alternatively, further increases in Card Acceptance Fees would, at a minimum, be discouraged. Without the Merchant Restraints, merchants could constrain Card Acceptance Fees through the most effective and straightforward means available; namely, by surcharging or declining to accept higher-cost credit cards (or the threat thereof).

Adverse Effects on Competition

478. The evidence demonstrates that the Merchant Restraints have adverse effects on competition, by substantially reducing or eliminating the incentive of the Respondents to reduce Card Acceptance Fees, distorting the price signals provided to customers when electing to use a payment method at the point of sale, and suppressing competition between Visa and MasterCard with respect to Card Acceptance Fees. The Merchant Restraints preserve and enhance the Respondents' market power.

479. The Merchant Restraints adversely affect competition primarily by constraining the ability and incentive of the Respondents to undercut high Card Acceptance Fees. Normally, when a supplier increases prices unilaterally and unrelated to cost increases, it risks losing sales to competitors that offer lower prices.[395]

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394 See Winter Report, *supra*, para. 92.

395 Frankel Report, *supra*, para. 148.

480. In any market in which firms compete vigorously, prices in excess of competitive levels cannot be sustained. Any firm in the market would undercut a higher price to gain additional market share. In a competitive market, firms continually reduce prices in an attempt to gain market share until prices fall to competitive levels.[396]

481. The ability of a firm to undercut a high price and gain additional market share is the very essence of competition – it is the mechanism that prevents high prices from being sustained. If that mechanism is somehow dampened (by agreement, arrangement or otherwise), firms can sustain high prices without competitive consequence. Therefore, an agreement or other arrangement that restricts the ability of firms to undercut high prices, or dampens the incentive for them to do so, is unambiguously anticompetitive.[397]

482. The Merchant Restraints are precisely such an agreement. They interfere with, and actually reverse, the normal competitive process, resulting in what has been described as a "perverse" form of competition in which credit card networks with lower prices are characterized in the industry as being at a "competitive disadvantage" and networks with higher prices are characterized as having an advantage and are better able to grow at the expense of the lower priced network.

483. For example, Mr. Sheedy, then Visa's Executive Vice President in charge of Interchange, now Group President of the Americas for Visa Inc., provided the following explanation as to why Visa was required to <u>increase</u> its fees as a matter of "competitive necessity":

> "Visa U.S.A. said its announcement Monday that it will raise interchange fees for credit card transactions -- a move bound to further anger merchants -- was a competitive necessity after MasterCard raised its rates in January.
>
> William M. Sheedy, Visa's executive vice president in charge of interchange, said in an interview Monday that for years his company has kept interchange fees lower than MasterCard partly to secure merchant acceptance.

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396 Winter Report, *supra*, para. 70.

397 *Ibid*., para. 71.

> But the new rates, which will still be slightly lower than MasterCard's, mark a recognition that Visa has reached near ubiquitous merchant acceptance and must now focus on the happiness of its members, who profit from interchange fees and had been defecting to MasterCard.
>
> 'If we were gaining share with merchants, I think that could have offset" the lower payoffs for issuers, Mr. Sheedy said. But 'we were losing share to merchants and issuers. In certain instances, we have had difficulty in securing issuer brand decisions because of our lower fee.'"[398]

484. The reason that Visa was not "gaining share with merchants" despite its lower fees was because merchants were precluded by the Merchant Restraints from favouring customers using the lower-priced Visa credit cards, through the application of surcharges (or higher surcharges) on higher-priced MasterCard credit card transactions.

485. Due to the Merchant Restraints, merchants were unable to effectively steer transactions to lower-cost Visa credit cards by surcharging higher-cost MasterCard credit cards. Because of the MasterCard No Surcharge and No Discrimination Rules, cardholders faced no difference in price between a Visa transaction and a MasterCard transaction at the point of sale. Without the threat of surcharging by merchants, there was little or no incentive on the part of MasterCard to reduce its fees.

486. [redacted]

398 "Visa Says MasterCard's Fee Hike Forced Its Hand (American Banker)", Compendium of the Commissioner of Competition (Opening Argument), **Tab 42**.

[redacted]

487. [redacted]

[redacted]

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

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399 [redacted]

400 [redacted]

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.[401]

489. These sources of increased demand that result from undercutting higher Card Acceptance Fees would prevent the Respondents from imposing or sustaining supra-competitive 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".[402]

490. In the presence of the Merchant Restraints, the ability of either Visa or MasterCard to capture a larger market share by undercutting a higher price – the essential mechanism for competitive discipline in any market – is severely hampered.

491. In the absence of the Merchant Restraints, Visa could also encourage merchants to reject particularly high priced MasterCard cards. The reverse is also true.

492. Due to the Merchant Restraints, merchants are unable to steer more transactions to the lower-cost credit card network or to effectively deter customers from using higher-cost credit cards. As Dr. Winter explained:

> "The [first] source…of increased demand is eliminated because a consumer, in making the choice of which credit card to use, does not face the costs of different credit cards. The merchant is prohibited from passing on these differential costs to consumers in the form of surcharges. Because merchants are unable to effectively differentiate the credit cards on the basis of cost, cardholders have no incentive to shift their credit card business to the lower-priced credit card network. Therefore, consumer choices of cards at the point of sale do not provide an incentive to

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401 See Winter Report, *supra*, para. 72.

402 *Ibid*., para. 73.

> undercut high prices. Similarly, [the second] source…of increased demand is eliminated because additional consumers are not attracted to carrying lower-cost credit cards: under the Merchant Rules, the use of these lower-cost cards does not translate into lower costs for consumers".[403]

493. Dr. Carlton explained the suppression of competition resulting from the Merchant Restraints during his testimony as follows:

> "The way to think about the no-surcharge rule is as follows. Let's suppose Visa was trying to get more business. Well, think about a normal market. Think about toothpaste, for example. You go to the drugstore and you are trying to decide, Do I want to buy Crest or Colgate? So you might look at their prices.
>
> Let's suppose Crest wants to sell more toothpaste. Well, one thing Crest could do is lower its wholesale price. That would induce the merchant to lower the retail price, and, when I show up in the drugstore, I would say, Gee, the price of Crest is now lower than Colgate. I am going to -- if I were buying Colgate, maybe I will switch and buy Crest.
>
> So the consumer is going to respond, and that is what provides incentives for price competition.
>
> Suppose, instead, there was an agreement that said Crest and Colgate have made an agreement that they have to charge the same price and they have told the retailer that.
>
> Well, now when Crest lowers its price, nothing happens, because when I show up at the store -- nothing happens from the point of view of the consumer, because when I show up at the store, the price that Crest is now the same of price of Colgate, just like it was before, so I have no incentive to shift.
>
> So that form of competition is getting muted, getting extinguished, by an agreement like the no-surcharge rule.
>
> 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.

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403 *Ibid*., para. 81

> 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".[404]

494. Dr. Carlton also found that the Merchant Restraints suppress any constraint on Card Acceptance Fees that may result from substitution to other methods of payment:

> "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.
>
> I think that the consequence of this is that fees are higher than they would otherwise be, and that if you got rid of the no-surcharge rule it would lead to a lowering of merchant fees.
>
> Now, if merchant fees go down, that means costs at retail, to the retailers, are going down. It is straightforward economics, a simple principle of economics. If your costs go down, that eventually will get passed on to consumers. Lower costs is good for merchants and consumers".[405]

495. In cross-examination, Dr. Carlton elaborated further on how the Merchant Restraints suppress competition between the Respondents with respect to Card Acceptance Fees:

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404 Transcript of May 17, 2012 (Volume 7), pp. 1261 (line 3) to 1262 (line 22).

405 *Ibid*. pp. 1262 (line 23) to 1263 (line 24).

"MR. KENT: …So I just want to start with this. You talk about successful steering there. What do you mean when you say 'successful steering'?

DR. CARLTON: Well, just to give an example, let's suppose right now Visa wants to get more business, so it cuts -- let's keep it simple. Suppose it cuts its service fees, abolishes service fees, so, therefore, merchant fees, when you use a Visa card, will fall to the retailer.

The retailer, if he could, now has much lower fees from Visa compared to, say, MasterCard. And, therefore, he would like consumers to use Visa rather than MasterCard, if they're going to use one of the two.

Well, how can the merchant influence the consumer to do that? He can say to the consumer, If you use Visa, I won't surcharge you as much as if you use MasterCard.

And if a consumer responds to that, then more volume will come to Visa and less will go to MasterCard. That increases the incentive of Visa to keep its fees low, and MasterCard obviously will see the same thing. That is an example of the competition I am talking about".[406]

496. [redacted]

406 *Ibid.* pp. 1347 (line 11) to 1348 (line 9).

[redacted]

497. In the absence of the Merchant Restraints, merchants have the ability to provide clear price signals to customers regarding the costs associated with credit cards. If surcharging is

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407 [redacted]

permitted, premium credit cards, such as the MasterCard World Elite, would only be used by those cardholders who believed that the benefits of such credit cards exceeded the cost, both in terms of surcharges and any inconvenience resulting from the refusal by merchants to accept those cards. In other words, in the absence of the Merchant Restraints, credit cards would be subject to the standard comparison of costs and benefits.

498. The importance of providing customers with clear price signals regarding the true costs of payment methods was confirmed by TD Bank's own expert on cross-examination:

> "MR. FANAKI: I want to ask you a question about the concept of blended surcharging that was a focus more of your testimony this morning than it was in your report.
>
> By that, I take it you mean the practice of charging the same surcharge for all credit cards, even if the credit card may cost the merchant more?
>
> MR. JAIRAM: Or less.
>
> MR. FANAKI: Or less. Now, for example, a merchant may be -- if we take the Australian example, a merchant may be surcharging American Express and Visa credit cards at the same level when those costs to the merchant can be quite different?
>
> MR. JAIRAM: Right.
>
> MR. FANAKI: And your concern is that that distorts the price signals to the cardholders? That is the way you stated it, correct?
>
> MR. JAIRAM: It doesn't send a clear price signal, yes.
>
> MR. FANAKI: It is important for consumers to receive those clear pricing signals, correct?
>
> MR. JAIRAM: Yes.
>
> MR. FANAKI: It is important that consumers will face the actual costs of the payment method that they're selecting to use, right?
>
> MR. JAIRAM: Sorry, can you repeat that?
>
> MR. FANAKI: It is important that consumers face the actual costs of the payment method that they're selecting?

MR. JAIRAM: That they're aware of, yes".[408]

499. Finally, the Merchant Restraints increase barriers to entry and impede competition from other existing or new payment providers and networks. If surcharging were permitted, a lower-cost entrant might have succeeded in entering the market by avoiding merchant surcharges, while MasterCard and Visa were surcharged by merchants at rates corresponding to their higher acceptance costs. However, in the presence of the Merchant Restraints, a new entrant is unable to benefit from that normal competitive response, because the Merchant Restraints prevent merchants from using surcharges to steer transactions away from the higher-cost Visa and MasterCard credit cards and towards lower-cost alternatives.

500. The elimination of the Merchant Restraints would unleash competitive forces that have been lacking in the market for Credit Card Network Services for years, by providing merchants with the ability to send the correct price signals to customers when electing to use a payment method, and enabling merchants to otherwise effectively steer transactions to lower-cost credit cards or other methods of payment.

Discounting Versus Surcharging

501. Visa and MasterCard argue that removing the No Surcharge Rules is not necessary to constrain Card Acceptance Fees because merchants are currently allowed to offer discounts to those consumers paying with lower-cost payment methods. The Respondents also argue that discounting is just effective as, if not more effective than, surcharging at steering consumers to lower-cost payment methods.[409]

502. As discussed below, however, the evidence in this case demonstrates clearly that this position is without merit. The evidence of virtually every merchant that testified was that discounting is not practical or viable and evidence from a variety of jurisdictions establishes that surcharging or the threat of surcharging is the most direct and effective means by which merchants can constrain Card Acceptance Fees. In contrast, *the Respondents have provided no*

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408 Transcript of June 7, 2012 (Volume 20), pp. 3427 (line 11) to 3429 (line 2).

409 See, *e.g.*, Expert Report of Michael Mulvey, Exhibit CRM-501 ["**Mulvey Report**"], para. 40.

evidence that merchants are able to use discounting to secure reductions in Cards Acceptance Fees.

(a) Actions and Documents of the Respondents Contradict the Respondents' Claims Regarding the Purported Effectiveness of Discounting

503. As discussed in more detail by Dr. Carlton in his expert report and evidence,, the Respondents' own actions are inconsistent with any claim that surcharging and discounting are economically equivalent.[410] If discounting and surcharging were equivalent, it would make no sense for Visa and MasterCard to allow discounting, but to insist on maintaining a blanket prohibition on surcharging. Rather, Visa and MasterCard prohibit surcharging precisely because they recognize that surcharging is far more effective in constraining the level of Card Acceptance Fees than discounting, and that if subcharging is permitted it may well impact on the volume of transactions over their networks as well as their "bottom line".

504. [redacted]

505. In his expert report, Professor Mulvey argues that the Respondents' opposition to surcharging is justified by the threat that surcharging allegedly poses to the Visa and MasterCard brands:

> "…. In fact, the deep concerns VISA and MC share with respect to merchant surcharging are perfectly justified because, apart from steering effects, surcharges pose a much greater threat to brand reputation by undermining consumer trust. The resources being devoted to defending the No-Surcharge Rule are an effort to defend brand equity, the firms' greatest asset, which is bound up in the ease of use and ubiquitous acceptance. In contrast, discounting

410 See Carlton Report, *supra*, para. 69 and Transcript of May 17, 2012 (Volume 7), pp. 1266 (line 12) to 1270 (line 3).

411 [redacted]

> schemes pose no immediate threat to the VISA and MC brands as merchants assume all of the risks and reap all of the rewards".[412]

506. In cross-examination, however, Professor Mulveyconceded that in preparing his report had had not seen (because Visa had not provided him with a copy of) a [redacted] document which concludes, despite the significant increase in the proportion of merchants in Australia who are surcharging, from just over 8% of merchants in June 2007 to almost 30% of merchants in December 2010,[413] that:

[redacted]

507. [redacted]

(b) Discounting is Not Feasible or Viable

508. Each of the merchant witnesses with operations in Canada called in this proceeding testified that surcharging is a more effective strategy for merchants in influencing consumers' choice of payment methods than discounting and that there are significant practical and

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412 See Mulvey Report, *supra*, paras. 53 to 56.

413 See Transcript of June 6, 2012 (Volume 19), pp. 3260 (lines 4 to 16); "Strategic Review of Innovation in the Payments System: Results of the Reserve Bank of Australia's 2010 Consumer Payments Use Study", Exhibit A-374, p. 18.

414 [redacted]

415 [redacted]

416 [redacted]

technological obstacles to discounting.[417] The principal reasons given by merchants in support of their testimony in this regard are discussed below.

i. Need to Offer Discounts to All Customers and Inflate Base Prices

509. In order to offer a discount on cash or debit transactions, merchants would have to offer that discount not only to those customers that would otherwise pay with credit cards, but also to those customers that already prefer to use (and do use) cash or debit cards. This can be an expensive proposition, considering that cash and debit can constitute well over 50% of the total sales for many merchants. In contrast to a discount, a surcharge can be targeted to only those customers that would otherwise pay with credit cards – the customers that merchants want to move to lower-cost payment methods.

510. Merchant after merchant testified that in view of the significant costs associated with offering discounts to all customers, if they did offer discounts in respect of the form of payment used by customers, they would have no practical choice but to increase their base (and advertised) prices. For example, if a merchant is selling a competitive product at $100 and wants to discourage the use of credit cards (which cost 2% to accept), the merchant could not simply offer a 2% discount off of the $100 for cash or debit customers. To do so would cause the merchant to sell to cash and debit customers below cost, without having any way to recover the loss associated with those discounts from credit card customers. Rather, the merchant would have to increase the product's base price to, say, $101. Supposing half of the merchant's customers use cash or debit, that would result in an average price of $100. However, this is not a practical strategy for merchants who have to advertise the lowest price they can offer for goods and services, as opposed to a price that may be further discounted at the point of sale. In this example, the merchant would have to advertise a price of $101, while all non-discounting competitors could advertise $100 instead. Even though the average price is the same, the higher advertised price could prevent the discounting merchant from even getting customers through the door.

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[417] Houle Statement, *supra*, paras. 61-63; Shirley Statement, *supra*, paras. 39-41; Broughton Statement, *supra*, paras. 27-28; Symons Statement, *supra*, paras. 65-70; Daigle Statement, supra, paras. 39-43; Jewer Statement, *supra*, paras. 54-60; Van Impe Statement, *supra*, para. 29; de Armas Statement, *supra*, paras. 60-65; Li Statement, *supra*, paras. 38-39.

511. [redacted]

[redacted]

512. [redacted] Pierre Houle, the Treasurer of Air Canada, stated as follows at paragraphs 62 to 63 of his Witness Statement:

> "… unlike additional fees, discounts cannot be targeted to particular categories of customers, such as customers paying with premium credit cards. They must instead be offered to all customers paying with lower-cost payment methods, most likely resulting in an overall reduction of revenue for Air Canada in excess of the savings on fees….

> In order to be able to offer a discount for customers that purchase air travel services using lower-cost methods of payment, Air Canada would have to increase the price of air travel services and then discount depending on the payment option selected. Air Canada must advertise the lowest possible fare for air travel, not a fare that will be further discounted depending on the payment method selected by the customer. Advertising higher fares is not an option for Air Canada given the markets in which it operates and the price sensitivity of customers for air travel services."

513. Moreover, Candice Li, the Vice President, Treasurer of WestJet Airlines, Ltd., testified that discounting would create a competitive disadvantage for WestJet since the airline would need to inflate its fares to implement the discount and that such an increase in price which would be competitively disadvantageous:

> "If we were to discount in order to stay consistent with the user-pay model, so we would discount for the cards that were lower interchange than what the maximum could possibly be, the first thing we would need to do is essentially inflate the prices we advertise to the maximum amount, right?
>
> So we would apply the maximum interchange rate to those prices, so that if the customer or the guest actually uses the higher interchange card, we would not be applying a discount and we would be charging for the correct fare.
>
> However, what happens is that the advertising, when it shows up online, you know, from a comparative perspective, like a $5.00, $10 difference actually makes a difference when a person makes a decision on which aircraft or which airline to fly with.
>
> And so we would see a competitive disadvantage on the pricing side if we were to inflate the fares, because we would lose against – you know, I think US competitors would be an obvious one."[418]

514. [redacted]

[418] See Transcript of May 22, 2012 (Volume 8), p. 1529 (line 17) to 1530 (line 13).

[redacted]

515. During his cross-examination, Professor Mulveydismissively characterized merchants' evidence regarding the competitive necessity of advertising their lowest possible prices as "bogus".[420] This is hardly the language one would expect to see used by a dispassionate, unbiased and impartial expert. The Commissioner's submits that the Tribunal should prefer the evidence of 9 merchant witnesses who must be presumed to know their businesses and the competitive imperatives they face.

ii. Significant, Practical and Technological Obstacles to Discounting

516. Merchants also testified regarding the significant practical and technological obstacles to discounting. For example, Paul Jewer, the Chief Financial Officer of Sobeys Inc., stated that "[s]helf-talkers … are a significant investment with little return" and that "given the large number of SKUs involved, it would be very costly for grocers to inform their customers of the

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419 [redacted]

420 Transcript of June 6, 2012 (Volume 19), pp. 3274 (line 21) to 3277 (line 14).

discounted prices".[421] Other challenges facing merchants were highlighted by Craig Daigle, the Senior Director, Treasure & Risk Management of Shoppers Drug Mart Inc. ("**Shoppers**")

> "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".[422]

517. In contrast, chip technology makes it relatively easy to implement surcharging functionality on a point-of-sale terminal. A merchant's customers could therefore be prompted to agree to a surcharge as they enter their credit card PIN number at the point of sale terminal.[423] Such disclosure is easy for consumers to understand.

iii. Consumer Perception and Reaction

518. Merchants testified that customers perceive discount and surcharges differently and react differently to them. For example, Paul Jewer of Sobeys gave compelling evidence regarding Sobeys' experience that discounting is not as effective as surcharging in affecting consumer behaviour. In particular, he testified that, prior to 2009, Sobeys had a program in place for 2 years in an effort to deter the use of plastic bags. As part of this program, customers were given a discount of 5 cents for each plastic bag that they brought to the store and used for groceries. This discounting policy had little effect on the consumption of plastic bags. In contrast, the introduction of a 5 cent surcharge on plastic bags in Toronto in October 2009 reduced plastic

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421 Jewer Statement, *supra*, para. 58.

422 Daigle Statement, *supra*, para. 40. See also, Jewer Statement, *supra*, para. 55.

423 See Broughton Statement, *supra*, para. 26.

bag consumption at Sobeys by more than 60%.[424] Mr. Jewer's evidence was consistent with the evidence of Mr. Daigle of Shoppers Drug Mart in this regard.

519. Similarly, Charles Symons of IKEA Canada testified that, in IKEA's experience, a discount is not as effective as a surcharge in encouraging customers to change behaviour. In particular, he indicated that "[a] surcharge is viewed by consumers as a real and tangible cost, whereas a discount is dismissed by many customers and viewed by other customers simply as an opportunity cost".[425]

520. As an example of this principle in application, the evidence demonstrated that in the United Kingdom, where Visa and MasterCard allow merchants to surcharge, IKEA for many years maintained a policy of surcharging 70 pence for customers that used credit cards, which was the equivalent of a surcharge of about 1% of the average transaction value.[426] The surcharge caused about 37% of IKEA's transactions to move from credit cards to debit cards. In contrast, in the United States, where surcharging on credit cards is prohibited, IKEA instead offered a 3% rebate on future purchases for customers that used a debit card, rather than a credit card. The rebate resulted in only 9% of credit card holders to switching to debit. This was despite the fact that the 3% rebate was three-times higher than the 1% surcharge applied by IKEA in the UK.[427]

521. The experiences of Sobeys and IKEA described above are consistent with the economic literature, which demonstrates that customers react more strongly to surcharges because they are perceived as an "out of pocket" expense, as compared with foregoing a discount, which is perceived as an "opportunity cost". For example, as Richard Thaler stated in an early article on this topic published in the *Journal of Economic Behavior and Organization* (1980):

> Credit cards provide a particularly clear example. Until recently, credit card companies banned their affiliated stores from charging

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424 See Jewer Statement, *supra*, paras 59-60. See also Transcript of May 24, 2012 (Volume 10), pp.1734 (line 25) to 1735 (line 11).

425 Symons Statement, *supra*, para. 69.

426 *Ibid*, paras. 55-58. See also Exhibit "D" to Symons Statement, *supra*, p. 77.

427 Carleton Report, *supra*, para. 73. See also Transcript of May 22, 2012 (Volume 8), p. 1604 (lines 9-20).

> higher prices to credit card users. A bill to outlaw such agreements was presented to Congress. When it appeared likely that some kind of bill would pass, the credit card lobby turned its attention to form rather than substance. Specifically, it preferred that any difference between cash and credit card customers take the form of a cash discount rather than a credit card surcharge. This preference makes sense if consumers would view the cash discount as an opportunity cost of using the credit card but the surcharge as an out-of-pocket cost.[428]

(c) Effectiveness of Surcharging

522. As described above, the evidence clearly demonstrates that threats of surcharges by merchants will be more effective than discounts in causing Visa and MasterCard to reduce or not increase Card Acceptance Fees. In fact, the Respondents have not pointed to a single example, from anywhere in the world, where the threat of discounts or the granting of discounts has caused Visa or MasterCard to reduce either Interchange Fees, Network Fees or Card Acceptance Fees. [redacted]

523. [redacted]

[redacted]

428 Richard Thaler, "Toward a Positive Theory of Consumer Choice" (1980) Journal of Economic Behaviour and Organization 1, p. 45; Commissioner's Closing Brief of Authorities, **Tab 27**.

429 [redacted]

430 [redacted]

[redacted]

524. [redacted]

525. Some of the merchant witnesses in this proceeding testified that the very existence of the right to surcharge, as opposed to actual surcharging, would impose a downward pressure on their Card Acceptance Fees. For instance, in cross-examination Mr. Daigle of Shoppers testified that "… it is not our objective to surcharge. Our objective is to have that ability to negotiate a better deal with Visa and MasterCard so we could lower the price across the board and not have to charge anyone surcharges."[434] Similarly, Mr. Houle of Air Canada testified that:

> "[Surcharging] is a means by which we can then control and reduce card acceptance fees generally. I would hope that the tools provided, if surcharging would be available, would be a means by which Visa and MasterCard would sit down with Air Canada and

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431 [redacted]

432 [redacted]

433 [redacted]

434 See Transcript of May 10, 2012 (Volume 3), p. 436 (lines 17-21).

> negotiate reduction in fees without the requirement of Air Canada to put in surcharges".[435]

526. In addition, Mr. Jewer of Sobeys testified as follows:

> MR. KWINTER: And so despite having agreed that you would not surcharge and having agreed that you would accept all Visa cards, you now want this Tribunal to relieve you of those obligations; is that fair?
>
> MR. JEWER: What I would suggest that we believe is necessary is for those obligations to be removed from the merchant rules so that merchants are in a better position to negotiate with the credit card companies, to ensure we get card acceptance fees that do not increase significantly, and hopefully can be lower, so we can pass that benefit on to our customers.
>
> MR. KWINTER: So as I said, you want to be relieved from those obligations in your merchant agreement, fair enough?
>
> MR. JEWER: We believe that we should not have to have surcharge – we should have the ability to surcharge and that we should not be required to honour all cards.[436] [emphasis added]

527. In this regard, it is noteworthy that in its submission to the RBA in August 2007, MasterCard stated that "[t]he threat of discouragement has value to the merchant (in restraining merchant fees) as long as it is credible – even if it is not exercised".[437]

528. In contrast to the overwhelming evidence summarized above, Professor Mulveyconcluded based on a survey performed by Benoit Gauthier, that "discounts are more effective than surcharges overall".[438] Professor Mulveyconducted no independent empirical analysis to substantiate this counter-intuitive opinion. However, as discussed in more detail below, there are serious issues with respect to reliability of the data collected by Mr. Gauthier, with the result that Dr. Mulvey's conclusions based on that data, should be given no weight by the Tribunal.

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435 *Ibid*., p. 535, (lines 18-24).

436 Transcript, May 24, 2012 (Volume 10), p.1744 (line 23) to p.1745 (line 17).

437 [redacted]

438 Mulvey Report, *supra*, para. 40.

(d) Survey Evidence Flawed

529. In carrying out his survey, Mr. Gauthier clearly failed to follow the best practices outlined in his paper titled "Assessing Survey Research: A Principled Approach"[439] and by the American Association for Public Opinion Research,[440] of which he is a member. For example, notwithstanding that he had not previously designed a survey questionnaire relating to consumer reactions to the surcharging of credit cards and that he knew very little about how consumers would react to certain methods to disrupt the status quo,[441] he made no effort to determine, among other things: (a) how potential respondents think or talk about credit card surcharging, discounting, selective card decline and-or ask-and-inform strategies; (b) the extent to which the wording of hypothetical questions might convey unexpected meanings or ambiguities to potential respondents; and (c) whether the order in which the hypothetical questions and answers were presented in his survey were likely to influence the answers given by potential respondents or otherwise bias them.[442] Ignoring these best practices undermines the credibility and reliability of the data gathered by Mr. Gauthier with the result that it should be disregarded in its entirety by the Tribunal, or given little weight.

530. Michael Kemp was qualified by the Tribunal as an expert witness to give opinion evidence on survey evidence, including survey methods and the principles governing the design and management of survey research.[443] Following a careful review of Mr. Gauthier's survey methods, Mr. Kemp concluded that "[i]n total, the likelihood of distorting response biases in the Gauthier Survey is so high that I believe that the Tribunal would be fully justified in regarding the data derived from the Gauthier Survey as unreliable".[444] Key findings informing this conclusion are neatly summarized in Mr. Kemp's Summary of Expert Report:

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439 Exhibit A-505.

440 Exhibit A-507.

441 See Transcript of June 6, 2012 (Volume 19), p. 3088 (lines 15-19) and 3089, (line 7) to 3090 (line 15).

442 *Ibid.*, p. 3125 (line 11) to 3127(line 22) and 3133 (line 16) to 3135 (line 11).

443 Transcript of May 24, 2012 (Volume 10), p. 1774 (lines 8-20).

444 Expert Reply Report of Michael A. Kemp, Exhibit A-110, para. 10.1.

- "The Gauthier questionnaire design was deficient in its failure to acknowledge or attempt to reduce the very high likelihood of hypothetical bias in response to the direct hypothetical questions that were used.

- The Gauthier questionnaire was deficient in using overly cursory hypothetical scenarios that do not well represent conditions appropriate to forecasting the long-run, sustained consumer behaviors in response to merchants surcharging or selective declining to accept certain credit cards.

- The Gauthier questionnaire was deficient in ignoring the strong likelihood of ordering effects associated with the order in which the scenarios were uniformly presented to respondents.

- The Gauthier questionnaire design could have been improved substantially by employing standard market research practices, most specifically by using qualitative survey techniques in the development of the questionnaire.

- In sum, the likelihood of distorting response biases in the Gauthier Survey is so high that I believe the hypothetical scenario data on which Professor Mulveyrelies in his report should be regarded as unreliable".[445]

531. Given the flawed design of the Gauthier survey, the results derived from the survey are at best questionable and unreliable. Moreover, it is hardly surprising to find that a consumer would prefer to pay a lower price than a higher price. The only choices presented to survey respondents were (a) pay the posted price for the product, or receive a discount when using a lower cost payment method, such as cash or debit; versus (b) pay the posted price, plus an additional amount if using a credit card. The fundamental assumption underlying these questions is that the posted price is the same in either case. What Mr. Gauthier failed to advise respondents, however, is that in order to profitably offer discounts to all customers using payment methods other than credit cards, merchants would have to increase their posted price.[446] Put differently, the relevance of the Gauthier survey was undermined by each of the witnesses who testified.

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[445] Summary of Expert Report of Michael A. Kemp, Exhibit A-112, p. 3.

[446] Transcript of June 6, 2012 (Volume 19), pp. 3164 (line 21) to 3165 (line 24).

532. The reaction of survey respondents might have been quite different if the choice presented was (a) pay a price that has been increased by 2%, or receive a 2% discount from that elevated price for paying with cash or debit, versus (b) pay a lower price with an additional 2% fee if electing to pay with a credit card. For example, imagine the reaction of survey respondents if the question posed was: "Do you mind paying a higher price to help cover the cost of your boss' free flight to Bermuda?"[447]

533. An additional consideration with respect to the reliability of the Gauthier Survey is the fact that his evidence has been rejected or found to be unreliable in previous cases.[448] Mr. Gauthier conceded in cross-examination that in one of those cases, a 2003 hearing before the Copyright Board, a majority of the Board found that Mr. Gauthier's "estimates of individual purchases of different types of blank media appear to be consistently overestimated by at least 64 percent to 600 percent".[449] Specifically, Mr. Gauthier was found to have "estimated that individuals purchased nearly 22-million CD-RWs during a period when all other indications, including the retailers' numbers, put the total market at only about 4- to 7-million units".[450]

534. Like the survey results presented by Mr. Gauthier to the Copyright Board, Mr. Gauthier's survey results in this case are inconsistent with the "real world" results of surcharging in other jurisdictions. By way of example, Mr. Gauthier's survey found that between 34% and 46% of customers would walk out of a store when faced with a surcharge.[451] Those results are not consistent with the way in which consumers have responded to surcharging in jurisdictions where surcharging is permitted. In this regard, Mr. Kemp states as follows, in paragraph 9.8 of his expert report:

> "I note that neither Professor Mulvey nor Mr. Gauthier offer any explanation as to why the results of the Gauthier Survey deviate so significantly from the actual experience in jurisdictions where

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447 *Ibid*., pp. 3167 (line 22) to 3172 (line 12).

448 *Ibid*., pp. 3240 (line 13) to 3241 (line 12).

449 *Ibid*, p. 3224 (lines 5 9).

450 *Ibid.*, p. 3224 (lines 10 16).

451 Expert Report of Benoit Gauthier, Exhibit CRV 498, p. 21. See also Mulvey Report, *supra*, p. 14.

> surcharging is permitted. As noted above, a recent study by the Reserve Bank of Australia reported that almost 30% of merchants in Australia apply surcharges to some or all purchases made using credit cards. It defies logic that these merchants would apply surcharges if, as the Gauthier Survey indicates, between 34% and 46% of customers were "walking out" of stores when faced with a surcharge. The Reserve Bank of Australia found that despite the fact that a growing number of merchants in Australia surcharge, "consumers appear to have become more sensitive to surcharges, or better at avoiding them; the proportion of credit card transactions where a surcharge was actually paid by the consumer was virtually unchanged between 2007 and 2010, at around 5 per cent."

535. Mr. Gauthier's conclusion regarding the impact of surcharging is also inconsistent with MasterCard's [redacted]

536. Given the significant issues described above in respect of the Gauthier survey data, the reports of both Mr. Gauthier and Mr. Mulvey should be given little or no weight by the Tribunal.

International Experience

(a) Overview

537. As previously noted, Visa and MasterCard contend that the Commissioner's Application is anomalous and somehow inconsistent with competition policy.[453] In fact, the present case is not at all novel, but is entirely consistent with the actions taken by competition and regulatory authorities in numerous other jurisdictions. In a number of jurisdictions, the authorities have recognized the anticompetitive effects of the Merchant Restraints and have taken regulatory or enforcement action to reduce or eliminate the Merchant Restraints. Indeed, given the number of jurisdictions where enforcement of the No Surcharge Rules has been prohibited, or in which

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452 [redacted]

453 See Transcript of May 8, 2012 (Volume 1), pp. 186 (line 24) to 187 (line 5); Transcript of May 8, 2012 (Volume 1), pp. 122 (line 22) to 123 (line 1); Transcript of May 8, 2012 (Volume 1), p. 173 (lines 10-18).

MasterCard has explicitly permitted surcharges, allowing Visa and MasterCard to maintain the Merchant Restraints in Canada would itself be anomalous.

538. [redacted] Moreover, in 2004, MasterCard formally abandoned its no surcharge rule in the European Economic Area. Merchants are permitted to surcharge the acceptance of MasterCard Credit Cards provided that the surcharges are clearly disclosed to consumers and bear a reasonable relationship to the costs of acceptance.

539. Much of the Respondents' evidence relating to foreign jurisdictions is focused on Australia and, in particular, on the issue of whether merchants have engaged in "excessive" surcharging on credit cards. However, in each of the jurisdictions where the No Surcharge Rule has been removed or modified, including Australia, substantial benefits have arisen from the elimination of the no surcharge rule. Perhaps for this reason, there has been no suggestion that the relevant authorities in any of those jurisdictions have any intention of permitting Visa and MasterCard to reinstate a blanket prohibition on surcharging, such as the No Surcharge Rules implemented by the Respondents in Canada.

540. As stated above, many of the foreign jurisdictions where surcharging is permitted, such as New Zealand and the European Community, the No Surcharge Rules have been modified to permit merchants to surcharge on Visa and MasterCard credit cards, provided that the surcharge is reasonably related to the cost of acceptance and is properly disclosed to customers. As explained below, the Respondents have failed to provide evidence of excessive surcharging by even one merchant in <u>any</u> jurisdiction where such a limitation has been applied. As stated by MasterCard's expert, Peter Dunn, during his cross-examination:

> "MR. THOMSON: Right. I am talking about the other countries in the world that have regimes in which surcharging is permitted as long as it is clearly disclosed at the point of sale and bears a reasonable relationship to the cost of acceptance. That is New

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454 [redacted]

> Zealand and a whole bunch of countries in Europe that MasterCard agreed to that regime in 2003. My question for you is this: You have not identified in your report even one example of excessive surcharging by even one merchant in any such jurisdiction?
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> MR. DUNN: I am not aware that I have, and I am not aware that I haven't".[455]

541. The submissions of the Commissioner below focus upon the evidence relating to the removal or modification of the No Surcharge Rule and Honour All Cards Rule in five jurisdictions that were the subject of testimony during the course of the hearing: Australia, New Zealand, the United States, the United Kingdom and the European Community. Each of these jurisdictions is discussed below.

(b) Australia

542. In 2003, the RBA implemented reforms to the credit card and debit card networks operating in Australia. By way of background, the RBA is Australia's Central Bank. Part of the legislative mandate of the RBA is to implement monetary and banking policy that is directed to the greatest advantage of the people of Australia. The RBA is required to exercise its functions in a manner that will best contribute to the economic prosperity and welfare of the people of Australia.[456]

i. Background to the 2003 Reforms

543. The 2003 reforms followed an extensive review of the credit card networks in Australia that commenced in the late 1990s. This review included investigations by the RBA and the Australian Competition and Consumer Commission ("ACCC"). For example, in March 2000, an investigation by the ACCC concluded that the collective setting of Interchange Fees by the credit card networks was in breach of the price-fixing provisions of the *Australian Trade Practices Act 1974*.[457]

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455 Transcript of June 7, 2012 (Volume 20) p. 3467 (lines 12-17).

456 Transcript of May 28, 2012 (Volume 12), pp. 2119 (line 24) to 2120 (line 3).

457 See Exhibit "I" to Buse Statement, *supra*, p. 159.

544. The ACCC advised the credit card networks that they should seek an approval of their Interchange Fee arrangements or cease collectively setting such fees. Following extended discussions, the ACCC concluded that the authorization process was "unlikely to meet its concerns about competition and efficiency". As a consequence, in March 2001, the ACCC requested that the RBA consider addressing the issues of Interchange Fees.[458]

545. Following further consultations, the RBA formed the view that it would be in the public interest to bring the credit card networks under the RBA's regulatory oversight. As a result, in April 2001, the Visa and MasterCard networks were designated as "schemes" so subject to RBA regulation. The RBA then commenced a process of consultation on potential regulations to be applied to Visa and MasterCard.[459]

546. During the consultation process, the RBA identified "a number of restrictions on merchants that were detrimental to efficiency and competition in the payments system", such as the No Surcharge and Honour All Cards Rules. Overall, the RBA found that (as alleged by the Commissioner in this case) the "normal forces of competition have not acted effectively on interchange fees" and that the "merchant's ability to exert competitive pressure on interchange fees has been further diluted by scheme rules".[460]

547. Ultimately, the RBA concluded that removing the No Surcharge Rules of Visa and MasterCard would promote competition and efficiency in the Australian payment system. The RBA found as follows:

> "The Board concluded that the no-surcharge rule masked the price signals to cardholders about relative costs of different payment methods and limited the ability of merchants to put downward pressure on interchange fees by threatening to charge the customer for using a credit card. It also contributed to the subsidization of credit card users by all other customers, as merchants charged a uniform price to all consumers regardless of

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458 *Ibid.*, pp. 159-160.

459 *Ibid.*, p. 160.

460 *Ibid.*, p. 172.

> the payment method used, with this uniform price needing to cover the relatively high costs of credit card acceptance."[461]

548. As Visa and MasterCard were unwilling to voluntarily remove their No Surcharge Rules, the RBA imposed regulations requiring the removal of these rules effective January 1, 2003. Although not subject to the regulation (because they operate "three party" payment systems and do not have interchange fees), American Express and Diners Club voluntarily agreed to remove their equivalent rules.[462] The RBA stated that the removal of the No Surcharge Rules would "introduce normal market disciplines into negotiations between merchants and acquirers" for use of a credit card, and that "the price signals facing consumers choosing between different payment instruments would lead to a more efficient allocation of resources in the payments system".[463]

549. In addition, the RBA applied a cost-based benchmark to cap the level of Interchange Fees for Visa and MasterCard. Specifically, the RBA required that Interchange Fees for Visa and MasterCard credit card transactions "be set subject to an objective, transparent and cost-based benchmark" that would be regularly reviewed by the RBA.[464] Initially, the weighted-average Interchange Fee cap was set at 0.55%, a significant reduction from the then-prevailing level of 0.95.[465] Following a further review, the Interchange Fee cap was reduced further to 0.50%.[466]

ii. Impact of the Reforms

550. The reduction in Visa and MasterCard's Interchange Fees due to the RBA's cap translated into even more significant reductions in Card Acceptance Fees for merchants. As noted above, the RBA regulation ultimately reduced weighted-average Interchange Fees by 45 basis points, from 0.95% to 0.50%. However, this resulted in a 58 basis point reduction in

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461 *Ibid.*, p. 161.

462 *Ibid.*

463 See Exhibit "B" to Buse Statement, *supra*, p. 24.

464 *Ibid.*

465 Transcript of May 28, 2012 (Volume 12), p. 2144, (lines 13-20).

466 *Ibid.*, p. 2144 (lines 21-24).

average Card Acceptance Fees for merchants, demonstrating that reductions in Interchange Fees do, in fact, result in reductions in Card Acceptance Fees for merchants.[467].

551. Although not subject to the RBA Interchange Fee cap, American Express steadily reduced its Card Acceptance Fees by [redacted] (65 basis points) [redacted] [redacted] [redacted][468] Moreover, Card Acceptance Fees for American Express transactions continue to decline, notwithstanding the fact that Card Acceptance Fees for Visa and MasterCard have remained essentially unchanged for the past four years. The reduction in American Express' Card Acceptance Fees appears to be the direct result of actual or threatened surcharging on American Express credit cards by merchants. As stated by Dr. Carlton during his cross-examination:

> "MR. KENT: So I am putting it to you that when the RBA regulated downward the MasterCard and Visa interchange rates, that the net effect of the discussion we have just had is it meant that Amex, in order to still compete as effectively on the issuer side, didn't need, to put it crudely, to spend as much on the issuer side as it used to have to do, and, therefore, could reduce some expenditure on that side, and, as a consequence reduce the merchant fee on the other side in reaction to that?
>
> DR. CARLTON: Why did they have to reduce the merchant fee?
>
> MR. KENT: It doesn't have to reduce the merchant fee.
>
> DR. CARLTON: It wants to make as much money as possible. That is my point. It is in competition with Visa and MasterCard. It was forced on the merchant side to lower its fee.
>
> MR. KENT: It is in competition on both sides?
>
> DR. CARLTON: I agree, but if it didn't have to give as many benefits to its cardholders because Visa and MasterCard can't give as many benefits, that has nothing -- why does that affect the merchant fee?
>
> If it can get away with keeping its merchant fee at a high level, if it wasn't worried that the surcharging was going to impede its

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467 *Ibid.*, p. 2148 (lines 13-22).

468 *Ibid.*, p. 2149 (lines 16-22).

> ability to sign up merchants, it would have kept the merchant fee at 2.5 percent. It is precisely because it was worried about competition, about the competitive response of merchants, by the ability to surcharge that explains, from an economic point of view, the competitive pressures that American Express had to lower its merchant fees. That is exactly my point."[469]

552. [redacted]

553. As expected, merchants were initially reluctant to surcharge on credit cards in Australia. However, over time, the number of merchants engaging in surcharging on credit cards has grown steadily. The chart below shows the proportion of merchants that surcharge on at least one brand of credit cards (e.g., American Express).

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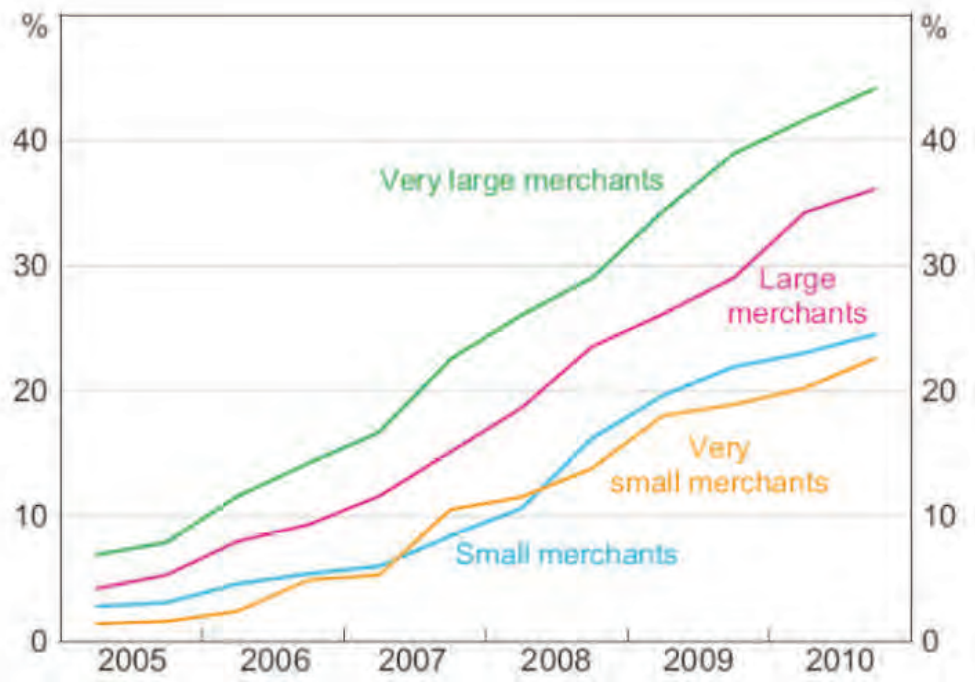
469 Transcript of May 17, 2012 (Volume 7), pp. 1366 (line 2) to 1367 (line 11).

470 [redacted]

471 [redacted]

472 [redacted]



Source: Reserve Bank of Australia, Review of Card Surcharging: A Consultation Document, June 2011, (GSSS6134_00000965 at 0968)..

554. In a 2010 study, the RBA found that approximately 30% of merchants surcharge at least one brand of credit card. This may be compared with 2007, when approximately 8% of merchants surcharged on one type of credit card. However, the proportion of transactions that actually resulted in a surcharge (approximately 5%) has remained the same between 2007 and 2010, despite the increased number of merchants who surcharge. This confirms the expected result that when merchants institute a surcharge on credit cards, customers respond by choosing a different payment method in order to avoid the surcharge.

555. As the RBA concluded in a June 2011 Report:

> "As noted above, there has been a clear shift towards consumers using debit cards in preference to credit cards between 2007 and 2010. A number of factors may have contributed to this slowdown in the use of credit cards. First is the increased prevalence of surcharging on credit card transactions since the first study was undertaken. In December 2010, almost 30 percent of merchants surcharged at least one of the credit cards they accepted, compared with just over 8 percent in June 2007. However, consumers appear to have become more sensitive to surcharges, or better at avoiding them; the proportion of credit card transactions where a surcharge

> was actually paid by the consumer was virtually unchanged between 2007 and 2010, at around 5 per cent. …"[473]

556. The Respondents have argued that the experience in Australia should be viewed by the Tribunal as a "cautionary tale" or, as counsel for Visa stated during opening argument:

> "We say Australia cannot reasonably be held out as a victory for competition policy to be emulated in Canada or anywhere else. To the contrary, it is a striking example of regulatorily-induced [sic] market failure. Output has been reduced, merchants have profited and consumers have been unambiguously harmed."[474]

557. Witnesses appearing on behalf of the Respondents and Intervenors have suggested that the RBA views the 2003 reforms as a "mixed success". For example, TD Bank's expert, Balaji Jairam, testified that: "[a]ccording to the Reserve Bank of Australia ("RBA"), the removal of the [No Surcharge] rule has produced mixed results…".[475]

558. Visa's submissions have the ring of considerable overstatement. In reality, the RBA has consistently recognized the significant benefits resulting from the removal of the No Surcharge Rules. For example, in a 2008 report appended to the witness statement of Elizabeth Buse from Visa, the RBA stated as follows:

> "In the Board's judgement, the reforms have met a key objective of improving the price signals that consumers face when choosing between use of credit and debit cards. In particular, the relative prices that consumers face for credit and debit transactions more closely reflect relative costs than was the case prior to the reforms. While the Board recognises that efficiency does not necessarily require an exact alignment of costs and prices in the various systems, its assessment is that the relative prices that consumers now face are a substantial improvement compared to those that existed prior to the reforms."[476]

559. In terms of the overall gains in welfare in Australia, the RBA concluded as follows:

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473 Exhibit A-374, p. 18.

474 Transcript of May 8, 2012 (Volume 1), p. 161, (lines 11-17).

475 Expert Report of Balaji Jairam, Exhibit CIT-516]["**Jairam Report**"], para. 101.

476 See Exhibit "I" to Buse Statement, *supra*, p. 176.

560. The Board's overall assessment is that the welfare gains from the reforms are likely to have been substantial. Not only has the change in payment patterns *relative to what would* have *occurred in the absence of the reforms* resulted in lower costs, but there has also likely been an increase in welfare from consumers using a payment instrument from which they derive higher benefits. An estimate of the welfare gains of some hundreds of millions of dollars per annum would not be inconsistent with available data.[477] [italics in original]

561. The Respondents also argue that the Australian experience demonstrates that even if Card Acceptance Fees are reduced, merchants will not lower retail prices, thereby creating a new "profit centre" for merchants. As support for this proposition, Elizabeth Buse quotes, misleadingly, from a portion of a 2007-2008 report by the RBA in paragraph 24 of her Witness Statement: "RBA noted in the preliminary conclusions of a 2007-2008 review of the Australian payments system that it had received "[n]o concrete evidence…regarding the pass-through of [merchant] savings [to consumers]". In fact, the RBA concluded in the 2007-2008 Report as follows:

> "No concrete evidence has been presented to the Board regarding the pass-through of these savings, although this is not surprising as the effect is difficult to isolate. The Bank had previously estimated that the cost savings would likely lead to the CPI being around 0.1 to 0.2 percentage points lower than would otherwise be the case over the longer term (all else constant). It is very difficult to detect this against a background where other costs are changing by much larger amounts and the CIP is increasing by around 2½ per cent per year on average.
>
> Despite these difficulties of measurement, the Board's judgement remains that the bulk of these savings have been, or will eventually be, passed through into savings to consumers. This judgement is consistent with standard economic analysis which suggests that, ultimately, changes in business costs are reflected in the prices that businesses charge. …"[478]

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477 *Ibid*., p. 177.

478 *Ibid.*, p. 180.

562. The RBA's view of the standard economic principle that merchants will, in fact, pass through cost savings to consumers was also confirmed by Dr. Church. During cross-examination, Dr. Church testified as follows:

> "MR. FANAKI: And would you agree that as a general proposition merchants that operate in a competitive market will pass along to customers their savings in costs?
>
> DR. CHURCH: It may take a considerable amount of time, but we expect that as costs fall -- costs fall down, and there is increasing competition, that the costs will eventually work their way through to customers."[479]

563. A number of merchants testified that as costs were reduced, they would pass along those savings to consumers. For example, Mario de Armas of Walmart testified as follows:

> "MR. FANAKI: My last question for you, Mr. De Armas, in the event that Wal-Mart receives savings through a reduction in card acceptance fees, would Wal-Mart pass along those savings to its customers?
>
> MR. DE ARMAS: Yeah, we absolutely would. Our model, as I said earlier, is based on everyday low prices, and so our business model is based on passing savings that we're able to generate on to consumers, and, as a lot of our senior leadership team has said, any reforms we see from swipe fee reforms would be passed on to consumers in the form of lower prices".[480]

564. In any event, to demonstrate that the Merchant Restraints distort competition and influence Card Acceptance Fees upwards, it is not necessary for the Commissioner to prove that merchants will immediately pass along the savings resulting from lower Card Acceptance Fees in the form of lower retail prices.

565. The Respondents have also argued that the experience with respect to surcharging in Australia does not support the Commissioner's submission that the ability to surcharge or threaten to surcharge has constrained Card Acceptance Fees. For example, counsel for Visa stated during opening argument as follows:

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479 Transcript of June 5, 2012 (Volume 18), p. 2997 (lines 8-16).

480 Transcript of May 9, 2012 (Volume 2), p. 248 (lines 4-16).

> "To the contrary, it suggests that surcharging has nothing whatsoever to do with reducing interchange, because in Australia interchange has been dramatically reduced, and yet merchants still surcharge".[481]

566. This too is considerable overstatement. As described above in the section addressing how the Merchant Restraints influence prices upwards, the evidence before the Tribunal demonstrates clearly how surcharges, or the threat of surcharges, have been effective in constraining the level of Card Acceptance Fees in Australia. [redacted] In addition, the Tribunal heard testimony from Douglas Swansson, a representative of an Australian merchant named Coles, who testified that surcharging and the threat of surcharging have been effective in securing reductions in Card Acceptance Fees.

567. By contrast, the Respondents purport to rely upon the evidence of Ms Buse, even though she was, at best, an unsatisfactory witness. Wholly apart from the fact that Ms Buse has responsibilities in more than 140 countries and little direct experience in Australia, it became apparent in cross-examination that Ms Buse had not reviewed Visa's own internal documents concerning its experience in Australia. Moreover, she had not even reviewed the very documents of the RBA in Australia that were appended to her Witness Statement.

iii. Recent Reforms to Standard on Surcharging

568. Most recently, the RBA has determined that it will modify the standard relating to surcharging by merchants to allow Visa and MasterCard to limit surcharges to an amount reasonably related to the cost of acceptance. Contrary to the suggestions of the Respondents, this is not an admission by the RBA that the 2003 reforms have been unsuccessful. In fact, in a 2011 document published by the RBA discussing the potential reforms on surcharging, the RBA described the following benefits accrued to date from the 2003 reforms:

> "The removal of the no-surcharge rules was expected to have a number of benefits for the efficiency of the payments system. **First**, it was expected to improve price signals to cardholders

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[481] Transcript of May 8, 2012 (Volume 1), p. 160 (lines 14-18).

> about the relative costs of different payment methods. This was clearly stated in the Gazette notice that accompanied the first of the Standards:
>
> … the price signals facing consumers choosing between different payment instruments would lead to a more efficient allocation of resources in the payments system, in the public interest.
>
> **Second**, the ability to surcharge provides a negotiating tool for merchants who might use the threat of surcharging to negotiate lower fees. **Third**, with the ability to surcharge, merchants no longer need to build the costs of accepting card payments into the overall prices of their goods and services; hence, customers who choose alternative payment methods are no longer subsidising credit card users. **The Payments System Board is satisfied that surcharging has been successful in achieving these benefits and by reviewing the Standards it is seeking to ensure that this continues to be the case**."[482] [emphasis added]

569. The recent reforms in Australia were undertaken in response to concerns expressed with respect to "excessive surcharging"; specifically, merchants that surcharge amounts in excess of their cost of acceptance. Concerns of excessive surcharging have largely focused on a 2010 study conducted by East & Partners on behalf of the RBA, which purported to show that merchants that surcharge applied a surcharge on Visa and MasterCard of credit card transactions between 1.8% and 1.9%, as compared with the average merchant services fees for Visa and MasterCard of approximately 0.9%.[483]

570. However, the comparison conducted by East & Partners was not a true "apples to apples" comparison. For an accurate comparison, East & Partners should have compared the average level of surcharges with the average level of Card Acceptance Fees <u>for those merchants that are surcharging</u>, as opposed to the average Card Acceptance Fees <u>for all merchants</u>. It may well be the case that merchants who choose to surcharge face significantly higher Card Acceptance Fees than the average Card Acceptance Fees paid by all merchants.

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482 See Exhibit "H" to Buse Statement, *supra*, p. 133.

483 Reserve Bank of Australia, "Review of Card Surcharging: A Consultation Document" (June 2011), Exhibit RM-069, p. 5.

571. [redacted].[484]

572. [redacted].[485]

573. The most commonly cited example of "excessive surcharging" in Australia is the 10% "surcharge" for credit cards that are used in Australian taxis. However, as the evidence before the Tribunal showed, this surcharge has not been imposed by taxi drivers. Instead, surcharges are imposed by a payment enabler called "Cabcharge". The evidence demonstrates that surcharging by Cabcharge was most assuredly not the result of the 2003 reforms implemented by the RBA. In fact, the surcharges of Cabcharge predate the2003 reforms in Australia. As stated in a document attached to the Witness Statement of Elizabeth Buse of Visa:

> **"Long before the 2003 reforms, Cabcharge, the company that dominates the industry with payments systems in around 95% of taxis nationwide, charged 10%.** The fee applied even before the advent of credit and bank cards and goes back to the time when paper-based payment methods, such as the 'blue dockets' similar to those you still see today, were the only option other than cash. Today, the 10% fee applies whether passengers use the company's own branded paper dockets and plastic cards, or credit cards and debit cards (including EFTPOS)."[486]

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484 [redacted]

485 [redacted]

486 See Buse Statement, *supra*, p. 72.

574. In any event, as noted above, there is no suggestion that the RBA has an intention of permitting either Visa or MasterCard to reinstate their No Surcharge Rules in Australia. Rather, the RBA has elected to permit Visa and MasterCard to apply a rule that limits surcharges to an amount that is reasonably related to the cost of acceptance, similar to the rules applicable in New Zealand and Europe.

575. Following the conclusion of the hearing in the present matter, the RBA issued a final decision on the variation to the surcharging standard. The RBA reaffirmed its assessment that the removal of the No Surcharge Rule has "contributed to the efficiency of the payments system; surcharging has improved price signals to cardholders about the relative costs of different payment methods and the ability to surcharge has been used as a negotiating tool by some merchants to put downward pressure on their costs of accepting credit cards"[487]. However, the RBA concluded that the following modification to the surcharging standard was appropriate:

> " … card scheme rules could limit surcharges to the reasonable cost of acceptance of the cards of that scheme. While the modified Standards would not define the reasonable cost of acceptance, they would specify that the merchant service fee would be included at a minimum. To provide some clarification, the Bank could publish a non-legally binding guidance note on the types of costs that the Bank considers might be included in the reasonable cost of acceptance."[488]

(c) New Zealand

576. The New Zealand Commerce Commission ("**Commerce Commission**") began an investigation into Interchange Fees and surcharging in 2003 and commenced litigation in November 2006. [redacted]

487 Reserve Bank of Australia "A Variation to the Surcharging Standards: Final Reforms and Regulation Impact Statement" (June 2003) ["**RBA Surcharge Variation**"], p.1, online: RBA <www rba.gov.au>.

488 *Ibid*., p.13.

[redacted]

577. [redacted]

[redacted]

578. In 2009, the Commerce Commission settled its litigation with Visa and MasterCard. [redacted]

489 [redacted]

490 [redacted]

[redacted]

579. However, the terms of the settlement also permitted Visa and MasterCard to implement and enforce rules that limit the amount of surcharges to those reasonably related to the costs of acceptance and that require surcharges to be clearly disclosed by the merchant. Section 4.4 of the settlement agreement between the Commerce Commission and Visa states as follows:

> "Nothing in clause 4.3 prevents Visa from providing in the Visa rules that if a merchant applies a surcharge for payment by any Visa card, the surcharge amount must be clearly disclosed to the cardholder at the time of purchase and must bear a reasonable relationship to the merchant's cost of accepting Visa products for payment. To avoid doubt, any such requirement imposed by Visa will not prevent merchants from applying such a surcharge on a flat rate basis, to some or all Visa branded payment cards".[492]

580. In these proceedings, the Respondents failed to adduce any evidence that surcharging in New Zealand is "excessive", that merchants in New Zealand have engaged in "bait and switch" behaviour or that the modification of the No Surcharge Rule in New Zealand has led to <u>any</u> adverse consequences for the Respondents or consumers.

581. [redacted]

[redacted]

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491 See Exhibit "N" to Buse Statement, *supra*, pp. 3-4.

492 "Visa Settlement Agreement", Exhibit A-239, p. 4.

493 Buse Statement, *supra*, p.16.

[redacted]

582. In addition, Ms Buse failed to disclose that there was a separate, parallel action by New Zealand merchants against Visa, MasterCard and their Issuers. She did not disclose the settlement of that proceeding, or the basis upon which this litigation was settled, such as whether the settlement included reductions in Interchange Fees for merchants. [redacted]

[redacted]

583. Finally, Ms Buse also did not disclose that at least one Issuer of credit cards has reduced Interchange Fees to below the maximum level of Interchange Fees set by Visa. During the hearing, evidence was provided that one New Zealand Issuer of Visa credit cards, TSB Bank, applied Interchange Fees that are 10% lower than the maximum Interchange Fees applied by other Issuers in New Zealand. For example, on a Visa Classic transaction, TSB Bank applied an Interchange Fee of 1.14%, as compared to the 1.25% maximum set by Visa. For Visa Platinum

494 [redacted]

495 [redacted]

transaction, TSB Bank applied an Interchange Fee of 1.69%, as compared to the maximum of 1.85% set by Visa.[496]

(d) United States

584. During his opening argument, counsel for Visa argued that the United States - "the most sophisticated anti-trust jurisdiction in the world and Canada's closest trading partner" - "soundly rejected" a proposal to remove the No Surcharge Rule.[497]

585. Once again, this is considerable overstatement. Contrary to the submissions of counsel for Visa, the evidence before the Tribunal demonstrated that the U.S. DOJ explicitly reserved its rights to initiate proceedings against Visa and MasterCard in respect of their respective No Surcharge Rules. The U.S. DOJ described its reservation of the right to challenge the No Surcharge Rule as follows:

> "The proposed Final Judgement contains a clause preserving the rights of the United States and providing that "[n]othing in this Final Judgment shall limit the right of the United Sates or of the Plaintiff States to investigate and bring actions to prevent or restrain violations of the antitrust laws concerning any Rules of MasterCard or Visa, including any current Rule and any Rule adopted in the future." Proposed Final Judgement §VIII. At this time, the United States takes no position on whether any Visa or MasterCard rule not challenged in the Complaint is in violation of the antitrust laws."[498]

586. In addition, the evidence also demonstrated that Visa and MasterCard are currently defendants in significant class action proceedings before the U.S. District Court for the Eastern District of New York seeking, among other things, to require Visa and MasterCard to remove

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496 See *In Re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation,* "Class Plaintiffs Reply Memorandum of Law in Further Support of Their Motion for Summary Judgment in Re: Payment Card Interchange Fee and Merchant Discount Antitrust Litigation", Exhibit A-487.

497 Transcript of May 8, 2012 (Volume 1), p. 164 (lines 10-13).

498 Sheedy Statement, *supra*, pp. 1810-1811.

their respective No Surcharge Rules.[499] The U.S. DOJ settlement was reached against the backdrop of those proceedings pending before the very same Court.

587. The first of these class action lawsuits was initiated on June 22, 2005, and alleged that the Visa and Mastercard fixed interchange fees at supra-competitive levels in violation of Section 1 of the U.S. *Sherman Act*. It is notable that, as disclosed in Visa's public filings, Visa has set aside a $2.7 billion provision for its portion of a settlement or judgment in that class action proceeding, and Visa considers that amount to be "consistent with the Company's estimate of its share of a lower end of a negotiated settlement for the entire matter".[500]

(e) United Kingdom

588. Surcharging on credit cards has been permitted in the United Kingdom since 1991. The Respondents have submitted evidence regarding complaints by certain a consumer group known as "Which?" regarding surcharging practices in the travel industry and improper disclosure of surcharges. In June 2011, the UK Office of Fair Trading ("**OFT**") responded to these complaints and reaffirmed support for permitting merchants to surcharge on credit cards, provided that it was adequately disclosed through up-front or "headline" prices:

> "The OFT accepts that where retailers charge different prices for different payment mechanisms , reflecting their underlying costs, this may benefit consumers by creating a signal to help them make efficient choices between payment mechanisms . However the OFT believes that headline prices need to be presented in a way that gives consumers a proper ability to shop around.[501]

589. The OFT made two recommendations. The first was a recommendation that the Government introduce "measures to prohibit retailers from imposing surcharges for payments made by debit card", given that debit was a low-cost form of payment. The second was a recommendation that retailers seek "to improve the transparency and overall presentation of

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499 *In Re Payment Card Interchange Fee and Merchant Discount Antitrust Litigation*, Defendants' Statement of Material Facts as to Which There is No Genuine Issue to be Tried (21 October 2011), U.S. District Court, Eastern District of New York, No. 1:05-md-1720-JG-JO, [AB-333], p.14.

500 "Visa Inc. 10-K", Exhibit A-419, p.130.

501 See Exhibit "E" to Sheedy Statement, *supra*, para. 1.15.

payment surcharges in the transport sectors, through action to ensure compliance with the Consumer Protection from Unfair Trading Regulations 2008".[502]

590. In December 2011, the UK Government responded to the OFT's recommendations and agreed to introduce legislation to prohibit "excessive surcharges", meaning surcharges that exceed the actual cost of processing credit cards.[503] Such a limitation is similar to the limitations applied in New Zealand and many parts of Europe, and the limitations adopted by the RBA in the most recent reforms in Australia.

591. However, as with all other jurisdictions discussed during the hearing, there is no suggestion that the UK Government will permit Visa or MasterCard to reinstate a blanket prohibition on surcharging, such as that enforced by the Respondents in Canada.

(f) European Community

592. The Merchant Restraints of Visa and MasterCard have also been the subject of extensive competition proceedings and investigations within the European Community.

593. By way of background, the European Commission is the body responsible for the enforcement and implementation of the treaty governing the European Community, including provisions relating to competition. In 2002, the European Commission commenced an investigation against MasterCard regarding various aspects of its credit card operations, including the setting of Interchange Fees, MasterCard's "No Discrimination Rule" (which included a No Surcharge component) and Honour All Cards Rule. The European Commission issued a Statement of Objections to MasterCard in 2003.

594. In 2004, MasterCard determined that it would voluntarily remove its No Surcharge Rule in Europe to allow merchants to apply surcharges on MasterCard credit card transactions. [redacted]

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502 *Ibid*., para 1.23

503 HM Treasury "Government to bring forward legislation to tackle excessive card surcharges" (23 December 2011), online: HM Treasury <http://hm-treasury.gov.uk/press_148_11 htm>.

[redacted]

595. [redacted]

[redacted]

504 [redacted]

505 [redacted]

596. Thereafter, the European Commission continued its investigation against MasterCard on the issue of the setting of Interchange Fees. In a decision dated December 19, 2007, the European Commission determined that through the setting of Interchange Fees, MasterCard "restricts competition between acquiring banks by inflating the base on which acquiring banks set charges to merchants and thereby setting a floor under the merchant fee."[506]

597. Although it was not a central issue in the decision, the European Commission also found that the Honour All Cards Rule "reinforced" the restrictive effects of the Interchange Fees set by MasterCard:

> "The "honour-all-products" functionality reinforces the restrictive effects of the MasterCard MIF on price competition between acquiring banks. MasterCard applies significantly higher interchange fees for some cards (commercial credit cards in particular) than for others (for example, consumer credit cards). By obliging merchants to accept *all* card products (including commercial credit cards) if they wish to accept MasterCard cards, the HACR [honour-all-cards rule] enables MasterCard's member banks to exert collective market power through the MIF by allowing issuing banks to introduce new card products in the market while at the same time pre-determining their price through the MIF for merchants who are bound to accept those cards. Merchants cannot prevent this by specifically refusing MasterCard branded cards altogether. The "honour all products functionality" of MasterCard's HACR therefore further decreases the countervailing buyer power of merchants in the presence of a MIF".[507]

598. The decision of the European Commission against MasterCard was recently affirmed by the General Court in a decision dated May 24, 2012.

599. In respect of Visa, the European Commission granted a limited exemption in 2002 which allowed Visa to apply a No Surcharge Rule and Honour All Cards Rule. In addition, as

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506 EC Decision, *supra*, para. 664; Commissioner's Closing Brief of Authorities, **Tab 9**.

507 *Ibid,* p. 144; Commissioner's Closing Brief of Authorities, **Tab 9**.

part of the resolution, Visa agreed to reduce its Interchange Fees to the level of 0.70%.[508] The exemption expired in December 2007.

600. Following the expiry of Visa's exemption in 2007, the European Commission commenced an investigation against Visa that was focused on Visa's No Surcharge Rule, Honour All Cards Rule and the setting of Interchange Fees by Visa. In April 2009, the Commission sent a Statement of Objections to Visa setting out its preliminary view that Visa's Interchange Fees harmed competition between merchants' banks, inflated merchants' costs for accepting payment cards and ultimately increased consumer prices. Moreover, the Commission was of the view that rules and practices such as the Honour All Cards Rule and No Surcharge Rule violated the competition rules of the EC Treaty.

601. Although the European Commission reached a resolution with Visa regarding aspects of its debit card operations, this settlement was explicitly without prejudice to the Commission's ongoing concerns with respect to the Honour All Cards and No Surcharge Rules as they relate to Visa's credit card operations. As the European Commission stated in a press release issued in respect of the debit settlement:

> "This decision does not cover a multilateral interchange fees for consumers credit and deferred debit card transactions which the Commission will continue to investigate. The proposed commitments are also without prejudice to the right of the Commission to initiate or maintain proceedings against Visa Europe's network rules such as the honour-all-cards rule."[509]

602. The European Commission investigation against Visa, including with respect to the Honour All Cards and No Surcharge Rules, is ongoing.

603. As with the other jurisdictions that allow surcharging by merchants, but restrict that surcharging to a level reasonably related to costs, the Respondents have failed to adduce any evidence that surcharging in Europe is "excessive", that merchants in Europe engaged in "bait

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508 Transcript of June 7, 2012 (Volume 20), p. 3395 (lines 17-20).

509 Transcript of June 7, 2012 (Volume 20), p. 3401 (lines 12-23).

and switch" behaviour or that the modification of the No Surcharge Rule in Europe has led to any adverse consequences for the Respondents or consumers.

Alleged Pro-competitive Justifications for Merchant Restraints

604. The Respondents have attempted to defend the Merchant Restraints on the basis of a number of purported defences or justifications. Apart from being irrelevant to the question of whether the Merchant Restraints contravene section 76 of the *Competition Act*, these so-called "defences" and purported "justifications" are merely self-serving assertions that are unsupported by the evidence and in many cases, are fundamentally at odds with market realities.

(a) Respondents' claims of merchant market power, "gouging" and price discrimination are without merit

605. The Respondents' main arguments involve the common theme that the Merchant Restraints are necessary to protect consumers from opportunistic or deceptive marketing practices by merchants. They contend that merchants who would surcharge must possess market power which, in the absence of the Merchant Restraints, would manifest itself in the form of "gouging", "profiteering", "excessive surcharging", and "price discrimination."

606. These arguments are not relevant to the question of whether the Merchant Restraints influence upwards Card Acceptance Fees and have an adverse effect on competition within the meaning of section 76 of the *Competition Act*. But even if they were (which is expressly denied), the Respondents have failed to adduce evidence that such conduct would be widespread among merchants in Canada, or be economically inefficient.

607. Indeed, the Respondents have failed to adduce evidence to suggest, let alone establish, that a substantial fraction of the merchant sector in Canada possesses significant market power. In fact, all eight of the retail merchant witnesses with operations in Canada testified that they operate in competitive or intensely competitive markets.[510]

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[510] See, *e.g.*, Houle Statement, *supra*, para. 7; Shirley Statement, *supra*, para. 8; Symons Statement, *supra*, para. 9; Daigle Statement, *supra*, para. 10; Jewer Statement, *supra*, para.16; de Armas Statement, *supra*, para. 11; Li Statement, *supra*, para. 6.

608. Similarly, the Respondents also failed to establish why providing merchants with the ability to surcharge on credit cards somehow bestows market power upon merchants. If a merchant does possess market power, it could exercise that market power directly over all of its customers by raising prices, rather than seeking to raise prices for certain customers through the imposition of a surcharge on credit cards.

609. It is also important to note that what the Respondents call "price gouging" or "discrimination" is actually nothing more than the normal competitive process by which merchants charge customers a higher price when those customers select a service (in this case a method of payment) that imposes higher costs on merchants. In this case, a merchant charging a customer a higher price when that customer elects to pay with a credit card that costs the merchant substantially more than when customers pay using an Interac debit card is not "profiteering" or "price gouging". Such surcharges are a normal part of the Canadian retail environment.

610. In fact, Canadian consumers pay such surcharges every day. For example:

- customers pay extra fees for home delivery or assembly of products;[511]
- travelers pay an extra fee for checking an extra bag or bring a pet on a flight;[512]
- customers at the grocery store pay a 5 cent fee if they want to use plastic bags, instead of their own bags.[513]

611. These additional fees are not a form of "hold up" or "gouging", but rather are a normal part of the Canadian retail environment. During cross-examination, Dr. Church acknowledged that these additional fees (provided they are properly disclosed) do not constitute a form of "hold up":

> "MR. FANAKI: . . . And you identify, in particular, a concern that you reference as a hold-up, a hold-up of cardholders. And I think I heard you mention that this morning, as well, and I want to clarify with you what constitutes a hold-up.

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511 Symons Statement, *supra*, para. 11.

512 Li Statement, *supra*, para. 32. See also Transcript, May 22, 2012 (Volume 8),t p. 1520 (line 16) to 1521 (line 8).

513 Jewer Statement, *supra*, paras. 59-60; See also Transcript, May 24, 2012 (Volume 10) at pp. 1734 (line 25) to 1735 (line 11) and Transcript, May 10, 2012 (Volume 3), pp. 468 (line 1) to 469 (line 20).

> And you look like you eat healthier than I do, Dr. Church. When you go to a restaurant and you substitute a salad for fries, and the waitress tells you it will be 50 cents more, is that a hold-up?
>
> DR. CHURCH: No.
>
> MR. FANAKI: When you ask for a gift to be wrapped by the store, and the store says it will cost an extra dollar, is that a hold-up?
>
> DR. CHURCH: No.
>
> MR. FANAKI: And if you ask for a product to be delivered to your home and that costs $5 more, that is not a hold-up either?
>
> DR. CHURCH: As long as they tell you that it is going to cost $5 more in advance.
>
> MR. FANAKI: So when the University of Saskatchewan applies a 1 percent fee for students that want to pay tuition online, and discloses that policy in advance, that is not a hold-up either?
>
> DR. CHURCH: That is not a hold-up".[514]

612. In addition to being part of the normal retail environment in Canada, surcharging is also part of the normal operations of Visa and MasterCard. In many countries around the world – Australia, Belgium, Czech Republic, Denmark, Estonia, Finland, Germany, Ireland, Malta, Netherlands, New Zealand, Poland, Portugal, Slovenia, Spain, Switzerland and the United Kingdom – merchants are permitted to surcharge on Visa and MasterCard credit card transactions.

613. Further, although not mentioned in any of their pleadings or expert reports, MasterCard and Visa also allow for a number of selected service providers to impose additional fees when accepting credit card transactions.

614. For example, the Tribunal heard testimony from Ms Marion Van Impe, Director of Student Accounts and Treasury at the University of Saskatchewan, about how MasterCard permits the University to apply a 1% surcharge for students (or more likely, their parents) that

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[514] Transcript of June 5, 2012 (Volume 18), pp. 2993 (line 17) to 2994 (Line 11).

elect to pay for tuition using a MasterCard credit card.[515] This form of surcharge is called an "administration fee". Substance governs, rather than form. For all intents and purposes, the administration fee imposed by the University is a surcharge.

615. As a result of the 1% surcharge and the University's decision to cease accepting Visa credit cards for tuition payments, because Visa would not allow the University to charge an additional fee, in the 2010-2011 academic year, the University of Saskatchewan realized approximately $600,000 in card acceptance cost savings, money that has been used to help build a new Student Health and Counseling Centre.[516]

616. Far from constituting a form of "price gouging", MasterCard's counsel described the surcharges being applied by the University of Saskatchewan as a "classic win-win-win" for all parties, including MasterCard:

[redacted]

515 Van Impe Statement, *supra*, paras. 30-32.

516 *Ibid.*, paras. 30-32.

517 [redacted]

617. The evidence also demonstrates that Visa [redacted]

[redacted]

[redacted]

618. [redacted]

[redacted]

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318 [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

619. [redacted]

[redacted]

319 [redacted]

320 [redacted]

321 [redacted]

(b) Respondents' Claim of "Bait-and-Switch" and "Free-Riding" are also Without Merit

620. The Respondents' concerns with respect to "baiting and switching", "hold ups" and "free-riding" are similarly without merit. The assumption in these claims is that merchants will not properly disclose surcharges to customers, resulting in an unpleasant surprise for customers at the point of sale. It is simply not credible to allege that Canadian merchants would risk the reputational harm, potential for regulatory proceedings and loss of sales resulting from failing to properly disclose surcharges to customers. And every merchant witness who testified in respect of this issue denied that they would engage in a conduct of this nature. As explained by Dr. Frankel: "Competition among merchants, which as the merchants who testified before the Tribunal consistently described as being intense, can generally be relied upon to constrain prices (and other competitive terms and condition of sale) to reflect costs and protect consumers. A merchant that sets prices far above those of its competitors, or price discriminates significantly against a subset of customers (on a basis unrelated to cost differences), or disappoints customers at the point of sale after they have invested time and effort in purchases, will find itself losing too many sales over time to competitors for such strategies to succeed."[522]

621. The Respondents contend that "free-riding" and "bait-and-switch" occurs with any credit card surcharge, irrespective of whether the merchant has primarily repeat customers, and irrespective of whether the surcharge is disclosed.[523] The "bait-and-switch" argument also does not account for any learning behaviour among consumers. Even if some consumers are surprised when surcharges are initially adopted, members of the public tend to become accustomed to the practice relatively quickly. For example, consumers have adapted quickly to the practice of surcharges on Automated Banking Machines when those have been permitted, and to the 5 cent "bag tax" in the City of Toronto (and elsewhere in Ontario).

622. Further, to the extent that Visa and MasterCard are concerned about the non-disclosure of surcharges, there are far less restrictive means available to Visa and MasterCard to address this issue, rather than applying a blanket prohibition on surcharges. For example, the

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[522] Reply Report of Alan Frankel, Exhibit CA-53 ["**Frankel Reply Report**"], para. 115.

[523] Visa Response, *supra*, paras. 9-10; Response of MasterCard International, January 31, 2011 ["**MasterCard Response**"], paras. 77.

Respondents have rules in New Zealand and Europe that requires merchants to disclose surcharges clearly at the point of sale. There is no evidence to demonstrate that this requirement has not been effective in addressing any "bait and switch" or other concerns of the Respondents.

623. As illustrated by the example of WestJet's second-bag surcharge, disclosure through proper communication and transparency prevent consumers from being surprised. In this regard, Candice Li, the Vice President, Treasurer of WestJet Airlines, Ltd. testified on cross-examination that if WestJet were to implement a surcharge on payment methods, it would follow the same steps that led to the successful adoption of WestJet's second-bag surcharge:

> "MR. SIMPSON: And would you agree with me that if you did begin surcharging, you wouldn't really have an expectation of losing any volume of credit card sales?
>
> MS LI: We hope not, yes. We hope that if we explain -- let me liken it to another example.
>
> I have spoken about our policy about charging for the second bag. And when we first charged for the second bag, we were really worried that a lot of our guests would be put off by it and we were concerned that we would lose volume as a result.
>
> However, what we found was that through proper communication and transparency, that our guests understood the concept, and we were able to launch that and pass that through.
>
> Of course, the hope is that on the credit card surcharge, if we undertake this charge, this surcharge, with the understanding that the public will gain, that they will hopefully realize that it is -- you know, it is something that is reasonable and not related to gouging or any negative marketing practices."[524] [emphasis added.]

624. Visa and MasterCard have failed to adduce any evidence of "baiting and switching" or of other misleading tactics engaged in by merchants that charge convenience fees in Canada, the United States or elsewhere. In the witness statements and expert reports filed by the Respondents (and the Intervenors), there is no reference to misleading tactics having been

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[524] Transcript of May 22, 2012, (Volume 8), pp.1568 (line 23) to 1569 (line 20).

engaged in by merchants that apply convenience fees to MasterCard or Visa credit card transactions.

625. The evidence demonstrates that, in reality, the "consumer protection" justifications offered by the Respondents for the Merchant Restraints are merely a pretext, and that these self-serving arguments are fundamentally at odds with Visa and MasterCard's own practices of allowing surcharging in other jurisdictions and, in the case of MasterCard at least, for select service providers in Canada. If the Respondents are truly concerned that merchants will deceive their own customers, they have alternatives available that are much less restrictive than a complete prohibition on surcharging.

(c) Certainty and Search Costs

626. The Respondents contend that enhancing "predictability for cardholders," reducing "price uncertainty and search costs," and reducing the "added time and effort required to search for merchants who have chosen not to surcharge" justify the Merchant Restraints.[525] [redacted] and that this is not only good for the networks' "brands," but is also good for the public.[527]

627. Again, the Respondents do not explain why disclosure of the surcharge cannot serve as a remedy for the potential problems they claim to identify. In any event, "certainty" and reduced search costs are not appropriate benefits that can justify anti-competitively higher prices resulting from the Merchant Restraints. A perfectly functioning price-fixing cartel, after all, makes shopping easy: there is no sense in engaging in any search, because the price will always be the same. Yet few would suggest that one should weigh the reduced search costs and increased certainty as benefits before deciding to condemn a price-fixing agreement.

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525 Elzinga Report, *supra*, para. 212; Mulvey Report, *supra*, para. 56; Jairam Report, *supra*, para. 93.

526 [redacted]

527 See Visa Response, *supra*, para. 3; MasterCard Response, *supra*, para. 59.

(d) Claim that Merchant Restraints Protect Interchange Fees

628. The main economic criticism of permitting credit card surcharges offered by Visa and its consultants in recent years has been that they permit merchants to undo the effects of network-set Interchange Fees. If these claims were true, that would mean that any effect of surcharging to reduce Interchange Fees would simply shift revenue from cardholders to merchants. Interestingly, the Respondents do not explain why they object to such a shift when the corollary – that the Merchant Restraints shift revenue from merchants to cardholders – is acceptable to them in their two-sided market framework.

629. They assert, in effect, that this is a zero-sum game between merchants and "consumers" and the credit card networks' efforts are designed to shift "wealth" from merchants to "consumers." But the only source merchants have for the funds to pay Interchange Fees and Network Fees are the prices that they charge to <u>all</u> of their retail customers. Thus, <u>all customers</u> pay what amounts to a hidden retail sales tax, *some* of which ultimately flows back to *some* consumers (only those customers using credit cards and within that group, only those that have credit cards that offer rewards). Cardholders may be happy to obtain rewards and make choices in light of those rewards, but they do not know that they are funding rewards through higher prices on all purchases (whether or not made with cards) and cannot escape the higher retail costs even by using another payment method.

630. As has previously been discussed, only a portion of the Interchange Fees obtained by the Issuers flow to cardholders through rewards. [redacted] And millions of Canadians hold basic credit cards that do not provide for rewards. The real concern of Visa and MasterCard is obvious: they seek to protect their supra-competitive profits.

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528 [redacted]

(e) Claim that Merchant Restraints Protect "Brand Equity"

631. The Respondents claim that the Merchant Restraints are justified because merchant surcharging or refusal to accept some credit cards harms the value of the networks' respective "brands."[529]

632. [redacted]

633. [redacted]

529 See, *e.g.*, Sheedy Statement, *supra*, para 54.

530 *Ibid.*

531 [redacted]

532 [redacted]

533 [redacted]

534 See Transcript of June 6, 2012 (Volume 19), pp. 3260 (lines 4 to 16); "Strategic Review of Innovation in the Payments System: Results of the Reserve Bank of Australia's 2010 Consumer Payments Use Study", Exhibit A-374, p. 18.

634. Further, and in any event, as Dr. Frankel concluded, the Respondents' brand/goodwill protection claims "miss the point".[536] Dr. Frankel states:

> "It is beneficial to the competitive process when the 'brands' of high cost providers suffer or become associated with those high costs in the minds of consumers who make purchase decisions at the point of sale. It is harmful to the competitive process when restraints such as the Merchant Restraints inhibit that effect".[537]

(f) Claim that Merchant Restraints "Maximize Output"

635. MasterCard and Visa contend that their Merchant Restraints (and their Interchange Fees) "maximize output" and therefore cannot be anticompetitive or harmful, while merchant surcharging or the refusal of particularly high priced credit cards will reduce output and therefore be competitively harmful.

636. However, the Respondents have failed to demonstrate that the Merchant Restraints increase output, or that the removal of the Merchant Restraints would reduce output. Indeed, the Tribunal received evidence showing that some merchants that would accept the cards without the Merchant Restraints do not accept them with the Restraints in place. For example, this can also be seen by the fact that even MasterCard and Visa have allowed surcharging in the form of so-called "convenience fees" where doing so promotes acceptance of credit cards with certain merchants and service providers that are otherwise unwilling to assume the higher costs of credit card acceptance (*e.g.*, governments and universities). MasterCard made this very point in its internal documents and external communications in Europe in 2004 when it decided to stop enforcing its no surcharge rule there.

Remedies

637. As described above, the Commissioner submits that the Merchant Restraints contravene section 76 of the *Competition Act*. The Merchant Restraints influence upwards or discourage the

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535 [redacted]

536 Frankel Reply Report, *supra*, para. 136.

537 *Ibid*., para. 136.

reduction of Card Acceptance Fees and have an adverse effect on competition in respect of the supply of Credit Card Network Services in Canada.

638. The Tribunal has a broad and flexible remedial jurisdiction to protect the public interest in competition and restore competition in the market.

639. The Commissioner respectfully requests an Order prohibiting each of the Respondents from continuing to implement or enforce No Surcharge, Honour All Cards and No Discrimination Rules, either directly or indirectly. Specifically, the Commissioner seeks an Order in the form attached as Appendix "A" or Appendix "B" to these Closing Submissions prohibiting the Respondents from entering into, implementing, enforcing or continuing agreements or arrangements that:

(a) impede or limit the ability of merchants to engage in any practice that discriminates against or discourages the use of particular credit cards in favour of any other credit card, or any other method of payment;
(b) impede or limit the ability of merchants to apply surcharges on particular credit cards or set prices for customers based on the particular credit card used; or
(c) impede or limit the ability of merchants to refuse to accept particular credit cards.

640. As stated above, during the hearing, the Tribunal received evidence regarding the issue of so-called "excessive" surcharges in Australia and certain other jurisdictions where the rules of Visa and MasterCard do not impose any limit on the level of surcharges by merchants. To the extent that the Respondents are, in fact, concerned that removing the Merchant Restraints would allow merchants to surcharge in amounts that exceed the reasonable costs associated with credit card acceptance, the Respondents have available a far less competitively restrictive alternative to a blanket prohibition on surcharging.

641. As noted above, Visa and MasterCard entered into a Settlement Agreement with the New Zealand Commerce Commission in 2009. The terms of the Settlement Agreement allow merchants to surcharge, but permit the Respondents to implement and enforce rules that limit the amount of surcharges to those reasonably related to the costs of acceptance and that

require surcharges to be clearly disclosed by the merchant. Section 4.4 of the settlement agreement between the Commerce Commission and Visa states as follows:

> "Nothing in clause 4.3 prevents Visa from providing in the Visa rules that if a merchant applies a surcharge for payment by any Visa card, the surcharge amount must be clearly disclosed to the cardholder at the time of purchase and must bear a reasonable relationship to the merchant's cost of accepting Visa products for payment. To avoid doubt, any such requirement imposed by Visa will not prevent merchants from applying such a surcharge on a flat rate basis, to some or all Visa branded payment cards."[538]

642. Similarly, MasterCard's modified European No Surcharge Rule also provides that surcharges must be reasonably related to costs and clearly disclosed. The modified MasterCard rule states as follows, in pertinent part:

> "If a merchant applies a surcharge for payment by MasterCard card, the amount of the surcharge must be clearly indicated to the cardholder at the [Point of Interaction] and must bear a reasonable relationship to the merchant's cost of accepting MasterCard cards".[539]

643. Most recently, following the conclusion of the hearing of this Application, the RBA issued a variation to the Standards regarding surcharging on credit cards to allow Visa and MasterCard to implement and enforce a rule which requires that surcharging by merchants be reasonably related to the cost of accepting credit cards. In a June 2010 decision entitled "A Variation to the Surcharging Standards: Final Reforms and Regulation Impact Statement", the RBA stated, in relevant part, as follows:

> "The main element of the draft variation was to allow card scheme rules to impose a limit on surcharge levels. Specifically, the draft variation provided that neither the rules of a designated card scheme nor any participant in the scheme could prohibit a merchant from recovering part or all of the reasonable cost of acceptance by charging fees or surcharges to credit cardholders. The practical effect of this provision of the draft variation would be that scheme rules would be able to impose some limit on

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538 "Visa Settlement Agreement", Exhibit A-239, p. 4.

539 [redacted]

> surcharge levels, but they could not prevent merchants from fully recovering their costs. The provision also clarified that card scheme rules could not prevent a merchant from differentially surcharging different card products either within a card scheme or across card schemes".[540]

644. The language used by the RBA for the variation to the surcharging Standard is as follows:

> "9. Neither the rules of the Scheme nor any participant in the Scheme shall prohibit:
>
> (i) a merchant from recovering part or all of the reasonable cost of acceptance of credit cards issued under the Scheme by the merchant charging fees or surcharges to credit card holders; or
>
> (ii) a merchant, in recovering part or all of the reasonable cost of acceptance of credit cards issued under the Scheme, from applying different fees or surcharges to credit card holders for different card types either within the Scheme or across card schemes.
>
> 10. For the purposes of paragraph 9, the merchant's cost of acceptance of credit cards issued under the Scheme may, for the purpose of determination of a fee or surcharge, be determined by reference to:
>
> (i) the cost to the merchant of the credit card transaction in relation to which the fee or surcharge is to be levied;
>
> (ii) the average cost to the merchant of acceptance of all credit cards of all types issued under the Scheme; or
>
> (iii) the average cost to the merchant of acceptance of a subset of credit cards issued under the Scheme that includes the type of credit card in relation to which the fee or surcharge is to be levied, and includes, but is not necessarily limited to, in the case of (i), the applicable merchant service fee and, in the case of (ii) and (iii), all applicable merchant service fees".[541]

645. The Respondents have not provided any evidence to demonstrate why such limitations would be inadequate to address their purported concerns regarding "excessive" surcharging by

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[540] RBA Surcharge Variation, *supra*, p. 1.

[541] *Ibid*, p. 25.

merchants, and why the more restrictive alternative of prohibiting all forms of surcharging (even those reasonably related to costs and that are clearly disclosed) is necessary or appropriate.

646. In any event, to the extent that the Tribunal is concerned that providing merchants with the freedom to surcharge on Visa and MasterCard credit cards may lead to "excessive" surcharges in certain limited circumstances, the Tribunal may elect to prohibit Visa and MasterCard from continuing to implement and enforce their respective No Surcharge Rules, but not prohibit the Respondents from implementing a rule that limits the amount of surcharges to those reasonably related to the costs of acceptance and that requires surcharges to be clearly disclosed by the merchant.

647. The Respondents argue that technology does not exist to permit merchants to surcharge credit cards transactions based on the type of card or the level of the Interchange Fee. However, there is significant evidence before the Tribunal that such technology does, in fact, exist or could readily be developed. For example, Mike McCormack, who was qualified by the Tribunal as an expert to give opinion evidence with respect to the payment card transaction industry and acquiring industry,[542] states as follows in paragraphs 182 to 185 of his expert report:

> "MasterCard, Visa and Canadian Issuers and Acquirers could provide Canadian merchants with the ability to access or receive product type and payment cost information for credit card transactions electronically through their POS systems. Such facilities could be made available and designed in such a fashion so as to have a negligible effect on the speed of credit card transactions. Many large merchants in the U.S., Canada, and elsewhere currently use payment card account information to determine whether a card is a credit or debit card, whether to prompt the customer to enter a PIN on the merchant's POS system, or to accept a network or service fee, and how the transaction should be routed from the merchant to a network for authorization and clearing.

[redacted]

[542] See Transcript of May 14, 2012 (Volume 4), pp. 562 (line 5) to 563 (line 13).

[redacted]

A Visa declaration filed in support of a settlement of litigation between Visa and the U.S. Department of Justice in 2011, concerning Visa's Operating Rules, states that Visa has made a service optionally available to Acquirers in the U.S. since 2006 called the "Product Eligibility Inquiry Service." According to the declaration, Visa's product inquiry service can be used to determine a credit card's specific Visa assigned product type.410 Based on my experience, disclosure of Visa's assigned product types should permit a merchant to determine at the POS the cost of accepting different Visa credit cards, given certain reasonable hardware and/or software upgrades.

Visa and MasterCard could also require their respective Issuers to add conspicuous and uniform product identifiers to the fronts of their credit cards to enable merchants to visually identify higher-cost cards. These changes could be made, and revised cards issued through Issuer's normal re-issuance cycles. [redacted]

648. Mr. McCormack's evidence in this regard was not challenged or contradicted on cross-examination.

649. Following his examination, Mr. McCormack elaborated further on his evidence in-chief in response to certain questions from Dr. Askanas:

> "DR. ASKANAS: In your opinion, is there technology that will allow customers to understand the cost of using a particular card?
>
> MR. McCORMACK: Yes. The networks have made steps in the United States, that I am aware of, to enable acquirers and merchants to determine the underlying card product and the interchange rate associated with that.
>
> So there are a number of steps a merchant would have to go through to make that service available, but it is certainly within -- it is certainly possible to do.
>
> DR. ASKANAS: So I can actually see on my receipt how much I am being charged by...
>
> MR. McCORMACK: Certainly, yes. There are ways to get that information. There are technologies out in the industry right now that don't necessarily do that particular thing, but there are technologies that are widely adopted which would allow you -- as a Canadian travelling overseas, if you used your credit card, you can pay in Canadian -- a Canadian amount in a place such as Hong Kong or within Europe.
>
> And that sort of technology is very similar to the type of thing one would need to do to implement fee level disclosure on a receipt".[543]

650. Merchant witnesses called by the Commission also indicated that the technology required for merchants to surcharge at the point of sale exists or could be developed. For example, Paul Jewer of Sobeys stated as follows at paragraphs 62 to 63 of his Witness Statement:

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[543] Transcript of May 15, 2012 (Volume 5), pp. 794 (line 4) to 795 (line 4).

> "I believe that the information required to allow grocers to determine the applicable Card Acceptance Fee for Visa and MasterCard transactions already exists and is available to Acquirers, Visa and MasterCard, but is not readily made available to merchants.
>
> For example, Sobeys has worked with this point-of-sale … provider … to develop an in-house POS technology that, with the help of its Acquirers, allows it to identify premium credit cards".[544]

651. This evidence from Mr. Jewer was not challenged or contradicted on cross-examination.[545]

652. [redacted][547]

Conclusion and Relief Sought

653. For all of these reasons, the Commissioner respectfully requests that the Application be granted and that the Tribunal issue an Order in the form attached hereto as Appendix "A" or

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544 See also Transcript of May 24, 2012 (Volume 10), pp. 1735 (line 12) to 1736 (line 5).

545 See also Transcript of May 24, 2012 (Volume 10), pp. 1760 (line 24) to 1761 (line 16).

546 [redacted]

547 [redacted]

"B". The Commissioner requests leave to make submissions regarding the appropriate scale and quantum of costs following the disposition of this matter on the merits.

ALL OF WHICH IS RESPECTFULLY SUBMITTED.

June 18, 2012

FOR **Davies Ward Phillips & Vineberg LLP**

FOR **Department of Justice Canada**

Counsel to the Commissioner of Competition

APPENDIX A

CT-2010-010

THE COMPETITION TRIBUNAL

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

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

ORDER

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[1] FURTHER to the Application filed by the Commissioner of Competition (the "**Commissioner**") pursuant to section 76 of the *Competition Act*, RSC, 1985, c C-34, alleging that Visa Canada Corporation ("**Visa**") and MasterCard International Incorporated ("**MasterCard**") have each implemented and continue to enforce agreements or arrangements in Canada imposing significant restrictions on the terms on which credit card network services may be supplied to merchants, and are thereby engaging in price maintenance contrary to section 76;

[2] AND FURTHER to the hearing of the Commissioner's Application between May 8, 2012 and June 21, 2012;

THE TRIBUNAL ORDERS THAT:

[3] Visa and MasterCard shall be and are hereby prohibited from implementing or enforcing, either directly or indirectly, and shall not implement or enforce, either directly or indirectly, their no surcharge, honour all cards and no discrimination rules in Canada. For greater certainty, Visa and MasterCard shall not implement or enforce any rule that prohibits or prevents, either directly or indirectly, merchants in Canada from: (i) surcharging Visa or MasterCard credit card transactions; (ii) refusing to accept particular Visa or MasterCard credit cards for payment; or (iii) discriminating against particular Visa or MasterCard credit cards.

[4] Visa and MasterCard shall be and are hereby prohibited from requiring or encouraging acquirers or payment processors in Canada to include any provision in their agreements or arrangements with merchants in Canada that is inconsistent with paragraph 3 of this Order.

[5] Visa and MasterCard shall take all necessary steps to bring this Order and the Reasons for Decision of the Tribunal to the attention of their respective Canadian acquirers and payment processors and to cause their Canadian acquirers and payment processors to disseminate to their Canadian merchant customers a Notice in the form attached hereto as Schedule "A" concerning this Order and the Tribunal's Reasons for Decision.

[6] The costs of this Application shall be and are reserved to the Tribunal to be dealt with after hearing submissions from the parties.

DATED at Ottawa, this _____ day of _____, 2012.

SIGNED on behalf of the Tribunal by _____

APPENDIX A

Schedule "A"

NOTICE REGARDING THE NO SURCHARGE, HONOUR ALL CARDS AND NO DISCRIMINATION RULES OF VISA AND MASTERCARD

On _____, 2012, the Competition Tribunal issued an Order that prohibits Visa and MasterCard from implementing or enforcing, either directly or indirectly, their no surcharge, honour all cards and no discrimination rules in Canada. As a result of the Tribunal's Order, Canadian merchants are now free to apply surcharges on transactions paid for using Visa credit cards or MasterCard credit cards, and to refuse to accept particular Visa and/or MasterCard credit cards for payment.

A copy of the Order and the Tribunal's reasons for decision can be found at the Tribunal's website at www.ct-tc.gc.ca. For additional information, consult the Competition Bureau's website at www.competitionbureau.gc.ca.

APPENDIX B

CT-2010-010

THE COMPETITION TRIBUNAL

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

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

ORDER

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[1] FURTHER to the Application filed by the Commissioner of Competition (the "**Commissioner**") pursuant to section 76 of the *Competition Act*, RSC, 1985, c C-34, alleging that Visa Canada Corporation ("**Visa**") and MasterCard International Incorporated ("**MasterCard**") have each implemented and continue to enforce agreements or arrangements in Canada imposing significant restrictions on the terms on which credit card network services may be supplied to merchants, and are thereby engaging in price maintenance contrary to section 76;

[2] AND FURTHER to the hearing of the Commissioner's Application between May 8, 2012 and June 21, 2012;

THE TRIBUNAL ORDERS THAT:

[3] Visa and MasterCard shall be and are hereby prohibited from implementing or enforcing, either directly or indirectly, and shall not implement or enforce, either directly or indirectly, their no surcharge, honour all cards and no discrimination rules in Canada. For greater certainty, Visa and MasterCard shall not implement or enforce any rule that prohibits or prevents, either directly or indirectly, merchants in Canada from: (i) surcharging Visa or MasterCard credit card transactions; (ii) refusing to accept particular Visa or MasterCard credit cards for payment; or (iii) discriminating against particular Visa or MasterCard credit cards.

[4] Visa and MasterCard shall be and are hereby prohibited from requiring or encouraging acquirers or payment processors in Canada to include any provision in their agreements or arrangements with merchants in Canada that inconsistent with paragraph 3 of this Order.

[5] Nothing in this Order prevents Visa and MasterCard from providing in their respective rules that if a merchant applies a surcharge on a transaction paid for using a Visa or MasterCard credit card, the surcharge must be clearly disclosed to the cardholder at the time of purchase and must bear a reasonable relationship to the merchant's costs of acceptance. .

[6] Visa and MasterCard shall take all necessary steps to bring this Order and the related Reasons for Decision of the Tribunal to the attention of their respective Canadian acquirers and payment processors and to cause their Canadian acquirers and payment processors to disseminate to their Canadian merchant customers a Notice in the form attached hereto as Schedule "A" concerning this Order and the Tribunal's Reasons for Decision.

[7] The costs of this Application shall be and are hereby reserved to the Tribunal to be dealt with after hearing submissions from the parties.

DATED at Ottawa, this _____ day of _____, 2012.

SIGNED on behalf of the Tribunal by _____

APPENDIX B

Schedule "A"

NOTICE REGARDING THE NO SURCHARGE, HONOUR ALL CARDS AND NO DISCRIMINATION RULES OF VISA AND MASTERCARD

On _____, 2012, the Competition Tribunal issued an Order that prohibits Visa and MasterCard from implementing or enforcing, either directly or indirectly, their no surcharge, honour all cards and no discrimination rules in Canada. As a result of the Tribunal's Order, Canadian merchants are now free to:

- apply surcharges on transactions paid for using Visa credit cards or MasterCard credit cards, provided that any such surcharge is clearly disclosed to the cardholder at the time of purchase and bears a reasonable relationship to the merchant's costs of acceptance; and

- refuse to accept particular Visa and/or MasterCard credit cards for payment.

A copy of the Tribunal's Order and related Reasons for Decision can be found at the Tribunal's website at www.ct-tc.gc.ca. For additional information, consult the Competition Bureau's website at www.competitionbureau.gc.ca.

CT-2010-010

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*;

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B E T W E E N:

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Applicant

- and -

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Respondents

- and –

CANADIAN BANKERS ASSOCIATION and THE TORONTO-DOMINION BANK

Intervenors

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