CT-2010-010

THE COMPETITION TRIBUNAL

IN THE MATTER OF THE *COMPETITION ACT*,
R.S.C. 1985, C. C-34, AS AMENDED;

AND IN THE MATTER OF AN APPLICATION BY THE COMMISSIONER OF COMPETITION PURSUANT TO SECTION 76 OF THE *COMPETITION ACT*;

AND IN THE MATTER OF CERTAIN AGREEMENTS OR ARRANGEMENTS IMPLEMENTED OR ENFORCED BY VISA CANADA CORPORATION AND MASTERCARD INTERNATIONAL INCORPORATED.

BETWEEN:

THE COMMISSIONER OF COMPETITION

Applicant

-and-

VISA CANADA CORPORATION and
MASTERCARD INTERNATIONAL INCORPORATED

Respondents

- and -

THE TORONTO-DOMINION BANK and
CANADIAN BANKERS ASSOCIATION

Intervenors

CLOSING SUBMISSIONS OF THE RESPONDENT, MASTERCARD INTERNATIONAL INCORPORATED

McMILLAN LLP
Brookfield Place
181 Bay Street, Suite 4400
Toronto, Ontario M5J 2T3

Tel: (416) 865-7000
Fax: (416) 865-7048

Jeffrey B. Simpson
David W. Kent
James B. Musgrove
Counsel to MasterCard International Incorporated

CT-2010-010

THE COMPETITION TRIBUNAL

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R.S.C. 1985, C. C-34, AS AMENDED;

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BETWEEN:

THE COMMISSIONER OF COMPETITION

Applicant

-and-

VISA CANADA CORPORATION and
MASTERCARD INTERNATIONAL INCORPORATED

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- and -

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INDEX

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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*;

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

B E T W E E N:

THE COMMISSIONER OF COMPETITION

Applicant

- and -

VISA CANADA CORPORATION and MASTERCARD INTERNATIONAL INCORPORATED

Respondents

- and -

THE TORONTO-DOMINION BANK
THE CANADIAN BANKERS ASSOCIATION

Intervenors

CLOSING ARGUMENT OF MASTERCARD

McMILLAN LLP
Brookfield Place
181 Bay Street, Suite 4400
Toronto, Ontario M5J 2T3

Tel: (416) 865-7000
Fax: (416) 865-7048

Jeffrey B. Simpson
David W. Kent
James B. Musgrove

Counsel to MasterCard International Incorporated

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INDEX

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PART I - OVERVIEW

1. *"MasterCard is a leading global payments company that provides a critical economic link among financial institutions, businesses, merchants, cardholders and governments worldwide, enabling them to use electronic forms of payment instead of cash and checks."*

    Witness Statement of Stanton, Exhibit "A".

2. This case poses challenges for the Tribunal and, indeed, for the Respondents, because it is so far from any similar case ever previously brought pursuant to the price maintenance provisions, and so counterintuitive, and the Commissioner's theory is so complex that it is very difficult to challenge that theory without first explaining it.

3. That theory is, firstly, that the three rules in issue: the No Surcharge ("NSR"), Honour All Cards ("HACR"), and Non-Discrimination ("NDR" and, together with NSR and HACR, the "Challenged Rules"), represent price maintenance under the *Competition Act*. No such conduct has ever been found, anywhere, to constitute price maintenance for the simple reason that it is not price maintenance. We will outline later in this argument the many detailed reasons why it is not. We focus here on just a few.

4. Firstly, there is no rule which seeks to maintain prices. In fact when the Commissioner's theory is examined in detail it turns out that the prices she alleges are maintained are the Respondents' own "prices" – that is MasterCard and Visa's prices. Further, the allegation is not that price maintenance leads to an adverse effect on competition, but rather that an adverse effect on competition leads to price maintenance. As well, the theory by which the Commissioner argues that the Challenged Rules result in an adverse effect on competition, which in turn leads to the maintenance of MasterCard and Visa's own prices, are convoluted and highly speculative.

5. All of this will be outlined below in detail, but at the starting point it is critical to recall that the alleged price maintenance is maintenance of the Respondents' own prices, and is based on reverse causation – not that set out in section 76 of the *Competition Act*.

6. And, as a final note on the point, the conduct does not involve a resale, which we say section 76 requires.

7. The first broad point is the conduct is simply not price maintenance, for all of the reasons noted, and additional points that will be explored in detail below. The second point is that the conduct does not lead to an adverse effect on competition. The Commissioner's theory, in essence, is that the Challenged Rules in issue – and most specifically the NSR – prevent Merchants from encouraging consumers to use other forms of payment, so as to put pressure on MasterCard and Visa's interchange rates (and, to a much lesser extent, because they are much, much smaller numbers, MasterCard and Visa's acquirer fees). As will be outlined below, this is the alleged adverse effect on competition. In fact, however, the Challenged Rules were established more than 35 years ago when MasterCard and Visa could not have had market power. Smaller payments networks have those Challenged Rules today. The Challenged Rules serve an obvious pro-competitive role in expanding output in the MasterCard system and protecting consumers from Merchant gouging and similar behaviour. All that aside, the fundamental point is that because the market is two-sided – a point which, while the Commissioner does not speak of it frequently, is undisputed – the result is that even if the Challenged Rules had the evil intent and consequence alleged by the Commissioner, they would not work because the competitiveness of the issuing/consumer side of the market forces competitive offerings.

8. Interchange, as the uncontested evidence shows, is a balancing device. The Commissioner agrees that interchange shifts value from the acquiring side of the platform to the issuing side. The reason it does so, and the reason there is a demand to do so, is because consumers have a much greater elasticity of demand with respect to payment mechanisms than do Merchants. Consumers can choose whatever payment means they want from time to time, depending on a host of factors, including what benefits they receive. By contrast, Merchants are happy to have transactions, however they get them. That fundamental economic fact explains why MasterCard and Visa compete with a wide variety of payment forms. Whether or not Merchants "have" to accept many of those

payment forms, consumers do not "have" to use them. MasterCard must compete with these other payment forms, not only for the affections of Merchants, but also of consumers.

9. It is not the credit card companies' rules that cause Merchants difficulties. Of course they would like freedom to surcharge, since it is money in their pocket, but the fundamental challenge that Merchants face is that consumers are fickle. They will pay with whatever gives them the best bang for their buck. Merchants want the transaction, whether it comes on a credit card or any other means of payment. That is why Merchants pay more with respect to credit card payments than consumers do. It is the same reason that advertisers pay more for newspapers than readers do. That is why Adobe Acrobat is free to users but not to programmers. Interchange is the card companies' mechanism which balances demand and maximizes output. The NSR is one of the means by which the card companies try and prevent Merchants from exploiting situational market power, rebalancing demand against consumer interests and maintaining the output maximizing balance.

10. Ultimately, Merchants do not like the fact that consumers can demand to use the form of payment which gives consumers the best reward, the best benefits. That, however, is not an anti-trust or competition law problem, that is the marketplace. It is the same reason Merchants are happy to give 10% or 15% off to make a sale in most cases. They are hungry for a sale. Consumers are much less so. The Merchants would like to have their cake and eat it too – but economics of demand, not the credit card companies' rules, are against them. That is why the Commissioner's case fails in the second branch of the test. The Challenged Rules create no adverse effect on competition.

11. This is a complicated case. As far as the economics go we have some very complex, confusing and, to some degree, contradictory evidence, although the Commissioner's experts ended up agreeing with us on some very important points, as discussed below.

12. This industry is also somewhat complicated, but we all moved up that learning curve during the hearing. We know clearing from settlement; interchange from interest.

[redacted]

13. Fortunately, the structure of the case that we have to deal with is reasonably simple. Because of the legal question – that this conduct, whatever else it is and whatever economic effect it has, is not resale price maintenance – virtually none of the complex economics needs to be addressed by the Tribunal. Because this is not resale price maintenance at all, the Tribunal does not <u>have to get there</u>.

14. For the <u>structure</u> of the case, the Tribunal must, in essence, decide three things and as soon as the first one is decided against the Commissioner, the case is over.

15. One, the Tribunal is required to show that, the NSR, HACR and the NDR – those three rules and what they do – constitute price maintenance, or as we say resale price maintenance – because of course the word resale was recently re-inserted into section 76.

16. To make it even simpler, this case is not really three rules, it is one rule. MasterCard's NDR is not, in anyone's estimation, a real issue. It does not prevent anything that the Commissioner is concerned about. No one thinks it is a real issue. We submit the Commissioner threw it in because she was worried it might be a problem for Merchants but, clearly on the evidence, it is not.

17. Then we have the HACR. That is a very important rule for the efficiency and efficacy of the card systems, and the protection of consumers but, as Professor Winter testified, it is not problematic for price maintenance, even on his theory of price maintenance. He said it supports the NSR, but if the NSR is gone, it is not a problem on its own.

Transcript of Cross-Examination of Winter at page 1957 (public).

18. So the Tribunal really must decide if one rule, the NSR, is price maintenance.

19. Whether the NSR constitutes conduct contrary to section 76 (the price maintenance provision) is the first thing to be decided. We submit it does not even come close to being price maintenance.

20. The second thing to be decided (only if it is concluded that the NSR does constitute resale price maintenance) is whether, on balance, the Commissioner has proved (for she has the burden) that the price maintenance conduct has caused an adverse effect on competition.

21. There is much evidence on the point one way or the other. Eminent – indeed world famous – economists are opposed on the point.

22. The Commissioner has the burden to prove her case. Has she met it? We submit she has not. We say, indeed, that the Challenged Rules result in a positive effect on competition and on consumers. We say the Challenged Rules protect consumers, and MasterCard, expand output and balance the two-sided market so that it works efficiently. The Challenged Rules protect legitimate franchisee interests and protect MasterCard's brand from reputational damage. We say the Challenged Rules improve conditions for consumers, make Merchants more competitive and make it easier for new, smaller Issuers, to compete.

23. To find for the Commissioner, the Tribunal must find, explicitly, that the Commissioner has met the burden of proof to demonstrate the opposite of those things. We submit that the Commissioner's evidence is speculative, at best. An hypothesis. By contrast, the pro-competitive consequences MasterCard posits are real – they are proven by the fact that MasterCard has encouraged entry. It is Avis – it tries harder. We say, in answer to some of the Commissioner's counsel's criticism, and of various witnesses, that the Commissioner does not have a crystal ball. Indeed, we say that everything her counsel suggested to Mr. Livingston of Capital One, as to his theory about his evidence being speculative, and the fact that he does not have a crystal ball, applies to the Commissioner's view, except of course that Mr. Livingston has 16 years' experience in the business, and the Commissioner has but a theory. Without a functioning crystal ball, the Commissioner's guess is good as the next person's – but not as good as the view of those with industry expertise. That is not proof. It does not meet the burden. We say, on the evidence, that you simply cannot find that anything anti-competitive has, or is likely to, occur as a result of the Challenged Rules – just the opposite.

24. The third thing the Tribunal must decide, the final thing, and only if it is found that the NSR is actually price maintenance; and only if found on a balance of probabilities that the alleged price maintenance has resulted in an adverse effect on competition – the third thing to be decided is whether it is appropriate to make an Order.

25. We submit, even if the first two things are found, that no Order should be made. There is no doubt, or dispute, that the Challenged Rules do have beneficial effects for consumers. There is no dispute that they were adopted, openly, at the outset of the MasterCard system and the Visa system—more than 35 years ago – for no anti-competitive purpose. There is no doubt that they protect consumers against surcharges – and against excessive surcharges, which have been seen elsewhere. There is no dispute that they prevent consumers being left in the lurch when their particular cards are refused by a Merchant. There is no doubt that they help balance the system. We have more sophisticated economic arguments as well – which are disputed by the Commissioner's experts – but these things are not disputed. We also say it is inappropriate to make an Order against the Challenged Rules when the Minister of Finance considered the matter only two years ago and decided not to do so; when the Code he did enact has just barely taken effect; inappropriate to make an Order when competitors such as American Express can have such rules. Finally, and fundamentally, we say that there is a host of unintended but problematic consequences which are likely should the Order sought be made.

26. We submit, in other words, that even if this Tribunal finds the necessary preconditions to a finding of price maintenance it should not make an Order.

27. So, there is lots of complexity and lots of detail, but if one takes a step back, those are the only three things to be decided.

[redacted]

PART II - BACKGROUND FACTS

(a) The Parties in the MasterCard System

(i) Nature of Four-Party System

28. MasterCard's network is commonly referred to as a four-party network. In actuality, five entities generally participate in the operation of MasterCard's four-party network: holders of MasterCard credit cards ("Cardholders"), issuers ("Issuers") and acquirers ("Acquirers") of MasterCard credit cards, merchants ("Merchants") and MasterCard.

> Witness Statement of Stanton at para. 8;
> Witness Statement of DeVita at para. 7;
> *Top Ten Responses To Dr. Frankel and Prof. Carlton*, Exhibit RV-482.

29. The four-party MasterCard network is two-sided. On one side, Acquirers offer a suite of services to Merchants, used by Merchants to assist them in accepting MasterCard credit cards and other forms of payment at their locations, as well as other services. On the other side, Issuers make MasterCard-branded credit cards available to individuals who thereby become Cardholders. The Commissioner's experts do not dispute that the network is two-sided. Moreover, there is an interdependence between the Cardholder and the Merchant sides of the market. The number of consumers willing to carry a particular card depends on the acceptance rate of that card among Merchants: and the willingness of Merchants to accept a particular credit card depends on the number of Cardholders using that card. This interdependence is captured in the common description of a credit card network as a "two-sided market".

> Witness Statement of Stanton at para. 9;
> Winter Report at para. 32.

(ii) MasterCard's Role

30. MasterCard's role as network operator is to establish and promote a well-known brand or trademark so that Cardholders know where their MasterCard credit card will be accepted.

> Witness Statement of Stanton at para. 11.

[redacted]

31. It is important to understand that MasterCard does not contract with Cardholders for Cardholder services and does not contract with Merchants for acquiring services. Issuers make contractual arrangements with Cardholders relating to the issuance of their credit cards, and Acquirers make contractual arrangements with Merchants regarding the provision of acquiring services. MasterCard establishes rules and protocols so that parties know when they will be paid and Cardholders know how and where they can use the card. Acquirers and Issuers establish fees charged to their respective customers and negotiate the terms that govern those relationships.

Witness Statement of Stanton at para. 10.

32. As Visa's witness, Mr. Sheedy, observed in his evidence, Visa itself is not a financial institution. It does not issue payment cards or extend credit to consumers, nor does it sign up Merchants to accept Visa credit cards. Rather, Visa provides an efficient, secure network for processing transactions among the financial institutions that do fulfill these roles internationally. The same is true for MasterCard.

Witness Statement of Sheedy at para. 8.

33. The success of the MasterCard network depends on achieving both widespread consumer demand for use of its credit cards and widespread Merchant acceptance of its cards. Merchants will not accept MasterCard credit cards unless both a meaningful number of consumers want to pay with MasterCard credit cards, and the related costs are acceptable. Consumers will not use MasterCard credit cards unless the costs are outweighed by the benefits and the card is widely accepted by Merchants.

Witness Statement of Stanton at para. 12.

34. MasterCard works hard to establish and promote a well known brand and trademark so that Cardholders will know where their credit cards will be accepted. MasterCard makes significant efforts to market its network to Issuers and Acquirers. MasterCard also seeks to maximize use of its credit cards by designing rules and protocols which are intended to

balance the demands and interests of both the Merchant and Cardholder sides of the market.

> Witness Statement of DeVita at paras. 16, 17 and 51.

35. As a result of the four-party network, Merchants and Cardholders both gain from its use. As Carlos Arango, the Principal Researcher of the Currency Department, Bank of Canada, stated in his testimony to the Canadian Senate on March 3, 2011:

> "In two-sided markets, payment service providers require both customers and merchants to be on board and to create demand for their service. The key element of these markets are efficiency gains for both consumers and merchants if a third party coordinates their demand. Among the benefits of this coordination are the sharing of large set-up costs and the gains by both merchants and consumers if more of them adopt the payment instrument."

> Witness Statement of Stanton at para. 13, Exhibit "B".

36. Two-sided markets can exhibit "loop" or "feedback" effects. These effects are the result of one side of the market impacting the other side of the market. Feedback effects may amplify the response to a change on either side of a two-sided market. To appropriately examine the market in which the four-party MasterCard network operates, the possibility of substitution on either side of the market should not be ignored.

> Transcript of Examination-in-Chief of Elzinga at pages 2714-2716 (public);
> Transcript of Examination-in-Chief of Church at pages 2884-2887 (public);
> Transcript of Cross-Examination of Church at page 2956 (public).

37. One example of the impact of imbalance on one side of a credit card market is the evidence of Mr. Broughton of C'est What?. C'est What? used to accept EnRoute and Diners Club but chose to stop accepting them because no one was using them. There was literally one transaction per month and the statement fees alone were worth more than the transaction. C'est What? stopped accepting those brands because there was no demand for them.

> Transcript of Cross-Examination of Broughton at pages 365-366 (public).

(iii) Cardholders in the MasterCard System

38. Cardholders do not receive credit cards from MasterCard, but instead may have a MasterCard branded credit card issued to them by any one of a number of Issuers.

Witness Statement of Stanton at para. 14.

39. There are significant advantages to Cardholders who use MasterCard credit cards. While these advantages do not restrict Cardholders from using other forms of payment, they provide value to consumers who choose MasterCard credit cards as a form of payment.

Witness Statement of Stanton at para. 15.

40. Karen Leggett, who was at the time Senior Vice President, Cards and Payment Solutions, Royal Bank of Canada, an Issuer of both MasterCard and Visa credit cards, gave evidence that consumers realize the following benefits from use of credit cards:

(a) Universal acceptance, anywhere, at any time by Merchants who accept Visa and/or MasterCard. Consumers obtain certainty from the ubiquity of credit card acceptance;

(b) Access to more Merchants, which in turn increases competition among Merchants;

(c) Ready access to a revolving credit facility without any collateral or down payment;

(d) Interest free payment from the time of purchase if the consumer pays by the end of the billing period;

(e) Zero liability protection against fraud;

(f) Reduced need to carry cash;

(g) Ability to pay online securely and confidently; and

[redacted]

(h) Card rewards and benefits (e.g., air travel points, auto insurance, damage and loss insurance, extended warranty programs, and affinity programs).

Witness Statement of Leggett at para. 23.

41. Cardholders also enjoy convenience and security from using MasterCard credit cards. Cardholders are not liable for fraudulent transactions, and responsibility for such transactions is instead borne by Issuers, Acquirers or MasterCard, depending on the nature of the fraud.

Witness Statement of Stanton at para. 16.

42. MasterCard and Visa credit cards provide customers with a convenient, safe and secure method to pay for goods and services on a deferred basis. A credit card provides the customer with revolving credit and an interest-free grace period as well as accurate record keeping. It may also provide the customer with rewards (such as cash back, air miles, car rental insurance, and extended warranties) that add value for the Cardholder, so he or she receives "more for their money" when making a purchase. Indeed, Issuers compete vigorously with each other and with other networks such as American Express, to attract new customers through reward offerings and promotions.

Witness Statement of Stanton at para. 16;
Witness Statement of Sheedy at para. 34.

43. Cardholders also enjoy "charge-back protection". Charge-back protection is available to Cardholders who pay for goods or services using MasterCard credit cards for a variety of reasons, including if Cardholders do not receive the purchased goods or services or such goods or services are not what they bargained for. An example of charge-back protection is a refund provided for a travel purchase that is not enjoyed due to the bankruptcy of a travel agent or airline. A recent example of the ubiquity of this protection can be observed in the recent shut down of chartered airline DirectAir. DirectAir's website expressly directs:

[redacted]

> "If you have not begun your travel and have a ticket for which you paid with a credit card, contact your credit card company for a refund. If you are currently at your travel destination, please arrange for alternate transportation. You can file a claim with your credit card company for a refund of the unused portion of your Direct Air ticket.
>
> If you paid by cash or debit card, please call 1-855-888-8090 or see the detailed instructions for filing a claim with the escrow bank and securer contained in the DOT Notice."

Witness Statement of Stanton at para. 17, Exhibit "C".

44. If a Cardholder uses a particular Merchant-branded MasterCard credit card, they may also receive additional rewards and benefits associated with use of the card. As discussed below, of the Commissioner's Merchant witnesses, each of WestJet, Sobeys, Wal-Mart, Shoppers Drug Mart and Coles have chosen to enter into special co-branding agreements with MasterCard and actively promote the use of their cards. Best Buy and Air Canada have entered into similar arrangements with Visa.

Witness Statement of Stanton at para. 18;
Transcript of Examination-in-Chief of Livingston at pages 2533-2534 and 2537 (public).

45. MasterCard credit cards offer Cardholders the convenience of not carrying cash or cheques, a source of unsecured credit, interest-free periods and easy record-keeping. They also benefit from universal acceptance when travelling and point-of-sale predictability. Cardholders using MasterCard credit cards also receive zero liability protection where, among other things, they are entitled to receive a refund if the goods and services they purchase are not delivered as promised.

Witness Statement of Stanton at para. 19;
Witness Statement of Livingston at paras. 21 to 22;
Transcript of Re-Examination of Leggett at page 2590 (public).

(iv) Issuers in the MasterCard System

46. Issuers are responsible for creating product offerings which interest Cardholders, issuing MasterCard credit cards to Cardholders and establishing the terms on which Cardholders maintain their credit card accounts.

Witness Statement of Stanton at para. 20.

47. Issuers' arrangements with Cardholders determine credit limits, when payments are due, the amount of time before interest is charged on account balances, the minimum repayment requirement, the minimum payment to be made by the Cardholder, the interest rate on unpaid accounts, the amount of the annual fee, if any, the rewards, cash advance transaction fees, foreign exchange markup rate and over limit fees.

Witness Statement of Stanton at para. 21.

48. Issuers compete to offer arrangements to Cardholders, offering different features, different interest rates, different annual fees and different rewards. MasterCard Issuers compete with each other to issue MasterCard credit cards, they compete with Issuers of other cards to encourage use of MasterCard issued credit cards instead of other payment card types, and they compete with suppliers of other payment mechanisms to encourage Cardholders to use MasterCard credit cards instead of other means of payment.

Witness Statement of Stanton at para. 22.

49. In some cases, MasterCard requires that Issuers provide Cardholders with certain levels of benefits with respect to particular types of cards. However, the fees paid to Issuers by Cardholders are generally determined by Issuers, not by MasterCard.

Witness Statement of Stanton at para. 23.

50. Issuers, and not MasterCard, also determine the interest rates or other charges to be applied in circumstances where, as an example, grace periods have expired and amounts remain due and owing. The only exception to this statement is that MasterCard's

[redacted]

Operating Rules prohibit Issuers from engaging in illegal actions, such as charging unlawful interest rates.

Witness Statement of Stanton at para. 24.

51. MasterCard credit card Issuers compete vigorously for transaction volume by a wide variety of offers and promotions. MasterCard's expert, Peter Dunn, testified that many credit card programs include an approximate 1% cash back reward, and it is reasonable to infer that a consumer who chooses a card with non-cash rewards values those rewards at least as much as a 1% cash discount. Issuers of credit cards on the MasterCard network customize their fees and, subject to any relevant guidelines set by MasterCard, the rewards associated with their cards to make their cards competitive with other payment systems and the card offerings of other Issuers.

Dunn Report at para. 17.

52. There are presently 15 Issuers of MasterCard credit cards and 14 Issuers of Visa credit cards in Canada. Issuers compete for Cardholders by offering them attractive benefits, rewards, and fee structures. Further, since the Competition Bureau eliminated its anti-duality rule preference in 2008, Issuers can now issue both MasterCard and Visa-branded credit cards to consumers. This has significantly increased competition among Issuers for Cardholders and between MasterCard and Visa for the business of Issuers such as Capital One Canada.

Witness Statement of Livingston at para. 10.

53. Today, smaller credit unions are able to compete with the big five banks and issue credit cards to their consumers. In addition, new entrants without broader banking relationships can enter Canada. They are able to rely on the MasterCard brand where they lack their own brand recognition.

Transcript of Examination-in-Chief of Jairam at page 3355 (public);
Transcript of Examination-in-Chief of Livingston at page 2534 (public).

54. Removal of the NSR and HACR would place any small Issuer in Canada at a competitive disadvantage. In the absence of the Challenged Rules, smaller Issuers would be particularly disadvantaged and there would be reduced Cardholder choice, fewer credit card options, fewer rewards, fewer opportunities for Cardholders to benefit from the increased number of smaller Issuers who are currently in the marketplace.

Transcript of Examination-in-Chief of Livingston at pages 2538-2539 (public).

55. Peter Dunn explained that in early 2012 he compared MasterCard Canada consumer default interchange rates with volumes and losses reported by Canadian MasterCard Issuers over the past five years. In that period, MasterCard Acquirers have paid as much as [redacted]% less in interchange than the costs Issuers have incurred to provide for guaranteed payment, prompt funding and processing of transactions. In every quarter since the fourth quarter of 2008 (and in some quarters prior), Issuers' credit and fraud losses and processing losses (not including other costs) have exceeded the monies received by Issuers for interchange.

[redacted]

(v) *Acquirers in the MasterCard System*

56. Acquirers that play a significant role in the MasterCard network in Canada include Moneris Solutions, Global Payments Canada ("GPC") and Chase Paymentech.

Witness Statement of Stanton at para. 32.

57. Merchants deal with their Acquirer – not with MasterCard. Merchants connect electronically via point-of-sale solutions to the proprietary system operated by their Acquirers. Merchants have no ability to connect to the MasterCard network (unless they also issue or acquire MasterCard transactions, thereby acting as an Acquirer or Issuer, rather than as a Merchant).

Witness Statement of Stanton at para. 40.

[redacted]

58. The suite of services supplied by MasterCard to Acquirers permit Acquirers to switch transactions and match MasterCard credit cards presented to their Merchant clients with Issuer accounts for authorization and clearance. The services which MasterCard supplies to Acquirers also include brand marketing, product development, and network/processing solutions involving the MasterCard network.

Witness Statement of Stanton at para. 33.

59. Acquirers supply a different suite of services to Merchants including, but not limited to, a guarantee of prompt payment, banking and deposit arrangements, deployment of terminals or other technology to accept card payments, implementation and project management services, assumption of risk, customer service support, replacement of equipment, flexibility of settlement/deposit arrangements, gift card processing, rewards processing, private label card processing, Merchant statements, training and training material packages.

Witness Statement of Stanton at para. 34;
Witness Statement of Sheedy at para. 24.

60. Jordan Cohen, President of GPC, an Acquirer, gave evidence that one aspect of GPC's business is to place terminals in Merchant locations. The vast majority of merchants rent terminals from GPC, although GPC tends to not be involved in major merchant procurement of infrastructure. GPC's goal is to ensure that the supporting infrastructure and processes provided to Merchants are up to date, secure and compliant. GPC supports the latest technologies such as EMV Chip and PIN technologies. Canadian Merchants have made significant investments in their point-of-sale devices, enabling the use of chip and PIN. Canada leads the world market in terms of GMV chip and PIN-enablement.

Witness Statement of Cohen at para. 14;
Transcript of Examination-in-Chief of Jairam at pages 3359-3360 (public).

61. Among other things, Acquirers often package and sell, to various Merchants, different forms of payment acceptance and related hardware. They also often offer Merchants a "float" of particular payments in the network.

Witness Statement of Stanton at para. 35.

62. It is important to understand that Acquirers bear considerable risk in connection with their dealings with Merchants. Acquirers bear the risk of the float they provide to Merchants. They prepay assessment fees to the network before they collect their fees from Merchants. In the event that an Issuer initiates a chargeback, whereby the purchase price is credited back to the Cardholder, the Acquirer may become the primary line of defence and advocacy for the Merchant. Acquirers also bear the risk of Merchant bankruptcy and Merchant fraud.

Witness Statement of Cohen at paras. 33 to 37.

63. The solutions which Acquirers offer to Merchants may vary and be industry-specific. For example, restaurants may desire solutions involving wireless technology. Gas stations may favour integrated solutions involving payment at the gas pump. MasterCard plays little or no role in many elements of the services provided to Merchants by Acquirers.

Witness Statement of Cohen at para. 16.

64. GPC has a written contract for the services which it provides to each Merchant. One agreement between GPC and a Merchant covers all of the services provided to a Merchant in GPC's role as an Acquirer or payment processor.

Witness Statement of Cohen at para. 17, [redacted]

65. In exchange for providing a suite of services to Merchants, Acquirers generally charge Merchants a fee, calculated as a percentage of each transaction, known as the Merchant discount rate. To determine its pricing, an Acquirer such as GPC will look at opportunity, cost base, technology, help desk staffing, telecom, variable processing costs, risk, overhead value and return. The cost base is affected by a variety of costs, including interchange, assessments and other transaction processing and customer servicing costs.

Witness Statement of Stanton at para. 36;
Witness Statement of Cohen at paras. 43-44.

[redacted]

66. The merchant discount rate paid by Merchants to Acquirers may be based on factors such as transaction volume, average purchase price, risk, and the Merchant's industry. The merchant discount rate is typically approximately [redacted]% to [redacted]% of the value of a credit card transaction.

[redacted]

67. No MasterCard rule, policy or agreement prevents an Acquirer from offering merchant discount rates to Merchants which are lower than the Acquirer's input costs, which input costs include interchange.

Witness Statement of Cohen at para. 45.

68. Visa and MasterCard do not concern themselves with the financial terms of Acquirers' agreements with Merchants. Given that Visa and MasterCard do not clear and settle transactions between Merchants and their Acquirers, they are not even aware of the amount of merchant discount fees paid to Acquirers. The terms of the agreements between Acquirers and Merchants, including the merchant discount rate, can vary widely, and the payments, if any, may cover services unrelated to Visa or MasterCard that the Acquirer provides to its Merchant accountholder on a bundled or blended basis.

Witness Statement of Sheedy at para. 25;
Witness Statement of Stanton at para. 37.

(vi) Merchants in the MasterCard System

69. Merchants in a variety of sectors choose to accept MasterCard credit cards. The vast and overwhelming majority of Merchants who accept MasterCard credit cards do not have any contractual relationship with MasterCard, but rather contract with Acquirers for a whole suite of credit card, debit and payment method services. Despite some Merchants having contractual relationships with MasterCard relating to incentives, marketing and technology, MasterCard does not acquire transactions for Merchants in Canada. That is, in all instances where MasterCard has concluded an agreement with a Merchant, the Merchant still has an agreement with an Acquirer for the provision of acquiring services.

Witness Statement of Stanton at para. 41.

70. Where it will add value to the network, MasterCard will negotiate agreements directly with Merchants. MasterCard has incentive agreements with many large Merchants, who have negotiated certain benefits directly with MasterCard in exchange for electing to issue or accept MasterCard credit cards. For example, [redacted]

Witness Statement of Stanton at paras. 42 and 112;
Witness Statement of DeVita at para. 18.

71. MasterCard has also been an innovator and first adopter in Canada, such as by introducing PayPass, a contactless card payment process, into Canada. PayPass has reduced point of sale transaction time by up to [redacted] for Merchants, which is a "win-win-win" for the network, Cardholders and Merchants.

Witness Statement of DeVita at paras. 23-24.

72. Merchant acceptance of MasterCard credit cards in Canada has increased every year in the past five years. [redacted] Further, approximately [redacted] Merchant locations accept MasterCard credit cards worldwide. This reflects a MasterCard core brand promise, being that a Cardholder's MasterCard credit card will be accepted at any Merchant location which accepts MasterCard credit cards anywhere in the world.

Witness Statement of DeVita at paras. 14-15.

73. However, MasterCard continues to face tremendous competition from other payment methods, as discussed below.

(b) The MasterCard Credit Card Payment Process

74. Payment by MasterCard credit card in Canada generally accords with the following process. The first step upon Merchant acceptance of a MasterCard credit card for payment is for the transaction to be authorized. In the authorization process, information goes from the Merchant to the Acquirer. The Acquirer then communicates with the Issuer, through MasterCard, to determine if the Cardholder has sufficient credit to make the purchase. If the Issuer approves the transaction, the approval is transmitted back to the Acquirer through the MasterCard Network. After MasterCard has received instructions from the Issuer, the approval is transmitted back to the Acquirer through the MasterCard network so that the goods can be released. The Merchant and Acquirer note the transaction and the Issuer debits the Cardholder's account.

> Witness Statement of Stanton at para. 45;
> Witness Statement of DeVita at paras. 8-9.

75. A clearance process takes place after the goods are sold. Merchants provide information about transactions, either sale-by-sale or in batches, to their Acquirer. This information is then transmitted to MasterCard, MasterCard takes the information, notes who is owed what, and advises each Acquirer and Issuer of their net position. Clearance and a form of settlement occur between Acquirers and Issuers, where Issuers pay the net transaction value to Acquirers, minus amounts for the related default interchange rate.

> Witness Statement of Stanton at para. 46.

76. Acquirers then settle their accounts with Merchants. The length of time for settlement between a Merchant and Acquirer will usually be driven by market conditions although MasterCard does establish minimum conditions. In Canada, Acquirers compete on the time they take to settle with Merchants. Settlement often occurs within one day. Barring any problems, MasterCard is not generally involved in the settlement process between Acquirers and Merchants.

> Witness Statement of Stanton at para. 47.

77. MasterCard operates its own electronic system for clearing transactions. While MasterCard Issuers and Acquirers are not obligated to use MasterCard's system for settlement of amounts owing between them, many choose to do so because it is cost-effective and efficient. However, other Issuers and Acquirers settle through other systems independent of MasterCard.

> Witness Statement of Stanton at para. 48.

78. Acquirers ultimately collect their fees from Merchants on a schedule determined by them. Correspondingly, Cardholders maintain an account with Issuers on terms agreed upon between them.

> Witness Statement of Stanton at para. 49.

(c) The Default Interchange Rate, Interchange Monies and Network Fees

79. The Commissioner argues that forcing MasterCard to discontinue the Challenged Rules will result in greater competition and lower fees charged by Acquirers to Merchants. It is important to understand the nature of fees and discounts within the MasterCard network, and how they are determined, to understand why the Commissioner's arguments are incorrect. The Commissioner mischaracterizes the revenue stream flowing from Acquirers to Issuers (i.e., the interchange fee) and the revenue stream flowing from Merchants to Acquirers (i.e., the merchant discount rate). In particular, the Commissioner does not appear to account for how these revenue streams represent different costs of doing business for different participants in the four-party credit card system.

> Notice of Application at para. 73;
> Witness Statement of Leggett at para. 27.

(i) Interchange Rate

80. The interchange rate is a percentage of the transaction value retained by an Issuer and not paid to the Acquirer on any given credit card transaction before payment is made to an Issuer. MasterCard does not receive interchange monies (they flow from Acquirer to

Issuer), and MasterCard does not earn revenue on interchange amounts. MasterCard's revenue comes from network fees paid by Issuers and Acquirers. Issuers and Acquirers are free to settle on their own interchange rate. Absent an agreement to the contrary, MasterCard's default interchange rate applies.

> Witness Statement of Stanton at para. 88;
> Witness Statement of DeVita at para. 25.

81. Interchange is an input cost for Acquirers. When Acquirers contract with Merchants, they may take into account the interchange rate when they negotiate the Merchant discount rate, or they may not. It is up to them. An Acquirer may conclude an agreement with a Merchant specifically enumerating default interchange rates or may conclude a flat-fee arrangement where the interchange rates are invisible and irrelevant to the Merchant. [redacted] Acquirers are free to negotiate whatever pricing they can. They can make money or lose money. MasterCard has no say in the matter.

> Stanton Witness Statement at para. 89;
> Transcript of Examination-in-Chief of Van Duynhoven at page 2511 (public);
> [redacted]

82. Merchants and Acquirers negotiate agreements without the involvement of MasterCard. Acquirers are not required by any agreement with MasterCard to charge specific amounts to Merchants or set their pricing so as to specifically enumerate interchange rates.

> Stanton Witness Statement at para. 90.

(ii) Interchange Rates in Canada and Internationally

83. [redacted]

> [redacted]

84. [redacted]

[redacted]

85. [redacted]

[redacted]

86. [redacted]

[redacted]

87. [redacted]

[redacted]

(iii) The Default Interchange Rate

88. In lieu of an agreement between an Acquirer and Issuer providing otherwise, MasterCard establishes the default interchange rate applicable to transactions on the MasterCard network. However, Acquirers and Issuers are not bound to the default interchange rate. At all times, Acquirers and Issuers have the ability to negotiate the interchange rate applicable to any particular transaction.

> Witness Statement of Stanton at para. 91;
> Witness Statement of Weiner at para. 21.

89. The cost and time required to negotiate individual agreements between Acquirers and Issuers lead them to most often utilize the default interchange rate. In addition to enhancing efficiency, default interchange rates prevent large participants from taking advantage of, or even "freezing out", smaller entities in the MasterCard network by ensuring that transactions are completed.

> Witness Statement of Stanton at para. 92.

90. But for an agreed interchange rate, Acquirers would not be assured of their costs of clearance, or that they could clear and settle at all, and could not commit to pay a pre-agreed amount to Merchants. As well, Issuers could not determine pricing to Cardholders. The default interchange rate ensures that there is an agreed rate. Without a default interchange rate no participant in the payment system would know how their transaction economics would work. Every participant in the network would have to negotiate bilaterally with every other payment participant in the network.

> Witness Statement of Stanton at para. 93;
> Transcript of Examination-in-Chief of Sheedy at pages 2168-2169 (public).

91. Without default interchange rates, the MasterCard network would not function at all or, at best, would function at a significantly reduced level with greater uncertainty for the involved parties. Default interchange rates remain the most efficient and productive way for Issuers and Acquirers to interact in a complicated business environment.

[redacted]

Witness Statement of Stanton at para. 94;
Witness Statement of Weiner at para. 22.

92. Further, as Mr. Dunn advised, without default interchange rates there would be fewer Issuers and Acquirers due to the cost and practicality of negotiating numerous bilateral agreements and the ability of large participants to put small organizations at a competitive disadvantage.

Dunn Report at para. 13.

93. Issuers do not have any involvement in setting either Visa's or MasterCard's default interchange rates. Visa and MasterCard advise their customers (Issuers and Acquirers) of their respective default interchange rates but deviations are rare (if they occur at all). The efficiency of the networks depends on default interchange rates being set by each card network. Otherwise, Issuers and Acquirers would need to engage in extensive and complex bilateral negotiations to set those rates. Because hundreds of separate Issuers and Acquirers participate in any credit card network, this would be highly impractical and inefficient. Issuers would need to negotiate agreements with hundreds of counterparties and would effectively become mini-network operators. The resulting duplication of relationships and efforts would increase costs and add complexity for all stakeholders.

Witness Statement of Leggett at para. 29.

(iv) Determination of the Default Interchange Rate

94. MasterCard's goal in establishing the default interchange rate, as with its use of other balancing devices such as the MasterCard Operating Rules, is to achieve a balance between the "value propositions" that MasterCard provides to Cardholders and Issuers on the one hand and Merchants and Acquirers on the other, so as to achieve the maximum possible volume on the MasterCard network.

Witness Statement of Stanton at para. 95;
Witness Statement of DeVita at para. 26.

95. MasterCard periodically reviews default interchange rates to ensure the rate maximizes the benefits of the MasterCard network for Merchants, Cardholders, Acquirers and Issuers.

Witness Statement of Stanton at para. 96.

96. The networks need to set interchange rates at a level that motivates both Issuers and Acquirers to participate in the system. If the credit card networks set interchange rates too high, Merchants' demand for card acceptance will decline and fewer Merchants will accept credit cards. If the credit card networks set interchange rates too low, Issuers' incentives to invest to attract and retain Cardholders will decline, as will consumer demand for credit cards. Fewer Cardholders would in turn lower the value to Merchants of accepting credit cards.

Witness Statement of Leggett at para. 30;
Transcript of Examination-in-Chief of Weiner at pages 2310-2312 (public).

97. Accordingly, MasterCard considers whether the default interchange rate would tend to encourage Merchants to accept MasterCard credit cards and tend to encourage Issuers to provide innovative card products that meet consumer demand. In order to achieve widespread consumer demand and Merchant acceptance of MasterCard cards, MasterCard sets the default interchange rate at a rate where Cardholders must perceive benefit and Merchants must be better off accepting MasterCard cards.

Witness Statement of Stanton at para. 97;
Witness Statement of DeVita at paras. 27-29.

98. MasterCard receives a financial benefit from the operation of its network in the form of network fees which MasterCard charges to Issuers and Acquirers based on each transaction. The more transactions which are conducted using a MasterCard credit card, and the larger the dollar value, the more revenue MasterCard earns. These network fees are distinct from the default interchange rate, from which MasterCard does not derive revenue.

Dunn Report at para. 14.

[redacted]

99. As MasterCard has sought to increase acceptance and volume in new Merchant categories, and to remain competitive in existing ones, it has tailored the default interchange rates applicable to particular Merchant sectors.

> Witness Statement of DeVita at para. 29;
> Witness Statement of Stanton at paras. 96-97.

100. MasterCard's current default interchange rates can be found in the MasterCard Worldwide Interchange Rate Overview of January 2011.

> Witness Statement of DeVita at para. 29.

(v) Market Impact on the Default Interchange Rate

101. In some instances, the amount charged by Acquirers to Merchants for their whole suite of services may be below the amount of the default interchange rate, and in others it may be well above it. In some cases, for on-us transactions, the interchange rate is zero per cent.

> Witness Statement of Stanton at para. 99.

102. Default interchange rates are constrained by operation of the market. MasterCard considers its "competitive positioning" against other forms of payment as one of the factors when establishing default interchange rates.

> Witness Statement of Stanton at para. 100.

103. To the extent default interchange rates influence pricing to Merchants by Acquirers, Merchant willingness to accept MasterCard credit cards may drop. MasterCard will, in that scenario, lose business to its competitors.

> Witness Statement of Stanton at para. 101.

104. If the credit card networks set interchange rates too high, Merchants' demand for card acceptance will decline and fewer Merchants will accept credit cards. If the credit card networks set interchange rates too low, Issuers' incentives to invest to attract and retain

Cardholders will decline, as will consumer demand for credit cards. Fewer Cardholders would, in turn, reduce the value to Merchants of accepting credit cards.

Witness Statement of Stanton at para. 102.

105. MasterCard's default interchange rates do not determine the merchant discount rate charged by Acquirers to Merchants. Historically, despite MasterCard's default interchange rate being lower than Visa's for many years, the merchant discount rate offered by Acquirers to Merchants for acceptance of MasterCard products was at times more expensive than for acceptance of Visa products. Some Acquirers offered pricing for blended services across payment types and sometimes, irrespective of MasterCard's default interchange rate, made up for a narrow margin on Visa credit card transactions by charging more for MasterCard credit card transactions.

Witness Statement of Stanton at para. 104.

106. MasterCard makes its revenue from Issuers and Acquirers in the form of network fees based on the number of transactions and the dollar volume associated with those transactions. MasterCard's financial interest and ultimate goal is to set default interchange rates and its Operating Rules so as to maximize the acceptance and use of MasterCard credit cards, against all forms of payment, by maximizing value to Cardholders and Merchants. Conduct to the contrary would cause MasterCard financial harm as Cardholders would instead make purchases using competing payment types, such as Visa, Interac debit and cash, among others.

Witness Statement of Stanton at para. 105.

107. The default interchange rate payable in relation to use of "high spend" and "premium High Spend" MasterCard credit cards is generally higher than that of core MasterCard credit cards, but Issuers are also required to ensure that Cardholders receive additional benefits for using those products.

Witness Statement of Stanton at para. 109; [redacted]

[redacted]

108. Interchange rates are transparent. The Department of Finance's Code of Conduct for the Credit and Debit Card industry in Canada (the "Code of Conduct") which both Visa and MasterCard have adopted, requires Acquirers to specify interchange rates clearly in their account statements to Merchants. Merchants are also able to access the card networks' interchange rates from Visa and MasterCard's respective websites. On the basis of these sources, interchange rates range between [redacted]% and [redacted]% for Visa and between [redacted]% and [redacted]% for MasterCard.

> Witness Statement of Leggett at para. 31; [redacted]

(vi) Default Interchange Rates are not a Price

109. One of the Commissioner's experts, Professor Ralph Winter, has suggested that interchange is one component of the "price" that is being maintained as a result of the Challenged Rules. Professor Winter suggests that MasterCard and Visa generate revenue from the sale of credit card network services through Acquirers to Merchants. He says that the price charged for this product is the total fee per transaction paid by Acquirers, being the sum of the interchange fee and the network fee, which he terms the "Acquirer Fee".

> Winter Report at para. 19.

110. It is inaccurate to characterize the interchange rate as a "price" that is capable of being maintained. Interchange is not a "price" at all. Interchange rates are intra-network transfer payments that are implemented to build and sustain transaction volume in Visa's and MasterCard's networks. Furthermore, as Professor Elzinga explained in paragraph 82 of his Report, the function of interchange rates is markedly uncharacteristic of prices for goods and services as economists usually define and analyze them. By way of illumination, Visa has a greater share of credit card transactions in Canada than MasterCard, but MasterCard establishes a higher default interchange rate. American Express has an even higher fee for Merchant participation in its network, even though American Express has a smaller market share than either Visa or MasterCard. Further,

Professor Winter's analysis ignores the significant fact that neither Visa nor MasterCard receives any revenue from interchange. MasterCard manages default interchange rates to balance the network to maximize its appeal on one hand to Merchants and Acquirers, and to Issuers and Cardholders on the other. It does not do so to derive revenue.

> Elzinga Report at para. 82;
> Witness Statement of Stanton at para. 88.

111. Neither Visa nor MasterCard plays any role in setting the prices that Issuers charge Cardholders or that Acquirers charge Merchants. Both Issuers and Acquirers remain free to set prices at their sole discretion and neither Visa nor MasterCard retain information on the merchant discount fees that Acquirers charge. For example, nothing in the Challenged Rules prevent an Acquirer from charging lower merchant discount fees to a particular Merchant based upon volume or other considerations, even if the Acquirer is paying the same interchange fee to the Issuer for transaction receipts from all Merchants in that category. The interchange fee paid to Issuers, and the processing fees charged by Visa and MasterCard to the Acquirer, are costs to the Acquirer, but none of Visa, MasterCard or the Issuer makes these fees a fixed percentage or any part of the merchant discount fee. Interchange fees and Acquirer fees are set based on the amount of the transaction or as a flat fee per transaction (or some combination of these two components), not based on the merchant discount fee charged. The merchant discount fee is set by the Acquirer in its own discretion, based on its own business strategies. The same interchange fee and Acquirer fees would apply regardless of the amount of the merchant discount fee.

> Witness Statement of Sheedy at para. 19;
> Witness Statement of Cohen at paras. 45-46.

(vii) MasterCard's Network Fees

112. MasterCard's financial interest is related to network fees charged by MasterCard to Issuers and Acquirers, which are not interchange fees. Because MasterCard earns revenue on volume-based transaction fees and dollar volume fees, not interchange rates, MasterCard has an economic incentive to make rules that increase the use of its brand of credit cards. Similarly, the networks do not generate revenue from the fees that

[redacted]

Merchants pay Acquirers for card acceptance services and have no commercial interest in either influencing upward or discouraging the reduction of such fees.

Witness Statement of Stanton at para. 127.

113. Rather, the networks' interests are in maximizing the number and volume of transactions processed over the networks over the long term. [redacted] and the networks have not sought to either influence upward or discourage the reduction of such fees. Acquirers may pass on to their Merchant clients the cost of interchange and other costs that Acquirers incur, the networks do not, through their rules or otherwise, require Acquirers to pass on any or all such costs to their customers, or dictate the manner in which their prices are established. These are all matters between Merchants and their Acquirers. Acquirers are free to set their fees to Merchants at whatever level the market will bear, to the extent that lower card acceptance fees encourage a greater number and volume of transactions on the networks through increased Merchant acceptance of credit cards for payment or increased credit card transactions. It is in Visa and MasterCard's interests for card acceptance fees to be lower not higher.

Witness Statement of Weiner at para. 5.

114. The blended total of all fees paid to MasterCard by Issuers and Acquirers, in or around 2010, was roughly [redacted] including costs of settlement between Issuers and Acquirers, less the effect of incentives and rebates.

Witness Statement of Stanton at para. 128.

(d) Balancing the System

(i) The Two-Sided Market

115. Both MasterCard and Visa witnesses have discussed the relationship between the two sides of their networks. The networks must ensure that transactions or products associated with transactions are attractive to Issuers so that they increase the number of

[redacted]

Cardholders they put into the network and, at the same time, the default interchange rate must represent value for Acquirers and Merchants compared to the cost. The value proposition of the credit card network must appeal to both sides. To maximize volume, the networks must balance competing interests between the issuing side of the network and the acquiring side of the network.

> Witness Statement of Stanton at para. 98;
> Witness Statement of Sheedy at paras. 30-31.

116. There is no dispute among the economist experts as to the existence of the two-sided market. MasterCard has also led largely uncontested evidence on what this means. MasterCard must ensure that MasterCard credit cards are attractive to Issuers (so that they increase the number of Cardholders in the system) and Acquirers (so that the network does not lose Merchants). If MasterCard is unable to balance both sides of the network (for instance, if it sets interchange fees too high or too low) it will discourage use of the card by one group or the other, or it will lose business to competing payment methods or card brands.

> Dunn Report at para. 12;
> Witness Statement of Stanton at para. 98;
> Witness Statement of Leggett at para. 30.

(ii) The Importance of Balance

117. In the credit card two-sided market, when the networks succeed in expanding their scope, both the Issuing and Acquiring sides benefit. The value of the payment system increases for Merchants as more Cardholders use credit cards, resulting in more sales for the Merchant. Simply put, Merchants that accept credit cards will attract more customers (and thus more sales) than Merchants that do not accept credit cards, just as Merchants with free parking or other customer benefits will generally see increased sales. Likewise the value of the payment system increases for Cardholders as more Merchants accept credit cards. The same principle holds true in reverse: if the network loses Cardholders, it becomes less worthwhile for Merchants to accept credit cards, and as fewer Merchants accept credit cards, fewer Cardholders will seek credit cards from Issuers. Therefore, in

[redacted]

order to maximize network volumes and revenues, the networks must balance demand on both the Issuing and Acquiring sides of the two-sided market.

Witness Statement of Sheedy at para. 32.

(iii) Interchange a Balancing Device

118. Visa's and MasterCard's goals in setting default interchange rates is to achieve a balance between the "value propositions" provided to Issuers and consumers on the one hand, and Acquirers and Merchants on the other, so as to achieve maximum volume on the MasterCard network. If MasterCard sets interchange fees too high or too low, it will discourage use of the card by one group or the other, or it will lose business to competing payment methods and/or other card brands. The key to maximizing use of MasterCard credit cards is to balance consumer and Merchant demand. MasterCard must therefore set default interchange rates at a level where both consumers and Merchants perceive benefit from using and accepting, respectively, MasterCard cards.

Dunn Report at para. 12.

119. Both MasterCard and Visa use interchange as a balancing device. Interchange fees are a vital tool for Visa (and MasterCard) to balance competing demands on both sides of the two-sided market. To reiterate, Visa and MasterCard do not receive any revenue from interchange fees. Rather, they strive to set default interchange rates at the network volume-maximizing level. This means setting interchange rates at a level that allows both Issuers and Acquirers to profitably participate in the Visa network. If interchange rates are set too high, Acquirers will not participate because they will be unable to profitably set their merchant discount rate at a level low enough to attract Merchants and if interchange rates are set too low, Issuers will not participate because they will be unable to profitably offer their current and potential new Cardholders sufficient value to induce them to use their cards or to acquire new cards. Thus, interchange rates are a key part of competition among the credit card networks to attract Acquirers and Issuers and, in turn, Merchants and Cardholders.

Witness Statement of Sheedy at para. 38.

120. Visa regularly stresses this point in its meetings with Issuers and Acquirers. For example, in a 2010 presentation to [redacted], Visa noted that interchange is "[a] mechanism to balance the economics of Issuers and Acquirers and effect the transfer of value between the participants in the payments system."

Witness Statement of Sheedy at para. 38.

121. At the same time, setting interchange is not an exact science. Visa monitors its relationships with Issuers and Acquirers on a regular basis and adjusts the interchange rates where deemed necessary to respond to competitive factors and maximize network volume over the long term. In setting interchange rates to maximize network volume, Visa takes the following factors into account: (1) promoting overall system growth and growth in particular Merchant segments in competition with other payment methods; (2) reflecting the value delivered to Issuers and Acquirers, and in turn their Merchant and Cardholder customers; and (3) delivering value sufficient for Merchants to accept credit cards and financial institutions to invest in the system and to assume risks of card issuance.

Witness Statement of Sheedy at para. 39.

122. Visa considers an interchange rate program to be in balance if it is connected to a business strategy that gives Visa the best opportunity to expand volume over the long term. However, this balance changes given that Visa is in a competitive and dynamic marketplace. In some cases, Visa has grown its payment system through reductions in interchange rates, in others through increases. For example, Visa makes a lower credit card interchange rate available to Acquirers in respect of emerging segments where consumers have not traditionally paid with credit cards. On the other hand, Visa sets a higher interchange rate on premium card transactions where Issuers need to be compensated for the cost of increased Cardholder benefits.

Witness Statement of Sheedy at para. 40;
[redacted]

123. Interchange rates provide revenue to Issuers, enabling them to provide greater benefits to consumers. In the U.S., about [redacted] of Issuer revenue from credit cards is from Acquirers' interchange fees; the remainder is derived from Cardholders. Revenues from interchange fees thus allow Issuers to lower costs to Cardholders by reducing annual or other fees, or finance charges for credit payments, thereby reducing the costs of purchases from Merchants. Interchange fee revenue also permits Issuers to add features and benefits to cards such as card rewards programs and extended warranties on products purchased with the card.

Witness Statement of Sheedy at para. 42.

(iv) The Challenged Rules as a Balancing Device

124. The Challenged Rules also maintain order and interoperability within the networks and among their Issuers and Acquirers. The Challenged Rules create predictability for Cardholders that drives both card usage and Merchant value. The Challenged Rules also, as discussed below, promote transaction volume. These functions are pro-competitive, not anti-competitive.

Elzinga Report at para. 212;
Transcript of Examination-in-Chief of Leggett at page 2591 (public).

125. To take the simplest example, if interchange has effectively balanced the system, by transferring value to the issuing side, thus optimizing its efficiency, surcharging, which takes value away from the Cardholder, will unbalance the system.

2. The Competitive Marketplace

(a) The History of MasterCard's Business in Canada

(i) Visa was Here First

126. When the network now operated by Visa Canada Corporation ("Visa") first came to Canada in 1968, it did so as an association of four of Canada's five largest banks:

[redacted]

Canadian Imperial Bank of Commerce, Royal Bank of Canada, Bank of Nova Scotia and The Toronto-Dominion Bank.

Witness Statement of Stanton at para. 25.

127. When MasterCard first came to Canada, it did so under the brand name MasterCharge. At that time, because the non-duality rule precluded the Visa banks from issuing MasterCard credit cards, MasterCard forged a relationship with the remaining major banks in Canada, including Bank of Montreal and National Bank of Canada.

Witness Statement of Stanton at paras. 26-27.

(ii) MasterCard is the Smaller Brand

128. Traditionally, MasterCard has been the second largest credit card network in Canada in most Merchant and Cardholder demographics, measured by both the number of transactions and by the gross dollar volume of its transactions. [redacted]

[redacted]

Witness Statement of Stanton at para. 28;
Witness Statement of DeVita at para. 20, Exhibit "B".

129. As the smaller network, MasterCard has to try hard to achieve transaction volume on its networks. Due to the historical positioning of credit card networks in Canada and

[redacted]

MasterCard's status as the second-largest credit card network, it competes vigorously with Visa. MasterCard, however, does not compete solely with Visa. Some of MasterCard's other competitors include cash, cheques, Interac debit, Interac e-transfer, money orders, traveller's cheques, gift cards, PayPal, Merchant-issued credit cards, peer-to-peer solutions such as Bill Me Later and other credit cards, including American Express and Discover. These competitors pose real threats to MasterCard in various spaces.

Witness Statement of Stanton at paras. 50-51.

(iii) Non-Duality

130. Until November of 2008, "non-duality rules" prevented Issuers from issuing both MasterCard and Visa cards. As a result, historically only one of Canada's five largest banks, Bank of Montreal, issued MasterCard credit cards.

Witness Statement of Stanton at para. 27;
Witness Statement of DeVita at para. 28.

(iv) Move to Duality

131. The Competition Bureau ended its expressed preference for non-duality in a letter dated November 7, 2008 stating:

> "In the past, the potential for credit card Issuers and acquirers to issue credit cards or acquire transactions for more than one of the two major credit card networks had been restricted by the rules of the Canadian credit card associations. These rules address potential concerns of the Bureau because they eliminated any likelihood of conflict that either Issuers or acquirers could be a member of both associations and thereby be able to simultaneously influence the corporate governance and competitive decisions of both associations (so-called "dual governance"). Entities, whether Issuers or acquirers, had to choose which of the major credit cards they would issue to consumers or use for merchant acquiring. In light of the restructurings and subsequent information obtained from various industry participants, the Bureau is no longer concerned that there is a potential for a member, or group of members, of one credit card network to negatively influence the competitive operations of another card network through dual governance. Because of the restructurings, Issuers and

[redacted]

acquirers are no longer involved in most of the governing decisions of the major credit card networks. As a result, the Bureau will not pursue enforcement action under the Competition Act against a credit card network or its Issuers and acquirers who enter into an agreement to simultaneously issue multiple credit card brands or acquire transactions for multiple credit card networks."

> [redacted]
> *The Competition Bureau's Letter to Financial Institutions — Duality and Dual Governance of Credit Card Networks in Canada*, Exhibit RM-446.

132. Upon the reversal of the Non-Duality Rules, MasterCard pursued an association, in addition to the new Issuers it brought to the system, with a number of large Canadian banks that were members of Visa's network. MasterCard credit cards are now issued by a number of banks that once issued Visa credit cards exclusively, such as Canadian Imperial Bank of Commerce, Royal Bank of Canada and The Toronto-Dominion Bank.

> *The Competition Bureau's Letter to Financial Institutions— Duality and Dual Governance of Credit Card Networks in Canada*, Exhibit RM-446;
> Witness Statement of DeVita at para. 28.

133. MasterCard's Issuers include banks, credit unions, and other financial service entities. MasterCard credit cards have also been issued by a number of small credit unions, such as Credit Union Atlantic, and foreign-based Issuers, including Capital One, Bank of America, Chase, GE Money Canada, and HSBC.

> Witness Statement of Stanton at para. 29.

134. Some of the largest retailers and Merchants in this country also issue MasterCard credit cards, including Canadian Tire and Wal-Mart.

> Witness Statement of Stanton at para. 31;
> Witness Statement of DeVita at para. 28;
> *Walmart Canada Bank Web Advertisements*, Exhibit RM-6.

(v) Disadvantage Respecting "Transactors"

135. In the last five years, MasterCard identified a sector of consumers in which MasterCard was not competitive, being "transactor" purchasers. MasterCard has had a

proportionately [redacted] These purchasers typically do not carry a monthly balance on their MasterCard credit card accounts and instead tend to pay their outstanding balances as they come due. On average, transactors spend more and more frequently. They also tend to expect benefits and be attracted to rewards from their payment cards.

Witness Statement of Stanton at para. 106;
Witness Statement DeVita at para. 31;
Transcript of Examination-in-Chief of Stanton at page 2455 (public).

136. It is desirable to attract transactors to the MasterCard network because MasterCard's revenues are derived from transaction count and volume and MasterCard derives no economic benefit from lending. Transactors, however, may be less desirable to Issuers than "revolvers", because transactors do not generate interest revenue for Issuers, whereas revolvers do generate interest revenue for Issuers.

Witness Statement of Stanton at para. 107.

(vi) Introduction of Premium Cards

137. When MasterCard found itself uncompetitive in the transactor segment with Visa, American Express and Interac debit, MasterCard developed product structures which would appeal to high-spend transactor Cardholders, the High Spend and premium High Spend programs.

Witness Statement of Stanton at para. 108.

138. The programs targeted at transactor Cardholders are intended to provide Issuers with MasterCard-branded credit card products which compete with, among others, programs offered by Visa and American Express.

Witness Statement of DeVita at para. 32.

139. In particular, Visa offers an "Infinite" line of products which provide Cardholders with enhanced benefits. American Express' Cardholder proposition relates to travel and

benefits. In response, MasterCard requires that Issuers offering World or World Elite MasterCard card programs provide certain levels of benefits and rewards. These programs effectively reduce the cost to Cardholders of holding and using these MasterCard credit cards.

Witness Statement of DeVita at para. 33.

140. [redacted]

[redacted]

141. Issuers are required to certify that minimum spend levels are met on an aggregate basis, in order for the Issuer to receive the higher default interchange rate related to a High Spend or premium High Spend product construct.

Witness Statement of Stanton at para. 110.

142. If an Issuer cannot meet the requirements of the premium High Spend product construct, that Issuer's program will be moved out of the product construct. MasterCard also retains the ability to assess penalties against non-compliant Issuers, so as to eliminate the receipt of interchange monies not otherwise payable to the Issuer, and to provide an economic incentive for the Issuer to be honest in the preparation of qualifying programs.

Witness Statement of Stanton at para. 111.

[redacted]

(b) Competition for Payments in Canada

(i) Generally

143. Use of a MasterCard credit card is one of many ways for consumers and businesses to pay for goods and services in Canada and for Merchants to accept payment for goods and services. A non-comprehensive listing of such methods includes cash, cheques, pre-authorized debit, Interac debit, Interac e-Transfer, money orders, travelers cheques, gift cards, Merchant-issued credit cards, PayPal, Bill me Later, Obopay, Bill Monk, Text Pay Me and Zoompass and general purpose credit cards, including MasterCard, Visa, American Express, Discover, JCB and China UnionPay.

> Witness Statement of Stanton at para. 50;
> Witness Statement of Sheedy at para. 29;
> Witness Statement of Weiner at para. 7;
> Dunn Report at para. 36.

144. MasterCard and Visa compete aggressively as general purpose credit card brands within the broad payments landscape in Canada. To compete with other methods of payment, MasterCard must successfully encourage both Merchants and Cardholders to use MasterCard credit cards. This competition occurs every day, multiple times a day, with millions and millions of transactions. By the time a purchase is made, MasterCard has competed with all the other available payment methods for that transaction.

> Witness Statement of Stanton at para. 53.

145. The Commissioner has argued that cash, debit cards and other payment methods are not substitutes for credit cards. This ignores the commercial reality within which Visa and MasterCard operate. Witnesses from each of Visa and MasterCard have testified that cash, cheques, Interac and PayPal are among the payment methods that compete with the Visa and MasterCard networks.

> Transcript of Examination-in-Chief of DeVita at page 2480 (public);
> Transcript of Examination-in-Chief of Weiner at page 2309 (public);
> Transcript of Examination-in-Chief of Jairam at page 3325 (public).

146. The Canadian payments industry is intensely competitive and highly innovative. Growth in credit cards over time has come from growth in the economy and cannibalization of the volume of transactions paid for by other payment methods, including cash and cheques. The card networks and Issuers continually develop new products and services to address the needs of Merchants and Cardholders. For example, MasterCard's PayPass technology provides the ability to conclude transactions even more efficiently than a credit card which does not have PayPass. Canada is already a leader in near field communication applications (tap, or proximity payments), with 11 % penetration at the point of sale, and it is predicted that the next wave in consumer payments will come from new mobile technologies.

> Witness Statement of Leggett at para. 24;
> Witness Statement of DeVita at paras. 23-24.

147. MasterCard seeks to maintain a fair playing field when competing with other forms of payment, including other credit card brands. MasterCard competes with various forms of payment, and cannot afford regulations or restrictions which permit Merchants to purport to accept MasterCard credit cards and then prejudicially decline them or levy a fee for their use (as some Merchant witnesses being called by the Commissioner are expressly threatening to do). This is especially true in light of MasterCard's historic role as the second-largest (and in some sectors third-largest) credit card network in Canada.

> Witness Statement of DeVita at para. 48.

(ii) Visa and American Express

148. While the acceptance of MasterCard credit cards by Merchants has increased, MasterCard traditionally struggled for Merchant acceptance in certain Merchant segments. MasterCard has made a conscious effort to expand Merchant acceptance by being more attractive to more Merchants, and broader categories of Merchants. They have succeeded in this. Presumably those Merchants who previously did not accept MasterCard credit cards decided that they would be better off accepting them than not, taking into account the merchant discount rate they had to pay to do so.

[redacted]

Witness Statement of Stanton at para. 54.

149. The competition between Visa and MasterCard is vigorous and occurs on both sides of the two-sided Canadian credit card business. On the Merchant side, MasterCard competes to enlist Canadian financial institutions and processors to acquire Merchant MasterCard credit card payments.

Witness Statement of Stanton at para. 56;
Transcript of Cross-Examination of Sheedy at pages 2163-2164 (public);
[redacted]
Transcript of Examination-in-Chief of Frankel at page 827 (public);
Transcript of Cross-Examination of Carlton at page 1364 (public).

150. Competition between MasterCard and Visa intensified markedly in Canada following the introduction of "duality" in November 2008, when the Competition Bureau indicated that it would not oppose Issuers and Acquirers simultaneously issuing credit cards or acquiring both Visa and MasterCard transactions.

Witness Statement of Weiner at para. 12 and Exhibit "F".

151. Visa and MasterCard also compete against American Express, which serves as its own Issuer and Acquirer. While Visa Canada's competition with American Express has been particularly intense with respect to the premium credit card segment and the business to business segment, Visa Canada does not consider American Express a minor participant in Canada; rather, American Express is a formidable competitor that is continually seeking to erode Visa Canada's business by offering Cardholders significant rewards, and Merchants significant benefits, and increasing brand presence and awareness in Canada in order to maximize volume on its system. Furthermore, many Merchant witnesses acknowledged that American Express generally has a higher cost of acceptance than Visa or MasterCard credit cards, but is not subject to these proceedings brought by the Commissioner.

Witness Statement of Stanton at para. 55;
Witness Statement of Weiner at para. 15;
Transcript of Cross-Examination of Broughton at page 364 (public);
Transcript of Cross-Examination of Daigle at page 439 (public);

[redacted]

152. MasterCard has found that American Express has an advantage with affluent Cardholders and performed similarly to MasterCard in the commercial sphere.

Witness Statement of Stanton at para. 55.

153. The merchant discount rates for accepting MasterCard and Visa credit cards are in the range of [redacted] or so. However, Merchant costs for accepting American Express cards are higher. The merchant discount fee for American Express transactions in the United States has been approximately 70 basis points higher than either MasterCard or Visa, and there is a proposed class action in Quebec in which it is alleged that Amex Bank of Canada's general merchant discount rate is approximately 3%, and the specific Merchant pays 3.63%.

Dunn Report at para. 38.

154. Merchants who choose to accept credit cards do not always accept every brand of card. For example, Costco Canada does not currently accept Visa or MasterCard credit cards in store; rather, Costco Canada exclusively accepts American Express credit cards and is an American Express Issuer. No Frills, a major grocer, accepts MasterCard and Interac cards, but not Visa credit cards. Until a few weeks ago Tim Hortons accepted MasterCard, but not Visa.

Witness Statement of Weiner at para. 32;
[redacted]

155. On the consumer side, MasterCard competes to enlist Canadian financial institutions to issue MasterCard credit cards. These Issuers seek to encourage consumers to use MasterCard credit cards instead of competing payment forms. MasterCard offers consumers a significant number of Merchants who choose to accept MasterCard branded credit cards.

Witness Statement of Stanton at para. 57.

156. As mentioned above, MasterCard's share of credit dollar purchase volume in Canada is below 35%, no matter how it is calculated. MasterCard's share of dollar purchase volume made on MasterCard, Visa, American Express and Interac debit in 2010 was approximately [redacted]%. MasterCard's share of dollar purchase volume made on MasterCard, Visa and American Express in 2010 was approximately [redacted]%.

Witness Statement of DeVita at para. 20, [redacted]

157. Mr. Weiner of Visa testified that Visa estimates that transactions over the Visa network account for approximately [redacted] of consumer spending in Canada and only [redacted] of business-to-business spending in Canada. According to the March 2011 Nilson Report, in 2010, there were approximately [redacted] billion transactions made over the Visa network, representing approximately [redacted] billion in transaction volume. Over the same period, there were approximately [redacted] billion transactions made over the Interac network representing approximately [redacted] billion.

Witness Statement of Weiner, para. 8, Exhibit "A".

(iii) Discover

158. The Discover credit card network is in the process of making significant investments to generate issuance and expand acceptance of its credit cards in Canada.

Witness Statement of DeVita at paras. 45 and 47;
Transcript of Examination-in-Chief of DeVita at pages 2486-2487 (public).

159. Discover is trying to enhance its presence in the Canadian market. Although Discover is not presently issued in Canada, Discover recently announced its intention to expand its Canadian presence through an agreement with Moneris, one of Canada's largest Acquirers. [redacted]

[redacted]. There are no material barriers to Discover expanding its presence in Canada, as it has in other jurisdictions such as the United States.

[redacted]

(iv) Debit/Interac

160. As noted above, Interac debit is a very strong competitor of Visa and MasterCard. According to the 2010 Nilson Report, Interac represented [redacted]% of purchase volume market share in Canada in 2010, compared to [redacted]% for MasterCard. As recently as March 2012, Interac ran advertisements on television focusing on substituting of Interac debit payments for credit card payments. Additionally, Interac has been offering programs mirroring those offered by the MasterCard networks. One example is "Interac Flash", which mimics MasterCard's PayPass technology. Another example is the selection of co-branded Interac debit programs being offered by financial institutions, such as the SCENE ScotiaCard, BMO Club Sobeys Card and RBC Shoppers Optimum Card.

> Witness Statement of DeVita at paras. 45-47;
> *Interac.ca flash movie*, Exhibit RM-453.

(v) Pay Pal

161. PayPal, a traditional on-line payment provider, has also begun to move into the bricks and mortar retail landscape. The merchant discount rate for Merchants to accept PayPal is substantially higher than MasterCard, Visa or American Express.

> Witness Statement of Stanton at para. 58.

162. Any suggestion that PayPal is only a complement to general purpose credit cards and not a substitute for them is incorrect. Mr. Weiner of Visa testified that Visa also views e-commerce/mobile alternative payment providers like PayPal as a significant

[redacted]

competitive threat. PayPal has established a global brand name, is a significant player in the e-commerce market, and is expanding its presence in the "bricks and mortar" environment. As recently as March of this year, PayPal introduced a new product in Canada called "PayPal Here," which enables traditional Merchants to accept PayPal payments in-store. PayPal's growth is driven by payments at Merchants, rather than its eBay marketplace or person-to-person payment, which makes it a direct competitor to Visa Canada.

Witness Statement of Weiner at para. 11.

(vi) Cash

163. Cash is a particularly significant competitor for MasterCard, and for all other payment card types. The Bank of Canada's Carlos Arango stated in his testimony to the Canadian Senate of March 3, 2011

> "Cash accounts for 54% of total purchases….Based on a rough extrapolation this could amount to at least 6 billion cash transactions compared to 2.5 billion for credit cards and 3.9 billion for debit cards in 2009."

Correspondingly, an active component of MasterCard's competitive strategy – not just in Canada, but throughout the world – has been a "war on cash".

Witness Statement of Stanton at para. 51;
Witness Statement of DeVita at para. 44.

164. Cash is the predominant competitor for not only MasterCard, but for all other payment card types. In particular, according to the Gauthier Study referred to by Professor Mulvey in his Report, cash and debit dominate transactions below $25.

Mulvey Report at para. 20;
Witness Statement of DeVita at para. 44.

[redacted]

(vii) Merchant-Issued Credit Cards

165. Some Merchants issue their own general purpose credit cards or operate store-branded cards. Many Merchants have discontinued their proprietary card arrangements to accept general purpose cards because of the relatively low cost of doing so. That is, they have concluded that they are better off accepting general purpose credit cards and paying the associated costs than operating their own proprietary credit card program.

Witness Statement of Stanton at para. 59.

(c) Value Merchants Get by Accepting Cards

(i) Advantages to Merchants

166. The many benefits to Merchants of accepting MasterCard credit cards include:

(a) Prompt payment;

(b) Guarantee of payment;

(c) Increased Sales: Consumers spend more when they are not constrained by cash on hand;

(d) Customer Satisfaction: Customers appreciate the fact that Merchants allow them the flexibility to pay the way they want to pay;

(e) Speed of Checkout: Merchants do not have to spend time counting change or waiting while customers write cheques;

(f) Improved Efficiency: Card transactions today are conducted electronically. These paperless payments can save Merchant's time and money by minimizing cash handling and payment reconciliation;

(g) Safety: With lower volumes of cash, Merchants are less vulnerable to costs of handling, depositing, shrinkage, dishonouring, counterfeiting, delay, theft and pilfering;

(h) Currency Conversion: Electronic payments on MasterCard credit cards are settled in the currency in which the Merchant sells goods and services, regardless of the Cardholder's country of origin;

(i) Reduced Credit Risk: Merchants accepting payment by MasterCard cards do not bear the risk associated with extending credit to customers;

(j) Access to customers who wish to use credit cards: Merchants gain access to customers whose purchasing power has been enhanced by convenient and immediate creditworthiness underwritten by an Issuer, and who are not restricted to making purchases with funds on hand without the expense and risk of developing and administering their own proprietary card programs; and

(k) Access to customers who spend more.

Witness Statement of Stanton at para. 44;
Witness Statement of DeVita at para. 13;
Witness Statement of Sheedy at para. 35;
Transcript of Examination-in-Chief of Leggett at pages 2586-2594 (public).

167. As the foregoing list shows, Merchants receive many benefits from accepting credit cards that they do not receive from other payment forms. Merchants have long recognized and capitalized on these benefits. For example, many Merchants in Canada have express lines or self-service kiosks for customers using credit cards (e.g., Loblaws, Safeway, Wal-Mart, Canadian Tire), while some Merchants effectively only accept credit cards.

Transcript of Examination-in-Chief of Leggett at pages 2588-2589 (public).

168. A transaction with a credit card takes much less time than a transaction with cash or cheque, and as such Merchants are able to process a higher volume of transactions in a shorter amount of time.

[redacted]

Transcript of Examination-in-Chief of Elzinga at pages 2723-2724 (public).

169. A significant benefit to Merchants of accepting credit cards is reduction in bad debt expense. For example, through the ten years when the University of Saskatchewan accepted credit cards, its bad debt ratio fell by 0.1% (a 20% improvement), and in the two years subsequent to that, it fell by another 0.1% (a further 25% improvement).

Transcript of Cross-Examination of Van Impe at pages 1687-1688 (public).

170. In addition, several Merchant witnesses before the Tribunal – specifically, those from Air Canada and WestJet – stated that the decision to exclusively accept credit cards in cabins on flights enhanced the customer service experience, increased convenience and also provided greater transaction efficiency.

Transcript of Cross-Examination of Houle at pages 507-508 (public);
Transcript of Cross-Examination of Li at pages 1553-1554 (public).

171. MasterCard's PayPass technology saves Merchants about 40% time versus MasterCard's regular transactions with PIN and chip.

Transcript of Examination-in-Chief of DeVita at page 2474 (public).

172. Credit cards also promote competition in retail markets. By allowing consumers to purchase online, credit cards reduce the need for retailers to have a "bricks and mortar" establishment. On a daily basis, Canadians make over 300,000 online transactions cumulatively valued at approximately $42 million. More and more retailers such as Amazon.com and e-Bay are online or exclusively online. Online retail has greatly expanded the customer base of many Merchants, reduced barriers to entry in many retail markets, reduced Merchants' costs, and increased competition in the retail sector. It also makes retailers more competitive because consumers can buy from more Merchants, more often.

Witness Statement of Leggett at para. 22;
Transcript of Examination-in-Chief of Leggett at page 2588 (public);
Elzinga Report at para. 157.

173. Confidential data compiled by the Canadian Bankers Association shows that the average transaction size and the average outstanding balance are both higher for premium credit cards than for standard credit cards. According to Statistics Canada, 51 % of Internet users ordered goods or services for personal or household use in 2010. In total, Canadians placed nearly 114 million orders valued at approximately $15.3 billion. This translates to 312,229 online orders worth $41.9 million per day in 2010.

Transcript of Examination-in-Chief of Leggett at page 2588 (public).

174. The fact that the use of credit cards by consumers allows the risk of fraud to be assumed by the Issuers is another important benefit. Absent certain limited circumstances, such as proof of fraud by a Merchant, an Issuer bears the risk for the funds it pays for the Cardholder's transaction. Because payment is guaranteed, Merchants are able to avoid the risk and time consumed by non-payment and collection costs—collection costs they must assume for payments such as cheques or Merchant-provided credit.

Witness Statement of Sheedy at para. 43;
[redacted]
Transcript of Examination-in-Chief of Leggett at page 2587 (public).

175. Merchants also benefit from a customer's revolving credit limit. Volume of transactions increase as customers make purchases that they might not otherwise be able to make, either because they do not have cash on hand, or may not have cash in their account.

Transcript of Examination-in-Chief of Leggett at page 2589 (public).

(ii) Merchants are Better Off Accepting Cards than not

176. Merchants who accept credit cards have determined that the benefits outweigh the costs. Merchants are aware of the cost of credit card payments because they receive disclosures pursuant to the Code of Conduct and within periodic statements from their Acquirers. Merchants also sign contracts outlining their costs before commencing acceptance of MasterCard credit cards.

[redacted]

Witness Statement of Stanton at para. 60;
[redacted]

177. In fact, in exchange for incentives, some Merchants enter into agreements with MasterCard directly to create credit card products that bear the brands of both the Merchant and MasterCard. These arrangements may be structured so that credit cards will be issued by any one of the MasterCard Issuers. They may involve incorporation of the Merchant's brand on the card, or they may not.

Witness Statement of Stanton at para. 112.

178. Where a Merchant does enter into a co-branding or an issuing arrangement with MasterCard, the associated card product most often provides benefits to Cardholders for use of the card, with extra benefits for use of the card at the participating Merchant.

Witness Statement of Stanton at para. 113.

179. As mentioned above, the Commissioner's witnesses, despite their desire to reduce their costs of accepting MasterCard credit cards, are among those Merchants who have chosen to enter into special contracts with MasterCard to co-brand MasterCard credit cards, and pursuant thereto, actively promote the use of MasterCard credit cards. The Commissioner's witnesses with special contracts of this nature with MasterCard include: [redacted]. Other Merchants who have co-branding agreements with MasterCard include: [redacted]. Particulars of the special contracts between MasterCard and each of [redacted] are discussed in greater detail below.

Witness Statement of Stanton at paras. 112-126;
Witness Statement of DeVita at paras. 36-42.

180. While there are clear benefits to Merchants to accept Visa and MasterCard credit cards, it is important to remember that Merchants are free to steer customers towards other payment methods (except via surcharging or refusing to honour their credit cards), or to choose not to accept Visa or MasterCard credit cards, or indeed to choose not to accept

[redacted]

credit cards at all if that Merchant does not believe that acceptance of Visa or MasterCard credit cards will increase its sales and/or decrease its costs. For instance, Merchants in a number of industries, including grocery and fast food, have only relatively recently begun to accept Visa credit cards (or credit cards at all) on the basis that Visa's value proposition makes it commercially sensible for them to do so.

> Witness Statement of Stanton at para. 76;
> Witness Statement of Sheedy at para. 37;
> Transcript of Examination-in-Chief of Jairam at page 3345 (public).

(iii) Costs of Cash, Debit and Cheques

181. Merchants tend to have less awareness about the costs of accepting cash, cheques or pre-authorized debit because such costs are less transparent and do not appear as an item on a statement. Other payment methods have their own associated costs, such as handling, theft, depositing, shrinkage, dishonouring, counterfeiting and delays. As Mr. Dunn noted anecdotally, different commentaries have referred to these costs as ranging from 0.5% to 2.0% of total purchase volume, depending on the Merchant and transaction sizes.

> Witness Statement of Stanton at para. 61;
> Dunn Report at para. 39.

182. [redacted]

> [redacted]

183. While it may be the case that on a per transaction basis, as Mr. Weiner testified, Merchants will generally pay more for a credit card transaction than a cash transaction, this statement fails to take into account the fact that by accepting credit cards, Merchants are able to avoid or minimize ancillary costs associated with other forms of payment. Examples of such costs include: the costs of extending credit to customers, fraud protection, pilferage, secure transport for large amounts of cash, bounced cheques, and cashier errors. This comparison also fails to account for the overall benefits to Merchants that accrue from accepting credit cards as opposed to other forms of payment. For

[redacted]

instance, Tim Broughton, co-owner of C'est What? says he does not accept debit because of the time it takes to process transactions.

Witness Statement of Weiner at para. 9;
Transcript of Examination-in-Chief of Broughton at page 342 (public).

184. Cheques also have costs associated with them and in particular a cost to provide a guarantee in the instances where a non-local cheque is even accepted. In the last year, Mr. Dunn has examined cheque guarantee services, which provide some analogous benefits to those related to Merchant debit card acceptance. The data Mr. Dunn reviewed came from actual pricing tables of cheque guarantee companies. In order for a Merchant to have a cheque "authorized" or "guaranteed" by a third-party similar to debit/credit card transactions, fees for cheque guarantees range from [redacted] on the face of the cheque, plus a fee of between [redacted] per transaction.

Dunn Report at para. 41.

(i) Default Rate on Credit Cards Makes Their Cost to Merchants Comparable to Cash or Cheques

185. In his Report, Professor Elzinga cites a Canadian Bankers Association study which measures lending costs for Visa and MasterCard Issuers, being the net loss rate. The study found that during the 2004 to 2011 time period, the net loss ranged from [redacted]% in the last quarter of 2006 to [redacted]% in the last quarter of 2009.

Elzinga Report at para. 112.

186. Professor Elzinga also cites an analysis of a 2006 survey of respondents conducted by Carlos Arango and Varga Taylor regarding the costs of payment to a Merchant for a transaction of \$36.50 (the median cash transaction in the survey). By their estimate, the cost of debit is \$0.19; the cost of cash is \$0.25 and the cost of credit is \$0.82; the latter in large part due to \$0.73 in "payment processing fees". Professor Elzinga notes that if one were to assume that if the Merchant were the lending party and (very conservatively) that the Merchant's lending costs would be 1.5% on a \$36.50 transaction, the cost would be

$0.55. Using the $0.82 estimate of Arango and Taylor and subtracting $0.55 as the cost of lending, the result is a cost of credit card acceptance to the Merchant of $0.27 per transaction, which is not much higher than the cost of cash ($0.25) or debit ($0.19).

Elzinga Report at paras. 112-114.

(ii) Premium Cards Bring Value to Merchants

187. Visa introduced premium cards in Canada in 2008, with higher interchange rates (reflecting in part the increased rewards offered by Issuers associated with these products), principally to compete for high-spending Cardholders with American Express, which has traditionally been the leader in this segment. Higher interchange rates for Visa's premium cards also reflect competition with MasterCard for Issuers to issue credit cards that will be attractive to the most high-spending Cardholders (who are also the most attractive customers for Merchants).

Witness Statement of Weiner at para. 36.

188. [redacted]

[redacted]

189. Merchants enjoy benefits from accepting high spend and premium high spend MasterCard cards. One significant benefit Merchants receive is from the increase in the average value of a purchase made by a consumer ("average ticket amount") on purchases made on MasterCard high spend and premium high spend cards when compared to the average ticket amount of purchases made on core (non-premium) cards.

Dunn Report at para. 26.

190. Mr. Dunn's analysis of historical MasterCard clearing data for Canada, conducted during late 2011 and into early 2012, shows that the average value of purchases made on core

cards has [redacted]

[redacted]

191. [redacted]

Dunn Report at para. 28.

192. Cardholders using high spend and premium high spend credit cards provided Merchants with substantially higher average ticket price growth than existed for core credit card accounts of Issuers (both those that did and did not introduce premium high spend and high spend cards).

Dunn Report at para. 29.

193. [redacted]

[redacted]

[redacted]

Dunn Report at para. 30, Exhibit "E".

194. Premium credit cards have proven to be popular with consumers who evidently value the benefits associated with them. If Merchants could elect either to surcharge premium credit card products, or not accept them at all, they risk losing the ability to attract or retain the patronage of a valuable segment of customers, some of whom would elect to shop at Merchants who accept such cards, or do so without surcharge. Such consumers, who will still seek the benefits associated with premium cards, may also elect to pay with a premium American Express credit card (assuming the Merchant accepts American Express) which conveys the premium benefits to the Cardholder, but generally at a higher cost to the Merchant.

Witness Statement of Weiner at para. 37, [redacted]

3. The Rules

(a) The MasterCard Operating Rules

(i) Generally

195. Within the four-party MasterCard network, MasterCard typically has agreements with two main types of parties: Issuers and Acquirers. In order for an entity to act as an Issuer or Acquirer within the MasterCard network, it must execute a license agreement.

Witness Statement of Stanton at para. 64.

196. MasterCard's role as network operator also includes the establishment of operating rules (the "MasterCard Operating Rules") to ensure that Acquirers promptly settle Merchant accounts and that Issuers clear transactions with Acquirers and treat Cardholders as they

[redacted]

promise. The MasterCard Operating Rules are designed to permit the MasterCard network to function as an attractive, efficient payment mechanism for both Cardholders and Merchants.

Witness Statement of Stanton at para. 62.

197. Certain of MasterCard's Operating Rules minimize negative impact and provide Cardholders ease and confidence in using their MasterCard credit card. If an Acquirer or Issuer of the network does not abide by the rules of the network, there is a risk that the consumer experience will be denigrated and the quality control that consumers have come to associate with the use of a MasterCard credit card will not have been lived up to.

Witness Statement of Stanton at para. 84.

198. As is common in other franchise situations, MasterCard strives to ensure that the members of its network meet certain quality control standards. Some of the standards primarily benefit Cardholders, while others (for instance, timely settlement of transactions) benefit Merchants. The standards are all designed to maximize the attractiveness of the network overall, to balance it, and thereby maximize its usage.

Witness Statement of Stanton at para. 85.

199. MasterCard's Operating Rules, including the Challenged Rules, are designed to expand output, benefit Cardholders and promote efficiency. The Operating Rules are efficiency enhancing and consumer protection rules, designed to make MasterCard an attractive form of payment. Reasons for adoption of the Challenged Rules have nothing to do with any sort of price maintenance.

Witness Statement of Stanton at para. 87.

200. MasterCard's Operating Rules require Issuers to settle all valid transactions which are submitted by Acquirers.

Witness Statement of Stanton at para. 63.

201. The Challenged Rules which the Commissioner argues constitute price maintenance are set out below:

(ii) The No Surcharge Rule

(a) The NSR for the Canada Region, Rule 5.11.2 (as modified by Section 11a of the Operating Rules), reads:

> "A merchant must not directly or indirectly require any Cardholder to pay a surcharge or any part of any merchant discount or any contemporaneous finance charge in connection with a Transaction. A merchant may provide a discount to its customers for cash payments. A merchant is permitted to charge a fee (such as a bona fide commission, postage, expedited service or convenience fees, and the like) if the fee is imposed on all like transactions regardless of the form of payment used, or as the Corporation has expressly permitted in writing. For the purposes of this Rule:
>
> 1. A surcharge is any fee charged in connection with a Transaction that is not charged if another payment method is used.
> 2. The merchant discount fee is any fee a merchant pays to an Acquirer so that the Acquirer will acquire the Transactions of the merchant.
>
> In addition to a discount for cash, a merchant may provide a discount to its customers for other forms of payment, including differential discounts for other payment brands. Such discounts must be clearly communicated at the Point of Interaction."

Witness Statement of Stanton at para. 67.

(iii) The Honour All Cards Rule

(b) The "honour all cards rule" ("HACR") for MasterCard credit cards in the Canada Region, Rule 5.8.1 (as modified by Section 11a of the Operating Rules), reads:

> **Honor All Other MasterCard Cards.** Merchants that choose to accept Other [non-domestic debit] Cards must honor all Other Cards without discrimination when properly presented for payment. The merchant must maintain a policy that does not discriminate among customers seeking to make purchases with another Card."

Witness Statement of Stanton at para. 65.

(iv) The Non-Discrimination Rule

(c) The NDR Rule 5.11.1, 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."

(v) Rules Which Balance the System in Favour of Merchants

202. Card payment systems, which include their operating rules, provide Merchants with multiple benefits. These include safety (protection against loss, theft and counterfeiting), convenience, record-keeping services, guaranteed payment and dispute resolution. By accepting a general purpose card, Merchants enjoy these benefits without having to develop and administer their own proprietary card programs as well as the significant cost associated with running a card system and absorbing bad debt losses. With the introduction of cards that can be electronically read, Merchants and consumers often can consummate transactions with cards more efficiently (i.e., in less time and at lower cost) than with cheques (which take time to write and may be "bad") or cash (which requires making change and adds security costs to the Merchant's operation).

Elzinga Report at para. 28.

(b) Benefits of the No Surcharge Rule

(i) Balances the System

203. The NSR prohibits Cardholders being asked to pay an additional amount above the posted price for using their credit card.

Witness Statement of Stanton at para. 69;
Witness Statement of Sheedy at para. 53.

204. The first point to note is that if the NSR were not in place, Merchants with the opportunity could extract value for themselves, with the effect that, among other things,

[redacted]

Merchants create a profit centre, the networks' brands are undermined, and ultimately credit card usage declines.

205. Professor Elzinga notes that the NSR protects the value of the network's brands from being eroded by the free-riding caused by bait and switch tactics whereby Merchants advertise to consumers their willingness to accept MasterCard credit cards, thereby benefitting from the MasterCard brand, only to impose a surcharge at the time of payment.

> Elzinga Report at paras. 226-227;
> Witness Statement of Stanton at para. 71.

206. Visa and MasterCard's value propositions to their Cardholders depends on broad-based acceptance. A key component of balancing the Cardholder and Merchant sides of their systems is the Cardholder's expectation that a Merchant who advertises acceptance of the credit cards of a network will accept all credit cards of the network without surcharging. A Merchant that advertises credit card acceptance, but then adds a surcharge to customers who want to pay with a particular credit card from that network, is not accepting credit cards in a manner consistent with customer expectations. This undermines the Visa and MasterCard brands and results in reduced consumer demand for their respective networks.

> Witness Statement of Sheedy at para. 65.

207. The benefits of the NSR also extend to Issuers. The removal of the NSR could result in large Merchants partnering with large Issuers to agree not to surcharge. That would constitute a serious competitive disadvantage for any small Issuer in Canada, as well as any small Merchant unable to compete with the corresponding advantage to large Merchants.

> Transcript of Examination-in-Chief of Leggett at pages 2604-2605 (public).

[redacted]

(ii) Protects Consumers

208. The NSR protects consumers by requiring that the price a consumer pays at checkout be no greater than the advertised price of the product. Merchants remain free to steer customers away from using their credit cards, through discounting or other means. The NSR also protects goodwill in the Visa and MasterCard brands from being damaged by negative consumer reaction to unexpected additional charges imposed by Merchants for use of their credit cards. As McCormack concedes at cross-examination: "… I would concede there are some issues, and the scope of which is a matter of some debate, as to the extent that Merchants would excessively surcharge. So there are incidents of merchants excessively surcharging, the scope of which is debated." The NSR also protects the balance of incentives in the Visa and MasterCard systems, to maximize the value of the network for stakeholders in the aggregate.

Witness Statement of Sheedy at para. 54;
Transcript of Cross-Examination of McCormack at page 763 (public).

209. Cardholders in Australia, where surcharging is permitted, are now paying $480 million more per year in Cardholder fees and have also seen their Cardholder benefits and rewards reduced.

Witness Statement of Leggett at para. 66;
[redacted]

210. Survey evidence presented to the Tribunal shows that surcharging is the least preferable strategy from a customer perspective: 3% to 8% selected surcharging over rebates and a single-price strategy. The single-price strategy is only slightly more preferable to customers than the rebate strategy: 48% prefer single-pricing to rebates and 77% prefer it to surcharges whereas 47% prefer rebates to single-pricing and 64% prefer rebates to surcharges.

Gauthier Report at page 22.

(iii) Provides Consistent Experience

211. The NSR ensures that the Cardholder has a predictable experience using his or her credit card at the point of sale. The Cardholder can rely upon advertised prices, rather than being unable to determine in advance how much each Merchant will charge (potentially for the same product). If a Merchant attracts a customer into its store by an advertisement (or to the checkout line by a price tag) offering one price and displaying the Visa logo, and then charges a higher price at the cash register by adding a surcharge, it is reasonable to expect that the consumer might feel deceived, and in any event, that he or she is being penalized for using a Visa credit card.

Witness Statement of Sheedy at para. 55.

(iv) Prevents Reputational Damage

212. Credit card companies oppose surcharging because it poses a threat to brand reputation, and, in contrast, implementation of discounting poses no immediate threats to the brands.

Transcript of Examination-in-Chief of Mulvey at pages 3078-3079 (public).

213. Without consistency in surcharging, the market place becomes chaotic, and consumers do not know if there is going to be a surcharge or if there is going to be an informed strategy – what the magnitude of that discount is, if it is temporary, if it is permanent. And so there is a lot of uncertainty in the market. As Professor Mulvey stated in his evidence:

> "Another thing is they don't know who to blame. They don't know who to point the finger at. Is it because of Visa and MasterCard that this stuff is happening, or is it a merchant level decision? So we have ambiguity in terms of attributions of responsibility, and so it is my view that the merchants are asking for the freedom to make this decision […] when you put the whole piece of the puzzle or all of the tiles of the mosaic together, it is not a pretty picture in terms of where their brand is being high-racked and taken in other directions, in terms of consistency of image. It is their most valuable asset and to me, this must—primarily it is an attack on the brand."

Transcript of Examination-in-Chief of Mulvey at pages 3078-3079 (public).

214. Insofar as surcharging would negatively affect use of MasterCard credit cards, the NSR protects the MasterCard network from injury. The purpose of NSR is to prevent certain Merchants from surcharging certain Cardholders in certain situations, to the detriment of those Cardholders, and to the detriment of MasterCard, since its brand would be seen as less valuable, and MasterCard cards used less often. This concern arises because MasterCard competes with many other forms of payment. In the words of Tim Broughton of Merchant witness C'est What?: "The way I would like to see this happen is it would say on the bottom a Visa surcharge, because it is Visa's surcharge. It is not mine. I don't want to do it. The cost of processing is not one that I set, okay? It is a cost of processing that is set by the payment card industry, the group, the acquirers and the issuing banks and the networks. This would be simply conveying to the customer their cost."

> Witness Statement of Stanton at para. 72;
> Transcript of Cross-Examination of Broughton at page 361 (public).

215. The deep concerns Visa and MasterCard 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 NSR 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 schemes pose no immediate threat to the Visa and MasterCard brands as Merchants assume all of the risks and reap all of the rewards.

216. Providing Merchants free rein to surcharge would be harmful to the Visa and MasterCard brands. Implementation of surcharging schemes would be uneven across Merchants making it difficult for consumers to compare the "true price" of a purchase before visiting a store. Furthermore, consumers may ask themselves why there is a surcharge and who is responsible for it, and then mistakenly infer that Visa or MasterCard were responsible for the policy. Visa and MasterCard are among the world's most trusted brands and are consistently ranked in the Top 100 global brands. Brand is about reputation, it generates trust for a company and for its products and services. A brand's success is rooted in

customer perceptions and behaviour, and is valuable only if the brand can translate customer sentiment into financial value.

217. Surcharges undermine the value that Visa and MasterCard offer their customers and pose a great threat to brand value for a variety of reasons:

(a) *Price precedence and fairness.* Traditionally, Canadian consumers have not paid surcharges on credit card purchases. Surcharges will generate ill will because consumers' reference point for completing credit card transactions, based on a lifetime of experience, is $0. Breaking out a "normal cost of doing business" as an itemized charge will be judged as unfair by consumers who suspect profit-seeking motives.

(b) *Price uncertainty and search costs.* In countries where surcharging is allowed, there are differences both in the adoption of surcharging practices and the surcharging rate. Cardholders may not understand the "true price" until they arrive at the register to pay and are faced with a surcharge that varies from Merchant-to-Merchant. Cardholders must incur new search costs to discover the surcharge levels imposed by Merchants.

(c) *Surcharges represent penalties to Cardholders.* From a Cardholder perspective surcharges are negative and there is widespread disapproval and opposition to surcharges. They don't believe they should have to pay extra when they pay with a credit card.

(d) *Consumers are confused.* People do not understand the reason for surcharges and it is unlikely that the supposed benefits will have been properly explained. Can Visa and MasterCard trust that Merchants will assume responsibility to educate consumers and explain their actions?

(e) *Profiteering on credit card transactions.* Surcharge gouging in Australia provides a cautionary tale about empowering retailers with an unchecked opportunity to

[redacted]

surcharge. Rather than setting surcharges to recover card processing costs, Merchants use surcharging as a new profit centre.

(f) *Masked surcharge responsibility causes confusion.* Surcharging breaks the price into two components: a large base price and a comparatively small surcharge, akin to the Harmonized Sales Tax (HST) which appears as separate item following the subtotal on a sales receipt.

(g) *Misattributions and guilt by association.* It is very difficult for consumers to know if the surcharges are fair and reasonable. Also, a lack of transparency may prevent consumers from knowing that Merchants are wholly responsible for surcharging. Consumers, misled and deceived, will not know who to blame. Yet blame they will, and many consumers will wrongly assume that Visa or MasterCard is responsible for the surcharge.

Mulvey Report at para. 56.

218. MasterCard works tirelessly to promote its brand. For instance, for the ten-plus years that MasterCard has worked effortlessly to put equity into its "Priceless" campaign, and recently its "Priceless Cities" campaign. One example of this work is found in Priceless Toronto, which offers experiences in sports, in culinary experiences, in arts, and in entertainment. This program offers some Cardholders access to practice games for the Toronto Maple Leafs.

Transcript of Examination-in-Chief of DeVita at pages 2472-2473 (public).

219. MasterCard's Priceless Cities campaign, and other brand marketing expenditures, are directed at consumers.

Transcript of Examination-in-Chief of DeVita at page 2473 (public).

220. Issuers rely on MasterCard's brand equity. Issuers new to Canada can rely on the network's brand, as has Capital One. As stated by Robert Livingston:

[redacted]

> "We have 4 million customers in Canada and they certainly wouldn't have had the option of Capital One's cards, or pricing and our services without the support that we felt coming into the marketplace from the MasterCard brand."
>
> "It was paramount for us and very important for us to enter with the halo of the MasterCard brand and relying on it, and the MasterCard brand, in our view, wouldn't have been powerful if a Capital One MasterCard wasn't as useful, didn't have the same utility, as a Bank of Montreal MasterCard or an RBC Visa card or any other big bank credit card".

Transcript of Examination-in-Chief of Livingston at pages 2535-2536 (public).

Mr. Livingston also commented on the strength of the MasterCard brand and its role in Capital One's entry into the Quebec marketplace. Capital One's brand recognition was below 5% while other Issuers had recognition of 90% or close to 100%.

> "We simply wouldn't have been able to compete in Quebec without a brand such as MasterCard that had similar brand recognition to the bigger cardholder financial institutions.
>
> And again, that is ubiquity, and the ability to use a MasterCard wherever MasterCard is accepted and this idea that a MasterCard is a MasterCard, that really enabled our business in Quebec to feel confident when signing up for Capital One."

Transcript of Examination-in-Chief of Livingston at pages 2536-2537 (public).

221. Merchants also rely on the MasterCard brand. Eight of the top ten Merchants in Canada have co-brand agreements with credit card networks.

Transcript of Cross-Examination of Livingston at page 2562 (public).

222. The Challenged Rules protect Cardholders from retailer market power, and they protect Visa and MasterCard against free-riding by Merchants. These are legitimate pro-competitive practices. The Challenged Rules keep the retailers from engaging in what Professor Carlton called super-surcharging, and they protect against free-riding, so that when Visa and MasterCard build this brand equity, Merchants cannot come along and free ride on that by not accepting certain cards, or by adding a surcharge to particular

[redacted]

cards that may be advantageous to that retailer, but represents free-riding on the Visa or the MasterCard platform.

Transcript of Examination-in-Chief of Elzinga at pages 2705 and 2739 (public); Witness Statement of Sheedy at para. 63.

223. [redacted]

[redacted]

224. In fact, no such agreement is necessary for harm to come to MasterCard because it is smaller than Visa. Merchant [redacted] have openly threatened to selectively surcharge MasterCard-branded credit cards.

[redacted]

225. Similarly, Visa's evidence is that it has spent more than forty years and invested millions of dollars to build the Visa brand into one that is universally known and trusted.

Witness Statement of Sheedy at para. 59.

226. While the Challenged Rules do not prevent Merchants from attempting to influence customers' choice of payment method, once a customer makes clear that she wishes to pay with a Visa or MasterCard credit card, he/she should not be punished for that choice. When a Cardholder approaches the checkout of a retailer only to find that she has to pay more to use her credit card, the Cardholder is deprived of the promise made. Visa has introduced its own research which shows that consumers oppose surcharging, in the form of report commissioned by Visa in Australia, showing that [redacted] of Australians oppose surcharging. Visa has also introduced a recent survey by the Consumers Association of Canada, which found that 75% of Canadians "strongly oppose" Merchant surcharging. This hostile reaction to surcharging and its impact on the MasterCard and Visa brands is

[redacted]

different from the effect of discounting. This is why MasterCard and Visa oppose Merchant surcharging but allow discounting, not because surcharging steers customers to alternative payment methods more effectively than discounting.

Witness Statement of Sheedy at para. 60, [redacted] and Exhibit "G".

227. As the Visa and MasterCard brand marks are used by multiple stakeholders across their respective systems, all parties making use of those systems have a stake in upholding the reputation, integrity, and equity of those systems by maintaining, protecting and enhancing their value.

Witness Statement of Sheedy at para. 61.

228. The NSR protects both Visa and MasterCard's brand images and their respective value propositions. Surcharging by even a small number of Merchants, could significantly harm their brands and consumer expectations of what it means for a Merchant to accept their credit cards.

Witness Statement of Sheedy at para. 64.

229. As Professor Elizinga notes, Visa and MasterCard need the NSR to protect the network, and their valuable brands, from the damage of surcharging. Some Merchants, for various reasons, may not be concerned with maintaining good customer relations and so may be more willing to surcharge and become free-riders. As Cardholders encounter such Merchants, they will come to view their cards as less valuable. As the card becomes less valuable to consumers, it becomes less valuable to those Merchants who do not surcharge.

Elzinga Report at para. 233.

(v) At Some Level, Surcharging is the Same as Refusing to Accept a Card

230. Were Merchants to be permitted to surcharge, Visa and MasterCard would have no ability to control surcharging, absent government intervention. Accordingly, Merchants could make it entirely uneconomic for Cardholders to use their cards through grossly

[redacted]

excessive surcharges. This would harm Visa and MasterCard's brands in the same way as if the "Honour All Cards Rule" were eliminated.

(c) International Experience with Surcharging

(i) The Majority of Jurisdictions do not Have Surcharging

231. The Commissioner relies heavily on the abrogation of the NSR in other jurisdictions to suggest that surcharging should be permitted here. The fact remains that the international experience is mixed: surcharging is allowed in some jurisdictions and in others it is not. According to the Commissioner's expert, Dr. Frankel, out of all the jurisdictions in the world, there are just 14 that have allowed surcharging. There are also 12 jurisdictions that have prohibited surcharging, and six that have allowed it with conditions. Surcharging is presently prohibited in Austria, Canada, France, Greece, Italy, Latvia, Lithuania, Luxembourg, Mexico, Romania, Sweden, as well as parts of the U.S.; it is allowed in Australia, Belgium, Czech Republic, Denmark, Estonia, Germany, Ireland, Malta, Netherlands, New Zealand, Poland, Slovenia, Spain and Switzerland; it is allowed with conditions in Portugal, Slovakia, the United Kingdom and other parts of the U.S.

> Witness Statement of Sheedy at paras. 82-83;
> Transcript of Cross-Examination of Frankel at pages 912-913 (public).

(ii) Many Jurisdictions Prohibit Surcharging

232. It is significant to note that while Australia and the United Kingdom have decided to permit surcharging, other jurisdictions have expressly prohibited it. Indeed, the development of Visa's NSR was influenced by U.S. legislation. In the U.S., surcharging was prohibited by federal law until 1984, when the relevant legislative provision expired. (The provision had a sunset clause, which was renewed twice. The provision lapsed in 1984 even though a bill to extend it passed the House by a vote of 355 to 34.). The Senate Report on the federal bill explained the reasons for the prohibition as follows:

> [P]ermitting unlimited cash discounts and prohibiting surcharges allows the competitive free market to operate. Merchants can utilize two-tier

> pricing systems and thereby price cash purchases lower than credit purchases, if they choose to do so. But, they cannot implement two-tier pricing systems which deceive or mislead the consumer. By permitting only cash discounts, the Committee intends to assure that consumers will be seeing at least the highest possible price they will have to pay when they see a tagged or posted price. In other words, consumers cannot be lured into an establishment on the basis of "low, rock-bottom price" only to find at the cash register that the price will be higher if a credit card is used.

Witness Statement of Sheedy at para. 84.

233. The NSR was implemented when the U.S. federal prohibition expired, for reasons that included continuing the same protection for Cardholders identified in the Senate Report. At least ten U.S. states, including many of the largest states, continue to prohibit surcharging of credit card transactions by Merchants.

Witness Statement of Sheedy at para. 85.

(iii) Only a Small Number of Jurisdictions have had Surcharging for a Reasonable Period of Time

234. As of five years ago, only five countries surcharged: the Netherlands, Sweden, Switzerland, United Kingdom and Australia. Of these jurisdictions, credit cards are not used very often in the Netherlands and there is no available data about circumstances in Switzerland. Sweden now prohibits surcharging.

Transcript of Cross-Examination of Frankel at pages 943-948 (public).

(iv) Serious Issues have Arisen When Surcharging has been Permitted

235. In 2001, the Reserve Bank of Australia ("RBA") decided to take a number of steps with respect to payment brands, which steps had the effect of allowing Merchants to surcharge credit card, debit card and charge card payments, and to regulate interchange. The prescribed Interchange rate is now capped at 50 basis points.

Dunn Report at paras. 42-43;
Transcript of Examination-in-Chief of McCormack at page 594 (public).

[redacted]

236. The RBA reforms, taken together, had the following types of impacts on credit and charge Cardholders:

- Higher annual fees and late fees to consumer Cardholders;
- Less valuable reward programs for consumer Cardholders;
- An American Express (or Diners Club) card could be issued in conjunction with a MasterCard or Visa card on the same Cardholder account, so that, for example, if the Cardholder's MasterCard was to be surcharged, he or she could use the American Express card instead; and
- Higher effective retail prices.

Dunn Report at para. 44.

- **Excessive Surcharging in Australia**

237. The RBA, Australia's central bank, has now commenced a consultation to consider changes to its surcharging standards (first introduced in 2003), including potentially capping surcharges, due to evidence of excessive surcharging by Merchants and the groundswell of negative consumer reaction. The RBA also found that surcharges were noticeably higher in circumstances in which consumers had fewer alternatives to credit cards, such as for online payments and within the holiday travel industry.

Witness Statement of Sheedy at para. 82.

238. Consumers appear to pay higher retail prices when they make a surcharged purchase because they pay the surcharge amount in addition to the purchase price but do not appear to benefit from lower retail prices.

Dunn Report at para. 50.

239. No quantitative analysis appears to exist that measures any decreases in retail prices; consumer and consumer group interviews indicate the dominant perception of consumers is that retail prices have not declined as a result of surcharging.

[redacted]

Dunn Report at para. 50 (fn6).

240. After reviewing the submissions the RBA concluded that "In light of the views expressed in consultation and developments in surcharging practices in recent years, the Payments System Board considers that there is a case for varying the [Surcharge] Standards". The proposal is that the credit card networks would be permitted to limit surcharges to the reasonable cost of accepting credit or debit cards.

Dunn Report at para. 51.

241. A survey of available data in 2010, from the RBA and others, indicated that:

(a) The number of Merchants that surcharge (20% to 35%) is likely considerably higher than the percent of card-based payment transactions that are surcharged.

(b) There is limited data that provides quantitative insight into the percent of payment transactions that are surcharged by card type (American Express, Diners, MasterCard, Visa, EFTPOS) within a specific payment channel (cardholder present/terminal, Internet, IVR, mail, direct entry). The RBA and others estimated that the percent of card transactions that are surcharged is no higher than 5% but with a significant variation around the average based on Merchant sector and payment channel.

Dunn Report at para. 45;
Transcript of Examination-in-Chief of Leggett at page 2599 (public).

242. In June 2011, the RBA issued a consultation document ("Consultation Document") to set the stage for a more formal review of surcharging practices because "The Board is concerned that in recent years some surcharging practices, including surcharging well in excess of card acceptance costs, may have reduced the effectiveness of previous surcharging reforms". This document noted that:

> "There was increasing evidence to suggest that it is becoming more common for merchants to set surcharges at levels higher than average merchant service fees."

[redacted]

Dunn Report at para. 46;
Review of Card Surcharging: A Consultation Document - 2011-06-01, Exhibit RM-69.

243. The RBA compared merchant service fees with the average surcharge fees (expressed as a percentage of the transaction value). For large Merchants in 2010, it shows that:

- The average merchant service fees are in the 1 %-1.5% range
- The average surcharge fees are in the 2%-2.5% range

244. In other words, market data in Australia shows that the average surcharge fee is set typically 1% above the merchant service fees actually paid by large Merchants for the acceptance.

Dunn Report at para. 49.

245. Consumers are very dissatisfied with increasingly prevalent Merchant surcharging. In line with this experience, the Choice Report found that 88% of respondents reported being surcharged, and that over 68% of Australian consumers oppose surcharging. Additionally, a 2011 Visa internal study found that [redacted] of Australians oppose Merchant surcharging and consider it "unfair." Only [redacted] of Australians consider surcharging "fair". Simply put, surcharging has been very unpopular with Australian consumers. This is consistent with Visa's and MasterCard's positions, which is that the NSR is a pro-consumer rule.

Witness Statement of Buse at para. 25, [redacted]

- **Excessive Surcharging In the UK**

246. Similar problems with surcharging have been experienced in the United Kingdom. In March 2011, Which?, a British consumer organisation, submitted a super-complaint to the Office of Fair Trading ("OFT") regarding surcharging practices in the United Kingdom. Which? is legally entitled to submit super-complaints to an authorised supervisory body, such as the OFT, if it finds "any feature, or combination of features, of

[redacted]

a market in the United Kingdom (..) to be significantly harming the interests of consumers."

Dunn Report at para. 60.

247. The concerns raised by Which? were that in recent years credit and debit card surcharging in the United Kingdom has become prevalent, especially in industries where it previously had not been present. The Which? super-complaint was made on the basis that Merchants in a number of industries inappropriately apply surcharging, although the travel industry was the focus. Which? called for an end to what it termed "rip-off" charges for credit and debit card payments. Which? believes that payment card surcharging might spread to other, as yet unaffected, industries, causing serious detriment to the consumer.

Dunn Report at paras. 61-62.

248. The super-complaint received widespread support from the public, including over 40,000 individual pledges of support.

Dunn Report at para. 62, Exhibit "H".

249. In June 2011, the OFT, which enforces consumer protection and competition law in the UK, responded to the Which? super-complaint as follows:

(a) The OFT accepted many of the arguments put forward in the Which? super-complaint but did not recommend a complete ban on payment card surcharging. A ban on debit card surcharging was, however, recommended.

(b) It found that 'drip-pricing', whereby consumers are led through several pricing stages and incur incremental costs at each stage, was occurring in several industries. This practise was found to obscure the 'headline price' for goods and services and was therefore misleading to the consumer.

(c) The OFT proposed measures to prevent 'drip-pricing' and a ban on debit card surcharging. It stated that" any cost the retailer incurs for processing debit card payments should be treated as part of the cost of doing business and should be included in the headline price."

(d) On the basis that there are varying costs of accepting different payment instruments, the OFT indicated that retailers should be allowed to surcharge for some payment instruments, including credit cards.

Dunn Report at para. 63, Exhibit "I".

250. The OFT concluded that surcharging inhibits consumer choice. In a Questions and Answers page on its website, it states:

> We agree with Which? that payment surcharges make price comparisons more difficult for consumers, which can weaken competition between traders, and result in consumers making uninformed choices between competing providers. We also consider consumer detriment is exacerbated when the lack of transparency is combined with a lack of practical alternatives for consumers to avoid paying the fee. [Emphasis added]

Witness Statement of Sheedy at para. 58.

251. In December 2011, the UK government announced that it would tackle excessive payment card surcharges, which it said are "opaque, misleading and prevent consumers from getting a good deal." The government will bring forward proposed European legislation that will ban "excessive surcharging" practises and the legislation, planned to be passed by Parliament, will be implemented into law by the end of 2012. The new law, which will be based on the European Consumer Rights Directive, will go further than the OFT recommended by banning excessive surcharges on all forms of payment. However, retailers will be able to "add a small charge to cover their actual costs for using any particular form of payment."

Dunn Report at para. 64.

[redacted]

- **Surcharging in Situations of Situational Market Power**

252. Since the removal of the NSR in 2003 in Australia, surcharging has become most prevalent among large retailers, such as Telstra and Optus (major telecommunications providers), Qantas and Virgin Australia (major airlines) and almost all major hotel chains, including Hilton, Starwood and InterContinental. These are the kinds of Merchants that have the ability to require Cardholders to absorb the surcharge because they have fewer alternatives or because it would be very inconvenient for the Cardholder to pay with a different payment method such as cash. The RBA similarly notes in its June 2011 publication "Review of Card Surcharging: A Consultation Document" ("2011 RBA Report") that surcharging is most prevalent with "very large merchants" (those with annual turnover greater than AUD$530 million) but that about 25% of smaller Merchants surcharge as well.

> Witness Statement of Buse at para. 18, Exhibit "F";
> Transcript of Examination-in-Chief of Leggett at page 2600 (public).

253. Additionally, because larger Merchants receive the greatest benefit from repeal of the NSR, small and medium sized businesses face an increasing cost disadvantage in the form of relatively higher card acceptance fees.

> Jairam Report at para. 101.

- **On-Line Surcharging**

254. As discussed above, based on concerns similar to those just cited, the OFT, in response to a complaint by Which? has recommended that the government prohibit surcharging for use of debit cards, the standard payment mechanism used online in the United Kingdom.

> Transcript of Examination-in-Chief of Dunn at pages 3461-3462 (public);
> *Summary Evidence of Peter T. Dunn*, Exhibit RM-522;
> Witness Statement of Sheedy at para. 56, Exhibit "E";
> Transcript of Examination-in-Chief of Leggett at pages 2597-2605 (public);
> [redacted]

255. The OFT found that surcharging is more common online, where use of cash or cheques is not available, and that surcharges were particularly prevalent in the airline sector

[redacted]

(an estimated £300 million in surcharges were paid by consumers in that sector alone in 2010).

Witness Statement of Sheedy at para. 57.

256. Further, the evidence of Visa's witness, Ms. Buse, is that in her experience surcharges are also noticeably higher in circumstances in which consumers had fewer alternatives to credit cards, such as for online payments and within the holiday travel industry. The RBA found and noted, in the 2011 RBA Report, that surcharges were more commonly paid for online purchases than in percentages person (18% versus 4%), and the average amount of the surcharge was double online (4% of the purchase value versus 2%). Consumers surveyed paid surcharges on 44% of consumer transactions relating to holiday travel (on or off line), compared to an overall average of 5%. This is not surprising given that hotels and car rental companies often require a credit card as security for bookings and that most airline ticket sales are conducted online.

Witness Statement of Buse at para. 19.

(v) There is No Evidence that Surcharging Reduces Interchange

257. The Commissioner's theory turns on Merchants being able to surcharge or refuse cards, or threaten to do so, credibly, resulting in MasterCard and Visa lowering their interchange or network fees. Her theory is not that Merchants should be able to surcharge to recoup their costs. That's what Merchants want to do. But that is not the Commissioner's theory. The Commissioner's theory is that surcharging is pro-competitive because it requires MasterCard and Visa to lower their respective interchange.

258. The Commissioner presented evidence of various documents, prepared by experts for MasterCard in various jurisdictions, saying that surcharging <u>or discounting</u>, could put pressure on interchange. Counsel suggested that these documents somehow undermined MasterCard's position. It does not.

[redacted]

259. MasterCard does not deny, before this Tribunal or anywhere else, that if surcharging were allowed, and if it were meaningful and widespread by a large number of Merchants, in a way that was likely to damage MasterCard, or there was a <u>credible</u> threat of that, MasterCard would have to think about what to do in response. One of the things it might do is lower interchange. Not that we say it has anything to do with improving competition or competitiveness – just the opposite. But, one of the things MasterCard might have to do, in the face of that <u>credible</u> threat, or fact, of surcharging, would be to lower interchange, to avoid the surcharging. It might have to do that. It would certainly have to think about it. Another thing, however, MasterCard said it might have to do and would have to think about it is <u>to raise</u> interchange, to offset the surcharge and give Cardholders benefits; or it might raise some interchange and lower others, to take away the incentive to surcharge some cards and not others. Of course, Mr. Bradley of Visa made the useful observation that, if a Merchant decides to surcharge, say even at 2%, there isn't enough interchange you could possibly cut to compensate for that.

> <u>Transcript of Examination-in-Chief of Sheedy at pages 2177-2178 (public);</u>
> [redacted]

260. [redacted]

> [redacted]

261. [redacted]

[redacted]

262. The third document which the Commissioner points to in this regard is the MasterCard Report of Frontier Economics of August 31, 2007, submitted to the Reserve Bank of Australia. That document *also* contains a lot of quite useful information about the unfortunate effects of the Australian regulations.

> *Payments System Regulation - Response by MasterCard Worldwide to the Issues for the 2007/08 Review*, Exhibit A-450.

263. Leaving that aside, however, that document notes that surcharging can discourage card use and the Commissioner points to the statement at page 16 that "*MasterCard considers that the ability of merchants to discourage card use, by such means as <u>cash discounts</u> and surcharging, should be more than sufficient to avoid excessive interchange fees*".

It goes on to note that the threat of discouragement has value to the Merchant in restraining merchant fees, as long as it is credible.

> *Payments System Regulation - Response by MasterCard Worldwide to the Issues for the 2007/08 Review*, Exhibit A-450.

264. [redacted]

265. So, MasterCard, and Visa, evidence says that at some extreme, if the important Merchants were credibly going to surcharge at significantly high levels, and it was widespread, they would have to think about what to do. What they would do might involve lowering interchange; it might, however, involve raising it to keep the Cardholders happier. It might not be either.

> Transcript of Examination-in-Chief of Sheedy at page 2177 (public);
> Witness Statement of Stanton at para. 136;
> Church Report at para. 49 and 55-56.

266. Now, the really interesting factual point is that MasterCard has not had to to decide if it will raise interchange, or lower interchange, in the face of surcharging. This is because even where surcharging has been mandated for long periods of time, the alleged "pressure" did not lead to that.

267. We have a few experiments here and there. In the UK, IKEA surcharged for six years. It stopped surcharging at some point, either because its customers didn't like it, as IKEA apparently said to Which?, or because it was awkward to process surcharges at check out, as Mr. Symons said, which presumably means it was not worth investing in a system to implement surcharging better. IKEA surcharged for six years and then it stopped surcharging. That did not result in IKEA's interchange cost being lowered. Indeed, surcharging has been allowed for 20 years in the UK and now there is a problem of over surcharging. There is no evidence before this Tribunal that surcharging has lowered interchange in the UK. The Commissioner did not call any evidence to that effect. Similarly for places like Sweden or Switzerland, she called no evidence.

> Dunn Report, Exhibit "H";
> Symons Report at para. 60;
> [redacted]
> Transcript of Examination-in-Chief of Dunn at pages 3456-3457 (public).

268. In respect of Australia the Commissioner called evidence to suggest that a few Merchants negotiated lower interchange with Visa or MasterCard. The Commissioner says this is as a result of threatening surcharge. It is difficult to tell of course, when there are a number of moving pieces to the puzzle of the negotiation.

269. [redacted]

[redacted]

270. But, Australia provides an opportunity for an example in another way, because there is both surcharging permitted and a regulated maximum interchange. In Australia, there is a regulated mandated maximum average rate. Card companies are allowed to charge a certain maximum interchange, and no more. They may charge less, and they may charge up to the maximum, but they may charge no more. So, after a decade of surcharging being allowed in Australia, Visa's and MasterCard's interchange rates are at the regulated maximum. They <u>could not be higher</u> – because the regulation prohibits it. They could be lower, if surcharging were effective to lower interchange rates, but they are not lower. There is no evidence that surcharging, even when undertaken for one or two decades, lowers interchange. Indeed the evidence is expressly to the contrary.

> Witness Statement of Buse, Exhibit "A";
> Transcript of Cross-Examination of Frankel at pages 1178-1179 (public);
> Transcript of Cross-Examination of Carlton at page 1367 (public).

271. Despite surcharging being allowed in Australia, default Interchange rates there are not below the 50 basis point cap for MasterCard and Visa credit cards.

> [redacted]
> Transcript of Cross-Examination of Carlton at page 1367 (public);
> Transcript of Cross-Examination of Frankel at page 1174 (public).

272. The NSR ceased having effect in Australia in or around January 2003 and in New Zealand in or around September 2009.

> Witness Statement of Buse at para. 6.

273. The removal of the NSR in Australia has had significant deleterious effects on the payments system, and Cardholders in particular, but has had no effect on Visa's default interchange rates. Visa's maximum credit interchange rates in Australia are controlled by the RBA and not by Visa or any other private actor. The presence of surcharging has hurt Visa, its Issuers and Acquirers, and Visa Cardholders, but has not affected IRF rates.

Witness Statement of Buse at paras. 6-7, 29.

274. The evidence available suggests that there has been minimal surcharging in New Zealand (though at least one major airline Merchant, Air New Zealand, has begun surcharging). To the extent that Merchants are surcharging, such surcharging has not affected Visa's default interchange rates there. In New Zealand, Visa is obligated to set a maximum interchange rate. Visa has not generally reduced the overall level of its maximum credit default interchange rates, which are publicly available, since the removal of the NSR in New Zealand, except for establishing a lower rate for charities, which was unrelated to the removal of the NSR, and was established to promote acceptance among entities that might otherwise be reluctant to accept Visa credit cards as payment.

Witness Statement of Buse at para. 8.

275. One result of the RBA reforms is that American Express market share has grown faster than either Visa or MasterCard share since the regulation came into force. In Australia, American Express issues its own cards directly to customers and also contracts with Issuers, who issue American Express companion cards through the Global Network Services system. Since the merchant discount rates American Express charges to its Merchants are not regulated, American Express can offer Australian Issuers a higher level of revenue for issuing American Express companion cards and offer Australian Cardholders a greater level of rewards for using American Express-issued cards.

Witness Statement of Buse at para. 30.

(vi) There is Evidence that Surcharging is Used as a Profit Centre, not to Steer Consumers

276. In general, the evidence from countries that allow surcharging is that Merchants who surcharge do not reduce prices for consumers who pay with cash or other payment methods, and often impose surcharges that exceed their cost of accepting Visa transactions. In other words, where surcharging is allowed, it becomes a profit centre for Merchants, not a mechanism for increasing payment system competition. In addition, Cardholder fees have gone up as Issuers try to replace the revenue lost by lower interchange rates.

> Transcript of Cross-Examination of Leggett, 2646-2647 (public);
> Witness Statement of Sheedy at para. 83;
> *Review of Card Surcharging: A Consultation Document - 2011-06-01*, Exhibit RM-69.

277. In February 2003, for instance, Australia's Qantas Airways announced its intention to impose a 1% surcharge on credit card transactions and publicly stated that it would not reduce prices, even if customers paid by cash or cheque. Qantas defended its position by stating that the amount of surcharge imposed was less than its Merchant Discount Rate.

> Witness Statement of Leggett at para. 46.

278. Recently, the OFT announced its intention to ban "excessive" surcharges in most retail sectors, including the travel sector. The discount airline EasyJet responded to the government's plan by restructuring and increasing its fees. Before the OFT's announcement, EasyJet imposed a booking fee that was the greater of £12.50 or 2.5% of the cost of the flight on credit card transactions. After the announced ban of "excessive" surcharges, EasyJet announced that all passengers would now pay a £9 "administrative fee" when booking a flight, regardless of the method of payment, plus an extra £4.95 or 2.5% on flights paid for by credit card. The United Kingdom's intended ban of "excessive" surcharges resulted in EasyJet imposing surcharges by another name, it did not result in consumers benefitting by lower prices.

> Witness Statement of Leggett at para. 47.

[redacted]

279. As the Qantas Airways and EasyJet examples illustrate, surcharging does not generally reallocate the costs of accepting credit cards from all consumers to only those who use credit cards, resulting in lower overall retail prices. Rather, consumers' costs tend to rise. Indeed, the notion that surcharging will lead to lower card acceptance costs and lower retail prices perhaps tacitly acknowledges that Merchants have already embedded the costs of accepting credit cards into their retail prices. Accordingly, allowing Merchants to surcharge at any fixed amount or transaction percentage would generally not result in cost recovery for Merchants. Rather, it would give Merchants a new profit centre, allowing them to charge consumers more.

Witness Statement of Leggett at para. 49.

280. Beyond the Qantas Airways example noted above, the Australian experience is instructive regarding the likely effects of surcharging. When the RBA eliminated the NSR, allowing Merchants to surcharge Visa and MasterCard credit card transactions and Visa debit card transactions in 2003, the RBA had assumed that surcharging would allow Merchants to recover "from cardholders the cost of accepting credit cards". This did not happen. The RBA's Payments System Board Annual Report for 2011 notes that the average fee paid by Merchants to Acquirers for accepting MasterCard and Visa credit card transactions in 2010/2011 was 0.81% of the value of transactions. However, many Australian Merchants surcharged more, and sometime much more, than their costs of accepting credit cards. For example, Australian taxi operators regularly impose a 10% surcharge on credit card payments.

Witness Statement of Leggett at para. 50, Exhibit "P" and Exhibit "Q".

281. The Australian experience shows that surcharging will not necessarily lower retail prices. Instead, it will become a new profit centre for Merchants. Consumers will likely be charged more, not less, because those Merchants who have decided to surcharge have tended to impose excessive surcharges.

Witness Statement of Leggett at para. 51, Exhibit "U" and Exhibit "V";
Transcript of Examination-in-Chief of Leggett at pages 2600-2604 (public).

[redacted]

282. Ms. Leggett's view, confirmed by the experience in Australia and other countries where surcharging is permitted, is that the following types of Merchants are more likely to surcharge:

- Large Merchants such as retail chains with market power, even though smaller Merchants often face higher credit card acceptance costs because they have less bargaining power in negotiating Merchant Discount Rates with Acquirers;
- Merchants in card-not-present transactions (such as airline ticket and entertainment ticket purchases), including online Merchants, who often offer fewer payment options to consumers;
- Utilities;
- Merchants with temporary monopolies because the customer is captive, such as taxis; and
- Hotels.

Witness Statement of Leggett at para. 52.

283. While part of the intent that the Reserve Bank of Australia had in allowing surcharging was to create differential pricing or price signals to Cardholders of what the different costs of payment acceptance would be in order to help them make a more informed decision, that is not what happened. Most Merchants have applied a blended surcharge. So the very intent of price signalling to Cardholders never materialized, because they charged a blended surcharge across all payment cards.

Transcript of Examination-in-Chief of Leggett at page 2601 (public).

284. As noted above, when the NSR was eliminated in Australia, Qantas Airways responded by imposing a 1 % surcharge on all flights. Qantas currently imposes a surcharge of AUS$30 (approximately CDN$31) per international ticket per passenger for credit card

payments. Optus and Telstra, Australian telecommunications companies, reportedly impose surcharges of 1-2% on credit card payments.

> Witness Statement of Leggett at para. 53, Exhibit "W" and Exhibit "X".

285. Similarly, in the United Kingdom, where surcharging has been permitted since 1991, numerous airlines impose surcharges for online purchases. Similarly, Eurostar charges £4 for booking by a credit card. At the Bristol Airport, customers paying for car parking by credit card are surcharged an additional £1.90.

> Witness Statement of Leggett at paras. 54-56, Exhibits "Y", "Z" and "AA"-"GG".

286. As these examples show, surcharging is not generally about cost recovery for Merchants. As detailed above, card acceptance costs are already embedded into Merchants' retail prices in the same manner as other operating costs. Surcharging would give Merchants a new profit centre and would allow many Merchants to charge Canadian consumers more for paying by credit card.

> Witness Statement of Leggett at para. 58.

287. In most cases, Merchants surcharge in excess of their cost of acceptance, thereby using their ability to surcharge not as a mechanism to steer consumers to alternative forms of payment, but rather as a profit centre. Surcharging has occurred, on average, at a rate of twice or more the merchant discount rate applicable to MasterCard and Visa credit cards. A 2011 RBA Consultation Document found that the average surcharge on MasterCard and Visa transactions is 1% (or 100 basis points) <u>higher</u> than the merchant discount fee, that 10% of Merchants surcharge at 5% or higher, and that surcharge levels are increasing:

> According to the East & Partners' survey, average surcharge levels have increased substantially over the past few years (Graph 2.2). In December 2010, the average surcharge for MasterCard credit cards was 1.8 per cent, for Visa it was 1.9 per cent, for American Express it was 2.9 per cent, and for Diners Club it was 4 per cent. <u>These average surcharge levels are around 1 percentage point</u>

[redacted]

> <u>higher than merchant service fees for</u> American Express, MasterCard and Visa cards, and around 1.8 percentage points higher for Diners Club cards.
>
> Transcript of Cross-Examination of Leggett at pages 2642-2647 (public); Witness Statement of Buse at para. 20; *Review of Card Surcharging: A Consultation Document - 2011-06-01*, Exhibit RM-69.

288. Another recent study by Choice ("Choice Report"), an Australian consumer organization, notes that Australian taxi companies levy a 10% surcharge on all credit card transactions, clearly well in excess of the cost of acceptance.

Witness Statement of Buse at para. 21, Exhibit "G".

289. The RBA has also recognized that removal of the NSR in Australia has led to problematic results. The 2011 RBA Consultation Document states that "allowing some limit to be placed on the level of surcharges could improve the effectiveness of the reforms at relatively little cost, particularly given that the practice of surcharging is now well established." In December 2011, the RBA published its conclusions stemming from the 2011 RBA Consultation Document. The RBA stated that "surcharging is now sufficiently common, and surcharging above the cost of acceptance sufficiently widespread, that an unconstrained capacity for surcharging may no longer be appropriate. The Board is of the view that relaxing the Standards to allow schemes to limit surcharges would provide a number of public benefits." Accordingly, the RBA has proposed a modified standard under which "scheme rules may limit surcharges to a reasonable cost of acceptance, but are not able to prevent Merchants from fully recovering their costs."

Witness Statement of Buse at para. 22, Exhibit "F" and "H".

290. There is no evidence that Merchants in Australia have reduced the prices they charge to consumers for the sale of goods or services at retail as a result of either the IRF benchmarks or the removal of the NSR. Consistent with Visa's experience in this regard, studies have also concluded that there is no evidence of any pass-through effect of savings by Merchants to consumers. Direct government intervention into setting default interchange rates has simply had no discernible effect on the retail prices that consumers

pay, while pervasive Merchant surcharging has increased the prices to consumers choosing to pay with Visa credit cards. Merchants do not pass on savings to Cardholders.

Witness Statement of Buse at para. 23;
Dunn Report at para. 50.

291. The 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]." A 2008 report by Robert Stillman and others of CRA International (the "Stillman Report") found that:

> "...while the RBA's regulations have clearly harmed consumers by causing higher cardholder fees and less valuable reward programmes, there is no evidence that these undeniable losses to consumers have been offset by reductions in retail prices or improvements in the quality of retailer services. The RBA's intervention has redistributed wealth in favour of merchants."

Buse Witness Statement at para. 24, Exhibit "I" and Exhibit "J";
Transcript of Examination-in-Chief of Dunn at pages 3461-3462 (public).

(vii) The U.S. Department of Justice did not Challenge Surcharging

292. In 2010, the US Department of Justice ("US DOJ") resolved, with Visa and MasterCard, a lawsuit it brought against Visa, MasterCard and American Express in respect of their respective operating rules relating to Merchant steering. The lawsuit alleged that the rules violated section 1 of the *Sherman Act,* 15 U.S.C.§1. However, despite the fact that price maintenance agreements with anticompetitive effects can violate U.S. antitrust law, the US DOJ made no allegations of resale price maintenance.

Witness Statement of Sheedy at para. 86.

293. Following an extensive investigation, although the US DOJ considered suing to seek the elimination of surcharging prohibitions, the US DOJ apparently concluded that allowing Merchants to offer customers discounts or otherwise encouraging them to use other forms of payment was sufficient to address the US DOJ's concerns and took no action with respect to the NSR.

Witness Statement of Sheedy at para. 87, Exhibit "J".

(d) Benefits of the Honour All Cards Rule

(i) Balances the System

294. One of MasterCard's core brand promises to Cardholders is that if a Merchant agrees to accept MasterCard credit cards, the Cardholder's particular MasterCard credit card will be accepted. If a Merchant agrees to accept a MasterCard credit card, the Merchant must accept all MasterCard credit cards, no matter the type of card, or who the Issuer, is or where the Issuer is located.

Witness Statement of Stanton at paras. 78-79.

295. The operating rules protect Cardholders from Merchant market power and they protect Visa and MasterCard against free-riding by Merchants. They are legitimate pro-competitive practices. The NSR and HACR are important parts of the business models of Visa and MasterCard and are there to protect the value of the franchise from free-riding.

Transcript of Examination-in-Chief of Elzinga at pages 2705-2728 (public).

296. The Commissioner claims that the HACR is a form of "merchant restraint". Just the opposite is the case. These rules embody the notion of universal acceptance for a network's credit cards. Without such rules, a credit card network could fragment into several overlapping networks where one type of credit card might be accepted by Merchants X and Y, and another by Merchants Y and Z. In such a scenario, MasterCard and Visa's networks would be deprived of the network externalities that sustain the value of their respective networks.

Elzinga Report at para. 235.

297. This kind of fragmentation will not only impose additional costs on all participants in the network directly, but the costs imposed on any one participant will diminish the value of the card throughout the network. Credit cards are valuable to Merchants to the extent that Cardholders will use them. Cardholders, in turn, want to use their cards only because

they expect Merchants to accept them. Decreased use and acceptance will ultimately lead to the diminishment of the brand.

Elzinga Report at paras. 236-237.

298. In short, the HACR, which ensures that Cardholders can use their cards at all Merchants who hold themselves out as accepting the cards, are pro-competitive because they enable the networks to compete by promoting and protecting their valuable brand capital. This is particularly the case for smaller, new (or innovative) Issuers of credit cards. If Merchants could selectively surcharge certain cards, they could dilute the benefits of the HACR simply by imposing prohibitively high surcharges on those cards they would like to decline to accept. Thus, the reason why the HACR is pro-competitive also serves to explain why the NSR is pro-competitive.

Elzinga Report at para. 238.

299. The HACR is fundamental to the payment network by giving Cardholders confidence that their MasterCard credit card will be accepted and avoiding negative experiences at the point of interaction. MasterCard's HACR enables the network to compete by protecting its valuable brand capital. Without confidence that their MasterCard credit card will be accepted for payment, a Cardholder will not be as inclined to carry or use a MasterCard credit card.

Witness Statement of Stanton at para. 80.

(ii) Protects Consumers

300. By providing for universal acceptance, the HACR benefits consumers by assuring them that their credit cards will be accepted at Merchants that display the brand logos, regardless of which financial institution issued the card or what type of card it is or what features it offers. Consumers thus avoid investing the time and effort necessary to determine whether each Merchant at which the consumer shops will accept the consumer's card for payment at the checkout counter.

Witness Statement of Sheedy at para. 94.

301. Absent the HACR, Cardholders would suffer in at least three ways. First, they would face the prospect that their credit card would be declined due to the type of card they hold. Like the NSR, the HACR prevents Merchants from engaging in a bait and switch exercise, by advertising the logo but then refusing to accept a network's valid credit card. Second, consumers would face the risk of the possible loss of benefits associated with many credit cards. Specifically, a consumer holding a Visa or MasterCard rewards card has likely paid for that card with the expectation that he or she will receive an enhanced benefit and that the card will be accepted wherever the Visa or MasterCard mark is displayed. If that consumer's credit card is not accepted, its value is diminished as the consumer is unable to enjoy the benefits for which he or she paid. Third, like surcharging, allowing Merchants to selectively refuse Visa or MasterCard credit cards would stymie Cardholders' ability to determine the value of a card product when deciding whether to enter a contract with the Issuer. In particular, a Cardholder cannot determine the value of a premium credit card if he or she cannot predict how often it will be accepted by Merchants.

Witness Statement of Sheedy at para. 95.

302. Cardholders do not receive credit cards, but instead may have a MasterCard branded credit card issued to them by any one of a number of Issuers. There are significant advantages to not restrict Cardholders from using other forms of payment, they provide value to consumers who choose MasterCard credit cards as a form of payment. Cardholders enjoy convenience and security from using MasterCard credit cards. They are not liable for fraudulent transactions and charge-back protection. Cardholder protections are so ubiquitous that Merchants who are out of business refer Cardholders to the protections offered by their Issuer.

Witness Statement of Stanton at paras. 14-17, Exhibit "C".

(iii) Provides Consistent Experience

303. One of the hallmarks of the MasterCard brand is its exceptionally broad acceptance worldwide. Because of the HACR, Cardholders know that if they present a MasterCard credit card for payment at a Merchant that displays the MasterCard logo, any MasterCard credit card will be accepted. The consumer can carry only a small amount of cash (or none at all) and have confidence that most Merchants, and certainly all Merchants that display the MasterCard logo, will accept their MasterCard credit card as payment, regardless of which Issuer and type of card the consumer has chosen.

Witness Statement of Stanton at paras. 78-83.

(iv) Prevents Reputational Damage

304. The HACR is fundamental to the payment network by giving Cardholders confidence that their MasterCard credit card will be accepted and avoiding negative experiences at the point of interaction. The HACR enables the network to compete by protecting its valuable brand capital.

Witness Statement of Stanton at para. 80.

(v) Allows Entry of New/Smaller/Innovative Issuers

305. The HACR promotes competition by preventing Merchants from limiting card acceptance to the major Canadian banks. It prevents Acquirers from entering into agreements to accept only certain credit cards from certain Issuers. It ensures that a consumer holding a card issued by smaller Issuers receive the same experience and obtain the same benefit as consumers holding cards issued by Canada's largest financial institutions. The HACR therefore facilitates competition by smaller financial institutions, and expands the MasterCard network to a broader range of Issuers and their Cardholders.

Witness Statement of Sheedy at para. 101.

[redacted]

306. It is particularly critical to the viability of the MasterCard network that cards issued by smaller entities be honoured, as MasterCard relies on many small Issuers and fewer larger Canadian financial institutions to issue MasterCard credit cards. Other general purpose credit card networks, such as American Express and Visa, do not rely on small Issuers.

Witness Statement of Stanton at para. 81.

307. Correspondingly, the HACR promotes innovation and entry by small, new innovative Issuers and promotes the existence of competing card types. New, smaller, innovative Issuers will have confidence that the MasterCard credit cards they issue will be accepted. Larger, more established Issuers cannot strike arrangements which exclude such smaller Issuers.

Witness Statement of Stanton at para. 82.

308. The HACR has value for Cardholders, small Merchants in particular, the network and Issuers. The rule prevents discrimination between MasterCard cards and is fundamental to consumers because it gives them confidence in the MasterCard network.

Witness Statement of DeVita at para. 53.

309. It is also important to MasterCard Issuers because it reassures new or small Issuers that any MasterCard they issue will be as widely accepted as MasterCard credit cards issued by much larger Issuers.

Witness Statement of DeVita at para. 54.

310. It is important to small Acquirers because with the HACR a small Acquirer can offer its Merchant customers the ability to accept payment cards issued by any Issuer that participates in the MasterCard network.

Witness Statement of DeVita at para. 55.

311. The Challenged Rules provide to Cardholders ease and confidence in using their MasterCard card. If an Acquirer or Issuer of the network does not abide by the rules of

[redacted]

the network, there is a risk that the consumer experience will be denigrated and the quality control that a consumer has come to associate with the use of a MasterCard credit card will not have been lived up to.

Witness Statement of Stanton at para. 84.

312. As Mr. Livingston, President of Capital One (Canada Branch) advised, the HACR facilitates the entry of new Issuers, especially smaller Issuers (for example, Home Trust or Bridgewater Bank) or foreign financial institutions with little brand recognition in Canada (such as Capital One and MBNA when they entered). This promotes competition among Issuers. Competition among Issuers brings advantages to consumers like more choices for credit cards, including more diverse rewards options and low interest rate cards. The HACR means that a new or smaller Issuer such as Capital One Canada need not have brand recognition with an Acquirer or Merchant to guarantee acceptance of its cards. Instead, Capital One Canada can rely on its network's brand. Mr. Livingston's evidence was that, in his view, eliminating the HACR would reduce customer choice by significantly reducing competition among Issuers, resulting in fewer credit card products available for consumers.

Witness Statement of Livingston at paras. 22-23.

313. Mr. Livingston gave a clear illustration of this by referring to Capital One's entry into Canada (except the Province of Quebec) in 1996 and into the Province of Quebec in 2011. His evidence was that Capital One would not have been able to enter either Canada or the Province of Quebec as quickly and successfully as it did without the HACR.

Witness Statement of Livingston at para. 24.

(e) International Experience with Honour All Cards Rule

(i) Has Seldom Been Challenged and has Never Been Successfully Challenged

314. The experience in other jurisdictions provides no assistance to the Commissioner in respect of the HACR, as no jurisdiction in the world has abrogated the HACR as it relates to credit cards alone.

> Witness Statement of Sheedy at para. 102;
> Transcript of Examination-in-Chief of Leggett at page 2606 (public).

(ii) U.S. Department of Justice Chose not to Challenge it

315. As noted above, in 2010, the US DOJ resolved with Visa and MasterCard a lawsuit it brought against Visa, MasterCard International and American Express in respect of their respective operating rules relating to Merchant steering. The lawsuit alleged that the rules violated section 1 of the *Sherman Act*, 15 U.S.C. §1. However, the US DOJ limited the relief sought to the abrogation of Visa and MasterCard's rules that in some cases prohibited Merchants from offering discounts not made available to the networks' Cardholders (notably, rules that Visa does not have in Canada). The US DOJ apparently concluded that it was not appropriate to take action with respect to HACR.

> Witness Statement of Sheedy at paras. 86-87.

(f) Benefits of the Non-Discrimination Rule

(i) Balances the System

316. The NDR supports "intrasystem competition on the issuing side".

> Transcript of Examination-in-Chief of Stanton at page 2453 (public).

[redacted]

(ii) Protects Consumers

317. The NDR is designed to protect the value of the MasterCard brand, including protecting against brand disparagement or behaviour which prevents a Cardholder from using his or her MasterCard credit card.

Witness Statement of Stanton at para. 74.

(iii) Prevents Disparagement

318. The NDR prevents Merchants from purporting to accept MasterCard credit cards and then preventing Cardholders from using them. Practical examples of conduct prohibited by the NDR are a Merchant automatically sending consumers paying with MasterCard credit cards to the back of a line at the point of sale.

Witness Statement of Stanton at para. 77.

(iv) Provides Consistent Experience

319. The NDR, generally speaking, is designed to prevent Merchants from inconveniencing Cardholders when using their MasterCard card. It is especially important in circumstances where the goods, like a restaurant meal or hotel stay, have already been purchased, and Cardholders may be put in a very bad position.

Transcript of Examination-in-Chief of Stanton at pages 2452-2453 (public).

(v) Prevents Reputational Damage

320. [redacted]

[redacted]

(vi) Does not Prevent Discounting or Steering

321. The NDR does not prevent steering. Merchants who agree to accept payment by MasterCard credit cards are free to effectively encourage Cardholders to pay for goods and services by various other payment options so long as they do not do so in ways which unduly damages or undermines the MasterCard brand proposition to Cardholder or Cardholder interests.

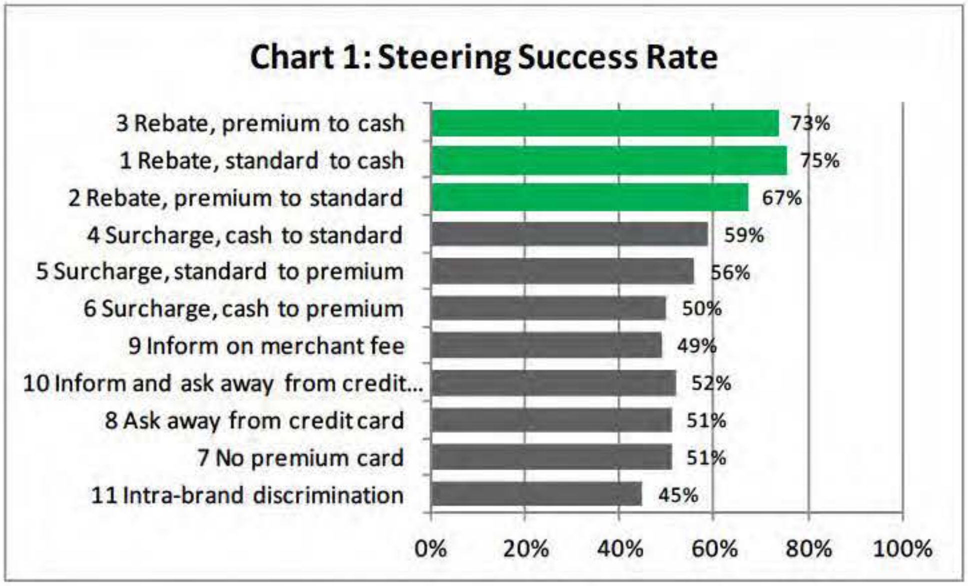
> Witness Statement of Stanton at para. 75;
> Witness Statement of DeVita at para. 58.

322. MasterCard permits steering and preference statements in the form of discounting. For example, signs promoting the use of other payment methods are permitted under the Challenged Rules.

> Witness Statement of Stanton at para. 76;
> Witness Statement of DeVita at para. 59 and Exhibit "G";
> [redacted]

323. Discounts are the most effective at steering. Usually across criteria, discounts are the most successful or have the most positive outcomes, whereas surcharges are the worst in four of five surveyed categories. Walking out is the most likely Cardholder reaction to surcharging at every purchase value.

[redacted]



Transcript of Examination-in-Chief of Mulvey at pages 3066-3067 and 3071 (public); *Summary of the Expert Report of Michael S. Mulvey*, Exhibit RM-503.

4. Canadian Government Review of Issues in Dispute Resulting in Code of Conduct Two Years Ago

324. In 2009 and 2010, the Government of Canada, through the Department of Finance. conducted comprehensive consultations with payment network industry stakeholders, including Issuers, consumers and Acquirers, to develop a voluntary code of conduct for the payment card industry. The Department of Finance received extensive submissions from stakeholders, including Merchants, with respect to the NSR and HACR.

Witness Statement of Weiner at para. 51;
Transcript of Cross-Examination of Jewer at pages 1749-1750 (public);
Transcript of Examination-in-Chief of Weiner at page 2320 (public).

325. In April 2010, the Government released the Code of Conduct for the credit and debit industry in Canada ("Code of Conduct") to which Visa Canada, MasterCard Canada and American Express are signatories. The Code of Conduct was enacted on or around April 16, 2010 and updated on May 18, 2010. Though stakeholder submissions discussed the HACR and NSR in depth, the Government nevertheless chose not to abrogate these rules in the Code of Conduct.

[redacted]

Witness Statement of Weiner at para. 52, Exhibit "R" and Exhibit "S";
Witness Statement of DeVita at para. 70;
Transcript of Examination-in-Chief of Weiner at page 2320 (public).

326. The Code of Conduct lists three principal objectives. The three objectives are:

(1) Ensuring that Merchants are fully aware of the costs associated with accepting credit and debit card payments thereby allowing Merchants to reasonably forecast their monthly costs related to accepting such payments.

(2) Providing Merchants with increased pricing flexibility to encourage consumers to choose the lowest-cost payment option.

(3) Allowing Merchants to freely choose which payment options they will accept.

Weiner Witness Statement at para. 54.

327. Importantly, Merchant associations representing a comprehensive range of sectors across the country participated extensively in the consultations that led to the Code of Conduct.

Witness Statement of Weiner at para. 55.

328. Indeed, Merchant representatives have expressed their satisfaction with the Code of Conduct. In an article appearing in the Toronto Star, Diane Brisebois, President and Chief Executive Officer of the Retail Council of Canada, called the Code of Conduct "a huge victory for us."

Witness Statement of Weiner at para. 56, Exhibit "T".

329. Catherine Swift, President and Chief Executive Officer of the Canadian Federation of Independent Business ("CFIB") similarly said, "[w]e got almost 95 per cent of what we wanted."

Witness Statement of Weiner at para. 56, Exhibit "T".

330. The CFIB also prepared a template thank you letter for its members to send to the Hon. Jim Flaherty, Minister of Finance, calling the Code of Conduct a "major step

forward" that gives Merchants "more power in dealing with Visa, MasterCard and their bank and processor partners."

Witness Statement of Weiner at para. 56, Exhibit "U".

331. The Code of Conduct was developed pursuant to submissions from industry stakeholders, including payment networks and Merchant groups.

Witness Statement of Weiner at para. 57, Exhibit "V".

332. Paragraphs 1, 2 and 3 of the Code of Conduct address the first objective, referenced above, ensuring Merchants are aware of the costs associated with the acceptance of payment cards. These provisions require Visa and MasterCard to "make all applicable interchange rates easily available on their websites" and " post any upcoming changes to these fees once they have been provided to Acquirers."

Witness Statement of Weiner at para. 58.

333. Paragraph 5 of the Code of Conduct addresses the second objective, "providing merchants with increased flexibility to encourage customers to choose the lowest payment option," an issue the Commissioner has raised in this proceeding, The Department of Finance determined that this objective could be met without abrogating either the NSR or HACR, but by permitting Merchants to provide discounts to their customers, including differential discounts, for different methods of payment such as cash, or debit cards, or different credit card networks.

Witness Statement of Weiner at para. 59.

334. The third objective, allowing, Merchants to freely choose which payment options they will accept, is addressed by Code of Conduct paragraphs 1, 2, 3, and 4. Under these provisions, Merchants who accept a payment network's credit product are not required to accept that network's debit product and vice versa.

Witness Statement of Weiner at para. 60.

335. MasterCard complies with the Code of Conduct.

Witness Statement of DeVita at para. 70.

336. In summary, among other things, the Code of Conduct requires that:

(a) Merchants receive a minimum of 90 days' notice of any fee increases or the introduction of a new fee related to any credit or debit card transactions. MasterCard must provide at least 90 days' notice to Acquirers for rate or fee changes and at least 180 days notice for structural changes;

(b) Merchants be allowed to cancel their contracts without penalty following notification of a fee increase or the introduction of a new fee;

(c) Merchants provide their express consent to accept new products or services;

(d) MasterCard make available all applicable interchange rates easily available on its website; and

(e) MasterCard post any upcoming changes to interchange fees once they have been provided to Acquirers.

Witness Statement of DeVita at para. 71.

337. The Code of Conduct addresses the same concerns as the Commissioner's application purports to address, such as cost awareness, interchange awareness and differential discounting for different methods of payment. The Ministry of Finance, in crafting the Code of Conduct, chose not to set aside the HACR, NDR or NSR. Similarly, in the Task Force for the Payments System Review's Report on Credit and Debit Card Markets, there is no recommendation to repeal the Challenged Rules.

Witness Statement of DeVita at para. 72, Exhibit "I".

PART III - LAW AND ARGUMENT

1. Overview

338. The theory of the Commissioner's case is that the Challenged Rules, and in particular the NSR, impede or constrain Merchants' ability to negotiate lower merchant discount rates with Acquirers by precluding Merchants from using effective methods to steer their customers to use one of the many other available methods of payment set out above, including cash, debit cards and other credit cards with lower merchant discount rates. The Commissioner argues that in the absence of the Challenged Rules Merchants could choose to refuse or selectively surcharge higher-cost credit cards, which would reduce transaction volumes on the MasterCard network to the point where MasterCard would choose to lower its default interchange rate.

Notice of Application at paras. 13-16.

339. The Commissioner's theory seeks to apply the resale price maintenance provisions to conduct that is simply not resale price maintenance as a matter of law or as a matter of economics, and further seeks a remedy that could disrupt the MasterCard network, harm its brand and lessen competition in the market for payment services.

340. The Commissioner's theory is wrong and her Application is misguided. The evidence presented at this Hearing makes it clear that the Challenged Rules are pro-competitive and perform a vital function within the MasterCard network. They are designed to improve efficiency in the use of the MasterCard network, to strengthen the MasterCard brand and enhance the confidence of Cardholders that their MasterCard credit cards will be honoured without discrimination or fear of special unexpected surcharges at point of sale. They are directed to a legitimate business purpose of increased output of MasterCard credit cards. They do not in any way prohibit or penalize Merchants or Acquirers from offering discounts. They are not anti-competitive in nature. They do not constitute the type of conduct that the resale price maintenance provisions have ever been intended to address.

[redacted]

341. MasterCard has not engaged in price maintenance for, among others, the following reasons:

(a) The Challenged Rules do not limit in any way the price at which Acquirers or Merchants may sell or offer to sell their products;

(b) There is no product of MasterCard that is "resold" by Acquirers, and thus there is no relevant price for MasterCard to influence. MasterCard provides services to Acquirers which are used as inputs by the Acquirers to provide services to Merchants;

(c) While the default interchange rate, which is used to balance both sides of the MasterCard network, is a cost to Acquirers which they will probably consider in determining merchant discount rates with Merchants, it does not preclude Acquirers or Merchants from charging whatever prices or fees they choose. The interchange rate is only a factor which may be considered as part of the negotiation of the merchant discount rate, as is the case with any cost input in respect of a finished product;

(d) MasterCard does not enjoy market power in the relevant market and as such is not in a position to create, enhance or preserve market power;

(e) The Challenged Rules, when considered in the context of how they function within the entire MasterCard network in balancing the demands of both Cardholders and Merchants, and the need to be competitive with other credit card networks, do not have an adverse effect on competition. Just the opposite. They improve efficiency and enable MasterCard to compete effectively in the market for payment services; and

(f) The Commissioner's attempt to fit the Challenged Rules under the ambit of the resale price maintenance provision is not just novel, it is unprecedented is directly contrary to recent case law dealing with similar issues.

2. The Resale Price Maintenance Provision

(a) The Statute

342. Section 76(1) of the *Competition Act* provides as follows:

> "Price maintenance
>
> 76.(1) On application by the Commissioner or a person granted leave under section 103.1, the Tribunal may make an order under subsection (2) if the Tribunal finds that
>
> (a) a person referred to in subsection (3) directly or indirectly
>
> > (i) by agreement, threat, promise or any like means, has influenced upward, or has discouraged the reduction of, the price at which the person's customer or any other person to whom the product comes for resale supplies or offers to supply or advertises a product within Canada, or
> >
> > (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."
>
> *Competition Act*, R.S.C. 1985, c. C-34, sub-s. 76(1).

343. On the plain words of the section, if the Commissioner can satisfy the test for resale price maintenance under subsection 76(1)(a), she must then go on and satisfy the requirement under subsection 76(1)(b) that the conduct has had, is having or is likely to have an adverse effect on competition in a market. Both elements must be proven separately. If the Commissioner cannot satisfy the test under subsection 76(1)(a), there is no need to move to subsection 76(1)(b) and the application must be dismissed.

344. In some circumstances, the courts may also consider legislative history and other admissible external aids:

[redacted]

> "There is only one rule in modern interpretation, namely, courts are obliged to determine the meaning of legislation in its total context, having regard to the purpose of the legislation, the consequences of proposed interpretations, the presumptions and special rules of interpretation, as well as admissible external aids. In other words, the courts must consider and take into account all relevant and admissible indicators of legislative meaning. After taking these into account, the court must then adopt an interpretation that is appropriate. An appropriate interpretation is one that can be justified in terms of (a) its plausibility, that is, its compliance with legislative text; (b) its efficacy, that is, its promotion of the legislative purpose; and (c) its acceptability, that is, the outcome is reasonable and just."
>
> *McCague v. Canada (Minister of National Defence)*, 2001 FCA 228.

(b) Legislative History of Resale Price Maintenance Provisions (Section 76 and Predecessors)

345. To appreciate the extent to which this Application represents a dramatic departure from the traditional legal and economic understanding of resale price maintenance, it is helpful to step back and review how the present resale price maintenance provision evolved and to what conduct it is intended to apply.

346. The legislative history of the price maintenance provision is summed up neatly in an article by J.A. VanDuzer and G. Paquet, as follows:

> Resale price maintenance has been prohibited in Canada since 1951. In 1960, the law was amended to add the current defences to the related offence of refusing to supply a customer because of the customer's low pricing policy. In 1976, the law was further amended to broaden its reach to include all forms of price maintenance, including price maintenance engaged in by competitors, or horizontal price maintenance. The amendments also brought within the ambit of the section transactions involving services and intellectual property rights.
>
> J.A. VanDuzer and G. Paquet, "Anticompetitive Pricing Practices and the *Competition Act* – Theory Law and Practice" (Ottawa: University of Ottawa, 1999).

347. When the price maintenance provisions were first introduced into the *Combines Investigation Act* in 1951, the focus of these provisions was on preventing upstream suppliers from attempting to set minimum prices for downstream suppliers of their products or impose restrictions on the ability of downstream suppliers and retailers to offer discounted prices for their products.

348. The first price maintenance legislation in Canada was enacted in 1951 as section 37A of the *Combines Investigation Act*. Subsection 37A(2) provided:

> "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 <u>specified by the dealer</u> or established by agreement, (b) at a price <u>not less than a minimum price</u> specified by the dealer or established by agreement, (c) at a <u>markup or discount specified by the dealer</u> or established by agreement..." (emphasis added)
>
> *Combines Investigation Act,* R.S.C. 1927, C-26, as amended by S.C. 1951, C-30, s.1.

349. The intent of the resale price maintenance provision at that time was articulated in the *Report of the Committee to Study Combines Legislation and Interim Report on Resale Price Maintenance* (the "MacQuarrie Report"). The MacQuarrie Report stated as follows:

> "The Committee, therefore, recommends that it should be made an offence for a manufacturer or other supplier:
>
> 1. To recommend or prescribe minimum resale prices for his products;
>
> 2. To refuse to sell, to withdraw a franchise or to take any other form of action as a means of enforcing minimum resale prices.
>
> It is to be noted that the Committee does not recommend that it be made an offence to prescribe and enforce resale prices which are not minimum…"

[redacted]

J.H. MacQuarrie, et al., "Report of the Committee to Study Combines Legislation and Interim Report" (Ottawa: Queen's Printer and Controller of Stationery, 1952), page 71.

350. In 1960, the price maintenance offence was amended to delineate the several defences to the offence, including loss-leading, bait and switch selling, misleading advertising and inadequate level of servicing on the part of the downstream customer of the accused. In the 1970 revision, the offence was renumbered as section 38.

An Act to Amend the Combines Investigation Act and the Criminal Code, S.C. 1960, c.45, s.14;
Combines Investigation Act, R.S.C. 1970, c. C-23.

351. In 1976, as part of a major revision to the *Combines Investigation Act*, the scope of the criminal price maintenance provision was expanded considerably so that it was no longer limited solely to resale price maintenance in the context of vertical supply arrangements, but also applied to horizontal situations (i.e. price maintenance between competitors). Further, the provision was amended to apply to persons who extend credit by way of credit cards or are otherwise engaged in a business that relates to credit cards.

352. The amended price maintenance provision then provided as follows:

> "61.(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, trademark, 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 a product within Canada
>
> …"

Competition Act, R.S.C. 1985, c. C-34, s.61.

353. Minutes from the Parliamentary Record illustrate that one of the purposes of the 1976 amendments was to preclude persons engaged in a business relating to credit cards from

[redacted]

preventing retailers <u>from giving discounts</u> to customers who wished to pay in cash. In his testimony before the House Committee, the then Minister of Consumer and Corporate Affairs, Mr. Andre Ouellet (the **"Minister"**), explained the purpose of these amendments as follows:

> "What we are doing is that we are adding the questions of credit cards in the series of activities where there should be no price maintenance:
>
> No person who is engaged in the business of producing or supplying a product or is engaged in the credit card area should ..
>
> … do certain things. Therefore, by putting the credit card apparatus here, we allow the retailers who honour credit cards <u>the possibility of giving a cash discount to a customer if he so desires to do this.</u>" (emphasis added)
>
> First Session – Thirtieth Parliament 1974-75. Minutes of Proceedings and Evidence of the Standing Committee on Finance, Trade and Economic Affairs. Issue No. 55, Tuesday, June 3, 1975 at 55:56.

354. In later testimony, the Minister explained:

> "I want to remind the members of the Committee that I have indicated to the members of the Committee that I will be introducing an amendment dealing with the use of credit cards. This will come in the price maintenance section. <u>It will forbid this practice that a company, in the credit card business, will not be allowed to force by contract – the retailers to refuse to give discounts to those who are paying cash. I think that is the main concern about the credit card operation</u>." (emphasis added)
>
> First Session – Thirtieth Parliament 1974-75. Minutes of Proceedings and Evidence of the Standing Committee on Finance, Trade and Economic Affairs. Issue No. 55, Tuesday, June 3, 1975 at 55:43.

355. Following passage of the 1976 amendments the Bureau of Competition Policy released a commentary titled "Background Papers" which confirmed the rationale for the amended provisions as follows:

> "…The amendments have further extended the scope of the provisions by deleting the definition of "dealer" and expanding the application of the prohibitions in this section…..to a person extending credit by means of credit cards and holders of intellectual property rights……It is also

anticipated that this amendment will effectively curtail the practices engaged in by a firm providing credit card services for retailers of preventing a retailer from giving a discount for cash. This provision will, therefore, be of benefit not only to retailers but also to consumers." (emphasis added)

Background Papers, Stage 1 Competition Policy, Bureau of Competition Policy, Consumers and Corporate Affairs Canada, April 1976 at page 55.

356. In *Canadian Competition Law, A Business Guide*, a 1979 article by C.J. Michael Flavell discussed the history of the price maintenance section to that time and noted at page 947 that the word "resale" disappeared from the Canadian competition law vocabulary in 1976, with the advent of the Stage Room I Amendments and the broadening of the provision to cover price maintenance in situations other than sale and resale.

C.J. Michael Flavell, *Canadian Competition Law: A Business Guide* (1979), at page 947.

357. Mr. Flavell's article articulated the significant expansion of the price maintenance provision in 1976. As he noted, the purpose of the 1976 amendments was to address concerns that the prior resale price maintenance provision required proof of a specific price having been maintained in a resale situation. However, in seeking to address this concern:

"…an elephant gun was drawn to fire at the mouse and the provision was entirely recast in such a way as to remove totally the basic link in the supply process between manufacturer, supplier and consumer. …by removing the vertical distributing link, long essential to the concept of resale price maintenance in Canada and in the US, an entirely new and arguable unnecessary, sphere of activity is added to the criminal sector under the guise of blocking a couple of identifiable, easily remediable loopholes."

C.J. Michael Flavell, *Canadian Competition Law: A Business Guide* (1979), at page 295.

358. The 1999 VanDuzer Report entitled, "Anticompetitive Pricing Practices and the Competition Act – Theory Law and Practice", assessed, *inter alia* the price maintenance provision:

> Price maintenance occurs where a firm tries to set a minimum price at which another firm can sell its product. It is one of the most pervasive restraints in the market place. Resale price maintenance may take place vertically, such as between a wholesale supplier and a retailer which resells the supplier's products. It may also be part of a horizontal arrangement between competitors who agree to impose resale price maintenance on resellers of their products.

and concluded that the often pro-competitive effects of price maintenance warranted a change in the law:

> The likelihood of efficiency justifications means that Canada's blanket *per se* prohibition of vertical resale price maintenance is not consistent with the economic analysis set out in Part I.
>
> J.A. VanDuzer and G. Paquet, "Anticompetitive Pricing Practices and the *Competition Act* – Theory Law and Practice" (Ottawa: University of Ottawa, 1999).

(c) Resale Requirement

359. In 2009, Parliament made extensive amendments to the *Competition Act,* and in doing so significantly narrowed the price maintenance provision, including by, among other things:

(a) moving the price maintenance provision out of the offences part of the *Competition Act* and inserting the provision into the part of the *Competition Act* which deals with matters reviewable by the Tribunal;

(b) restricting the provision to vertical sale/resale situations by amending the words "…the price at which any other person engaged in business in Canada supplies or offers to supply a product" to read "…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

(c) adding a requirement that, in addition to finding resale price maintenance conduct, it was necessary to find that the conduct has had, is having or is likely to have an adverse effect on competition in a market.

Competition Act, R.S.C. 1985, c. C-34, s.76.

360. The Competition Bureau has described the new section 76 as follows:

> "The price maintenance provisions are designed to provide resellers of products with the freedom to set their own prices and to provide suppliers with the ability to compete through low-pricing policies."

A Guide to Amendments to the Competition Act, Competition Bureau (April 22, 2009) at page 3.

361. As the Competition Bureau made clear at the time, section 76 represented a significant departure from the broad change to the price maintenance provision in 1976, and a return to the traditional focus of the resale price maintenance provisions on prohibiting conduct by an upstream supplier which prevents downstream suppliers from engaging in discounting behaviour with respect to the upstream supplier's products.

362. The provision is focused on permitting downstream resellers to discount the goods it acquires from upstream suppliers. Resale has always been a requisite component of the prohibition on price maintenance.

(d) Issue of Direct or Indirect

363. "Indirect" price maintenance can occur in situations involving an indirect means by which the resale price has been influenced. For example, an advertising policy that promotes advertising by dealers at or above defined minimum prices has been found to be price maintenance that was "indirect", with reference to the manner in which the resale was influenced.

R. v. Moffats Ltd., [1957] O.R. 93, 28 C.P.R. 57 (Ont. C.A.).

[redacted]

364. The case law does not support the proposition advanced by the Commissioner that the inclusion of the phrase "indirectly" means any conduct, however remote and tangential, can be argued to have "indirectly" influenced prices in some way so as to fall within section 76. The conduct must be closely linked to the price alleged to have been maintained. The *R. v. Moffats Ltd.*, case referred to above dealt with a co-op advertising plan. The Court in that case held that influencing the price via advertising was indirect price maintenance, but illustrated that the conduct in issue must have a close connection to the price alleged to have been maintained:

> "[I]f an agreement binding a person to advertise commodities for sale at not less than specific designated prices causes such persons to resell such commodities at not less than that price, or has the effect of exerting an influence upon or creating an inducement to such persons to resell such commodities at not less than the price so designated, then the agreement assuredly falls within the prohibition of that section. It makes no difference whether this is a direct or indirect result of the operation of the scheme." (at para. 32)

R. v. Moffats Ltd., [1957] O.R. 93, 28 C.P.R. 57 (Ont. C.A.).

(e) Issue of Requisite Causation

365. As noted above, pursuant to the language of new resale price maintenance provision, if the Commissioner can satisfy the test for price maintenance under subsection 76(1)(a), she must then satisfy the requirement under subsection 76(1)(b) that the conduct has had, is having or is likely to have an adverse effect on competition in a market. Both elements must be proven separately. If the Commissioner cannot satisfy the test under subsection 76(1)(a), there is no need to move to subsection 76(1)(b) and the application must be dismissed.

366. The Commissioner has not taken this approach. Rather, she has proceeded on the basis that she need not first establish price maintenance conduct, and then go on to prove that this conduct is having or is likely to have an adverse effect on competition in a market. Rather, she argues that she can proceed by proving first the Respondents have engaged in

[redacted]

conduct which is having or is likely to have an adverse effect on competition, and then rely upon that conduct as having an influence on prices.

Notice of Application at paras. 68-93.

367. It is respectfully submitted that this approach makes no sense having regard to the construction of section 76. This can be seen by taking the example of a "refusal to supply" proceeding under section 76. Using the Commissioner's theory, she could begin by proving that a respondent to an allegation of refusing to supply has engaged in conduct having an adverse effect on competition in a market. But how could she use that conduct to establish the refusal to supply? The answer is she cannot because that is not how the section is to be applied. The section is clearly structured so that the prohibited conduct, either resale price maintenance under (a)(i) or refusal to supply under (a)(ii) is to be proven, following which the Tribunal is to consider, the first element having been established, whether the conduct is also anti-competitive under (b) such that a remedy is appropriate.

(f) Commissioner's Theory of Price Maintenance is Inconsistent with the Statutory Wording, History and Intent

368. The Commissioner's theory is without precedent. In the many years since the first price maintenance provision was enacted, 83 cases have been indentified dealing with price maintenance. None of these cases support the "effects-based" theory of price maintenance urged upon the Tribunal by the Commissioner.

369. The recent decision of the Ontario Superior Court of Justice in *Fairview Donut Inc. v. TDL Group Corp.,* which concerned a claim of price maintenance under the old section 61 (which was broader than section 76), accepted the following description of price maintenance which had been articulated by the Competition Bureau:

> "Price maintenance may occur when a supplier prevents a customer from selling a product below a minimum price by means of threat, promise or agreement. ...The typical price maintenance offence occurs where a supplier uses threats, promises or agreements to prevent a customer from

selling a product below a minimum price or refuses to supply a product to a customer or otherwise discriminates against the customer due to its low pricing policy."

Fairview Donut Inc. v. TDL Group Corp., 2012 ONSC 1252, 2012 CarswellOnt 223 (WL Can) at paras. 586-87.

370. Underlying section 61, and its various predecessor price maintenance provisions, was the concern that the public be protected from conduct that interfered with the ability of retailers to engage in price competition. In this regard, under section 61, it was not sufficient that a party be found to have "influenced upward" the price of a product it sold. Section 61 prohibited doing so by "agreement, threat, promise or any like means…".

Fairview Donut Inc. v. TDL Group Corp., ibid. at para. 599;
R. v. Philips Electronics Ltd., 1980 CarswellOnt 102 (Ont. C.A.) at para. 21.

371. The introduction of the words "like means" to replace "any other means whatsoever" which was in the original price maintenance provision indicated that the influencing upward of price per se was not a contravention of the section. As the Ontario Court of Appeal stated in *R. v. Phillips Electronics Ltd.*:

"It is significant that the present section, among other significant changes, has substituted the words 'any like means' for 'any other means whatsoever'. This is a clear indication of the intention of Parliament to substantially restrict the type of attempts which constitute an offence under section 38(1)".

R. v. Phillips Electronics Ltd., supra at para. 21.

372. In other words, the purpose of the impugned conduct was relevant under section 61 and its predecessors. It had to be shown that the conduct at issue was an attempt to influence prices for anti-competitive purposes. Further, only attempts to influence prices which eliminated competition or competitive market forces were prohibited.

Fairview Donut Inc. v. TDL Group Corp., supra at para. 601;
R. v. Royal LePage Real Estate Services Limited, 1993 CarswellAlta 92 (Alta. Q.B.) at para. 36;
See also *Commissioner of Competition v. Canada Pipe Company*, 2005 Comp. Trib. 3 at paras. 63-66.

[redacted]

373. The Commissioner's theory of price maintenance is also inconsistent with the economic understanding of resale price maintenance.

374. One of the Respondents' experts, Jeffrey Church, addressed the novel approach taken by the Commissioner and her expert, Professor Winter. As a matter of economics, Professor Church explained why the Challenged Rules cannot be seen as resale price maintenance conduct. First, the rules are non-price vertical restraints. They clearly restrict the behaviour of Merchants at the point of sale, but they are not a vertical price restraint. Unlike price maintenance, the Challenged Rules do not set limits on the price at which Merchants or Acquirers can sell the products. Second, Professor Winter's analysis identifies two mechanisms which allegedly lead to an increase in the fees which Visa and MasterCard charge Acquirers, not the prices charged by Acquirers or Merchants for their products and services. Third, the economic logic of Professor Winter's analysis is not a recognized theory of harm in the economic and competition policy literature on price maintenance. Fourth, there is no resale of a product in this case. The role of retailers is the provision of distribution services on behalf of manufacturers and so retailers incur costs to make products available to consumers.

Transcript of Examination-in-Chief of Church at page 2858 (public).

375. Competition responses occur on both sides of the market. That does not result in perverse competition where high interchange fees are interpreted as a high price and a sign of strength, paradoxically. Instead, a high interchange fee means a low price to Issuers. Such a low price would be expected to lead to an increase in competition by Issuers. That would lead to an increased number of Cardholders and increased usage by Cardholders. From this perspective, it is not necessarily surprising that an increase in interchange leads to an increase in MasterCard's volumes and market share.

Transcript of Examination-in-Chief of Church at page 2872 (public).

376. As Professor Church explained in his Report, the economics literature on vertical restraints addresses the incentives and effects of restrictions, usually contractual or conduct that has a similar effect, between different levels in a supply chain. In the

simplest scenario, absent any vertical restraints, an upstream firm (seller) posts the price, the downstream firm (buyer) selects the quantity purchased and all of the rights to the input supplied are transferred by the upstream firm to the downstream firm. But there are many alternatives where, as here, some of the property or decision rights might be retained by the upstream firm and thereby constrain the buyer (downstream firm). These are known generally as vertical restraints.

> Church Report at para. 16, citing M. Trebilcock, R. Winter, P. Collins and E. Iacobucci, The Law and Economics of Canadian Competition Policy, University of Toronto Press (2002) at pages 373 -375;
> F. Matthewson and R. Winter, "The Law and Economics of Resale Price Maintenance", (1998) Review of Industrial Organization, 13:57 at 58.

377. There are many examples of vertical restraints on downstream firm conduct that do not involve pricing. Non-vertical restraints include exclusive territories (restriction on the geographic area in which sales can be made by the downstream firm), exclusive dealing (the downstream firm can only deal in the supplier's brand), and limitations on additional services that can be provided. Non-price vertical restraints are distinguished from vertical restraints that involve restrictions on the downstream firm's ability to set the price of the product transferred.

> Export Church Report at para. 17;
> Transcript of Examination-in-Chief of Church at page 2858 (public).

378. Representative definitions of resale price maintenance from the economic and competition policy literature include:

(a) "This restraint describes any contract in which an upstream firm (e.g., a manufacturer) retains the right to control the price at which a product is sold downstream, usually in a retail market. Resale price maintenance often refers to the specific restraint of a minimum price at which a product can be resold, but it can refer to a price ceiling as well. The context in which they are most often observed involves contracts between manufacturers and the distributors (resellers) of their products."

M. Trebilcock, R. Winter, P. Collins and E. Iacobucci, *The Law and Economics of Canadian Competition Policy* (2002).

(b) "A resale price maintenance (RPM) agreement is a contract in which a manufacturer and a downstream distributor (retailer) agree to a minimum or maximum price the retailer will charge its customers (consumers)."

K. Elzinga and D. Mills, *The Economics of Resale Price Maintenance* (2010);
R. Blair and D. Kaseman, *Antitrust Economics* (2009:Oxford University Press).

(c) "Resale price maintenance (RPM) is a vertical restraint that prevents distributors from lowering resale prices below a specified minimum."

R. Blair and D. Kaserman, *Antitrust Economics* (2009:Oxford University Press).

(d) "…A resale price maintenance agreement where a manufacturer sets a minimum price that retailers may charge."

Witness Statement of Church at para. 6.

(e) "The term 'resale price maintenance' encompasses a number of price-related understandings between upstream and downstream firms. The most common variety involves retailers agreeing with a supplier that they will not charge customers less than a certain price for the supplier's product. Leaving the retailers free to charge any price above that level."

OECD, *Policy Roundtables*, "Resale Price Maintenance" (2008).

(f) "Resale price maintenance involves the setting of a vertical price floor on downstream distributors of a product."

R.A. Winter, *Presidential Address: Antitrust Restriction on Single-File Strategies* (2009).

(g) "…Resale price maintenance, which is manufacturer or supplier regulation of the price at which the product is resold by independent dealers."

[redacted]

H. HovenKamp, "Federal Antitrust Policy: The Law of Competition and its Practice" (2005);
Church Report at para. 19.

379. Professor Church concludes that MasterCard's Challenged Rules cannot and should not be characterized as resale price maintenance as a matter of economics and Canadian competition policy for the following reasons:

(a) The Challenged Rules do not limit in any way the price at which either Acquirers or Merchants may offer to sell their products. There is no limitation under the Challeneged Rules on the discretion of competing Acquirers and Merchants to apply whatever price they so choose for the products and/or services they may provide. The Challenged Rules restrict the ability of Merchants to impose surcharges and selectively accept cards, which does not influence prices upwards;

(b) There is no product of MasterCard that is resold by Acquirers and thus there is no relevant price for MasterCard to influence. MasterCard provides services to acquiring banks which are used as inputs by the acquiring banks to provide services to Merchants. The bundle of services provided by MasterCard to Acquirers involves connection to the MasterCard network and access to authorization, clearing and settlement services. The service provided by the Acquirers to Merchants is the ability to accept payment by credit cards from customers. Merchants are not connected to the MasterCard network by Acquirers but instead to the proprietary systems of the Acquirers;

(c) It is not the price of a downstream firm that is alleged to be influenced upward or discouraged from being reduced by the Challenged Rules, but rather the "prices" charged by Visa and MasterCard themselves to Acquirers. The Commissioner only posits that the downstream distributor's price is "maintained" by virtue of the costs being passed on; and

(d) The economic analysis of price maintenance is very different than the Commissioner's economic analysis of the Challenged Rules. Mutual adoption of

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price maintenance by two manufacturers may facilitate collusion and reduce price competition between because their retailers cannot pass on reductions on wholesale prices to their customers and thereby increase sales volume for manufacturers. However, under the Commissioner's analysis, the Challenged Rules are (allegedly) anti-competitive because they effectively result in price matching: the price increase for use of a credit card effects equally the "cost" of all forms of payment because it raises retail prices equally. Hence the economic analysis and incentives of price maintenance and the Challenged Rules are fundamentally different.

Church Report at paras. 21-25.

(g) MasterCard's Operating Rules Do Not Constitute Price Maintenance Under Section 76 as a Matter of Law

(i) The Commissioner's Approach is Contrary to the Purposes of the Competition Act

380. Section 1.1 of the *Competition Act* provides as follows:

> "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."

Section 1.1, *Competition Act*, R.S.C. 1985, c. C-34.

381. As discussed below, the Challenged Rules are pro-competitive. It is the Commissioner's proposed remedies that are anti-competitive. The Commissioner's proposed remedies will have the direct result of increasing prices (through surcharging) and potentially decreasing output and efficiency within the Visa and MasterCard networks (this is the Commissioner's stated goal). The Commissioner seeks to obtain cost relief for Merchants on their side of the two-sided market at the expense of Cardholders, who will

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be forced to either pay more (through surcharges) or resort to less desirable and efficient payment methods. Her proposed remedies will not encourage competition, but instead will weaken Visa's and MasterCard's positions as against American Express, Interac and other payment methods against which they compete in the payment services market. The Commissioner's proposed remedies will reduce efficiency, restrict output and result in higher prices.

(ii) No Agreement, Threat or Promise to Maintain Prices

382. Although the Commissioner contends that the Challenged Rules constitute price maintenance, she has been unable to point to an agreement, threat, promise or like means whereby MasterCard has attempted to maintain any downstream supplier's prices. She cannot because there is no such agreement, threat or promise.

383. The "agreements" the Commissioner purports to rely upon are MasterCard's agreements with its Acquirers that require Acquirers to incorporate the Challenged Rules into Acquirers' agreements with Merchants. The Challenged Rules do not prescribe minimum pricing or preclude discounting, as one would expect when responding to an allegation of price maintenance. In fact, the evidence is clear that the Challenged Rules are intended for an entirely different purpose, and in any event expressly permit discounting. However, the Commissioner contends that, regardless of either the express language or the intent of the Challenged Rules, by their effect they constitute price maintenance and are anti-competitive.

Notice of Application at paras. 68-73.

384. The Commissioner's theory is therefore not based on an actual agreement, threat, promise or like means which is directed at influencing upward or discouraging the reduction of a particular price; rather, it is based on a more general theory that the Challenged Rules are anti-competitive and therefore must influence pricing in the MasterCard network.

385. Nor does MasterCard "maintain" prices. The conduct upon which the Commissioner relies simply does not fit within the section 76 resale price maintenance provision. There

is no evidence that MasterCard has tried to prevent Acquirers or Merchants in the MasterCard network from offering to sell their products at whatever price they see fit, or that it has engaged in any other conduct that would be described generally as resale price maintenance. There is no such evidence because MasterCard does not do it and has no interest in doing it. MasterCard does not receive interchange or the merchant discount rate. It receives network fees from Issuers and Acquirers. Its interest is therefore in increasing input by making the use of its credit cards as attractive as possible to both sides of the MasterCard network, not in recovering profits from high interchange rates.

386. The fact that MasterCard has no interest whatsoever in maintaining the prices of its Acquirers or Merchants is evidenced by the fact that MasterCard:

- does not track, compile or control the merchant discount rate or any other fee charged by Acquirers to Merchants;
- does not prescribe or even suggest how Acquirers charge Merchants;
- does not have knowledge of the particular merchant discount rates paid by Merchants to their Acquirers; and
- does not have knowledge of those Merchants who accept, or cease to accept, MasterCard credit cards.

Witness Statement of Stanton at para. 37.

387. MasterCard is not trying to influence Acquirer's fees or prevent anyone within the MasterCard network from competing on price. The Challenged Rules are intended for an entirely different purpose and are necessary for the network to function effectively. They are designed to expand output, protect consumers and make MasterCard's credit cards attractive to both consumers and Merchants. They are not an attempt to influence prices for an anti-competitive purpose.

388. The recent decision in *Fairview Donut Inc. v. TDL Group Corp.*, *supra*, provides helpful analysis on this point. This case concerned a claim of price maintenance under section 61

[redacted]

in respect of agreements between Tim Horton's and its franchisees pursuant to which franchisees were required to purchase their products from designated distributors. Tim Horton's negotiated the maximum price that distributors could charge franchisees, but did not prescribe a minimum price. The franchisees nevertheless claimed that Tim Horton's arrangements with the distributors resulted in inflated prices for franchisees by Tim Horton's, and therefore constituted price maintenance.

Fairview Donut Inc. v. TDL Group Corp., supra.

389. Justice Strathy of the Ontario Superior Court of Justice found that these agreements did <u>not</u> constitute price maintenance, on the basis that they were legitimate agreements entered into by the franchisees and Tim Horton's for a legitimate purpose. Further, while Tim Horton's prescribed a maximum price at which the distributors could sell the products, it did not preclude the distributors from reducing those prices. They could not charge more, but could charge less. The fact that Tim Horton's did not prohibit distributors from reducing their prices was found to be a reflection of a legitimate agreement led by market forces, as opposed to anti-competitive conduct.

Fairview Donut Inc. v. TDL Group Corp. supra, at paras. 506-605.

390. The situation here is similar. MasterCard's Challenged Rules were also developed for the legitimate business purposes of protecting MasterCard's brand and maximizing the attractiveness of the cards for both Cardholders and Merchants. They are not directed at maintaining prices. MasterCard does not in any way dictate the fees that Acquirers charge Merchants or that Merchants charge their customers. MasterCard does, in order to maintain the efficiency of its network, set a non-mandatory default interchange rate for Issuers and Acquirers to facilitate transactions between them, but this is nothing more than an input cost to Acquirers that they are free to take into account in setting their fees to Merchants as they see fit, which they do without any input from MasterCard.

Witness Statement of Stanton at paras. 63, 89 and 90.

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391. The Commissioner has cited the 1957 decision of the Ontario Court of Appeal, *R. v. Moffats,* referenced above, for the proposition that a specific intent to engage in price maintenance is not required, and that it is sufficient if the respondent advertently entered into an agreement which had the effect of inducing a downstream supplier to resell the respondent's commodities at not less than a minimum price.

R. v. Moffats Ltd., [1957] O.R. 93, 28 C.P.R. 57 (Ont. C.A.) at paras. 17-19.

392. *R v. Moffats* does not assist the Commissioner or conflict with the legal principle that for price maintenance there must be an intent to engage in an anti-competitive act. In *R. v. Moffats,* it was clearly established that the accused had prescribed the price at which a downstream supplier was to advertise its products for resale. In other words, there was conduct directed specifically at maintaining prices. The Commissioner's theory in this case is based on a far more tenuous and remote connection between the conduct in issue and the alleged eventual impact on downstream costs. Even the numerous economists who gave evidence during this hearing cannot agree on the nature of the impact, if there is any at all. There is simply not a sufficient connection between the conduct in issue and the alleged impact on pricing to constitute price maintenance.

Ibid.

393. The Challenged Rules are essential elements of the MasterCard network that have been developed for the legitimate purpose of permitting the network to function efficiently for the benefit of Issuers, Acquirers, Cardholders, Merchants and MasterCard. They are necessary features of the network. MasterCard does not dictate how Issuers, Acquirers or Merchants account for their costs in negotiating the prices and fees they charge for their participation in the network.

Witness Statement of Stanton at paras. 63, 89 and 90.

394. In summary, the Commissioner's theory simply does not make sense as a matter of law. The Commissioner seeks to apply the section the 76 resale price maintenance provisions to conduct to which it was never intended to apply.

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395. The Commissioner's theory also does not make sense as a matter of economics.

396. The difficulty with the Commissioner's theory is illustrated by the confusion in her submissions and her experts' evidence regarding what "price" is alleged to have been influenced upward. This is reviewed in greater detail below but, by way of summary, the Commissioner has taken the following positions:

(a) In paragraph 69 of her Notice of Application, the Commissioner takes the position that the Challenged Rules influence upward or discourage the reduction of the merchant discount (being the fees paid by merchants to Acquirers for credit card network services).

(b) In paragraph 78 of her Notice of Application (and in her experts' reports), the Commissioner takes the position that the prices that are being influenced are the prices that Merchants charge their customers, on the basis that "as merchants need to cover payment processing costs, merchants pass some or all of the increased costs from higher Card Acceptance Fees onto customers in the form of higher retail prices for goods and services".

Notice of Application at para. 78;
Frankel Report at para. 183.

(c) The Commissioner's expert, Professor Winter, argues that the price that is alleged to be influenced upward is actually the price that MasterCard charges Acquirers as network fees and the interchange which is paid to Issuers. (In other words, he contends that MasterCard's conduct influences, in part, its <u>own</u> prices upwards).

Notice of Application at paras. 69 and 78;
Frankel Report at para. 183;
Winter Report at paras. 13 and 17;
[redacted]

397. None of the Commissioner's various theories constitute price maintenance as the term is used by economists. What the Commissioner is calling price maintenance is nothing more than the natural effect of input costs being factored into pricing by participants in

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MasterCard's network. The fact that Acquirers would consider their input costs, which would include interchange, in setting the merchant discount rate is not surprising, nor is the fact that Merchants would consider their merchant discount costs when setting their own prices. However, from an economist's point of view, influencing one of the costs of a downstream firm is not the same thing as setting or maintaining the downstream firm's prices.

Elzinga Report at para. 79.

398. At paragraphs 80 and 81 of his Report, Professor Elzinga, one of MasterCard's economists, uses the example of franchise arrangements in which the franchisor may control many aspects of their franchisee's business operations, which may have the economic effect of increasing the costs borne by franchisees. For instance, franchisors may require that a franchisee purchase certain inputs from it or from a set of approved suppliers. Franchisors do this to prevent the franchisees from using lower cost, lower quality inputs that would harm not only the franchisor but other franchisees as well. Certainly this may result in higher input costs to franchisees. However, Professor Elzinga suggests that it would strain credibility to suggest that such contractual provisions constitute "price maintenance".

Elzinga Report at paras. 80-81.

399. In *Fairview v. TDL*, Justice Strathy took precisely this view in finding that Tim Horton's requirement that franchisees acquire products from designated distributors at prices not exceeding a stated price was not price maintenance under section 61 (the former price maintenance provision). Strathy J. stated:

> "This lack of autonomy is the result of legitimate agreements entered into by the plaintiffs and Tim Horton's for legitimate business purposes. Moreover, there is nothing in the distribution agreements that prohibits the distributors from charging lesser amounts to the franchisees…The fact that they do not do so is a reflection of a legitimate agreement led by market forces, as opposed to anti-competitive conduct."

Fairview Donut Inc. v. TDL Group Corp., *supra* at paras. 603 and 605.

400. A Merchant, like a franchisee with respect to its franchise arrangements, is free to choose whether to accept MasterCard. However, having chosen to accept MasterCard, and to enjoy all of the many benefits that flow from being part of the MasterCard network, the Merchant must accept all of the features of the network. One of those features is that it must pay a merchant discount to Acquirers, which will reflect various input costs incurred by the Acquirers.

Elzinga Report at para. 81.

401. [redacted]

(a) [redacted]

(b) [redacted]

(c) [redacted]

(d) [redacted]

[redacted]

(e) [redacted]

(f) [redacted]

402. Just as a franchisor may impose certain controls on supply of products to its franchises, so too do the Challenged Rules maintain the essential character of a general purpose payment network by ensuring that every Issuer's and every Cardholder's credit cards are accepted on the same terms by every Merchant who chooses to participate in the market, and that every Cardholder pays no more than the Merchants' posted price.

Elzinga Report at para. 84.

403. The Challenged Rules are not intended to prohibit discounts by Acquirers and Merchants and in fact ensure that Merchants may discount. MasterCard does not enter into vertical agreements with its Acquirers that control the Acquirer's merchant discount rate. Nor has MasterCard issued ultimatums to its Acquirers about the structure or level of merchant discount rates. Acquirers and Merchants have full discretion to set their fees as they see fit, and do so. The way in which cost changes, such as changes in interchange rates, are transmitted into price changes is at the discretion of Acquirer. Consequently, Professor Elzinga concludes, it is inaccurate and misleading to characterize the application of the Challenged Rules as "price maintenance".

Elzinga Report at para. 87.

404. Professor Elzinga's conclusion is that the Challenged Rules "do not equal price maintenance. Price maintenance is when the sale of a product has conditions that set limits on the resale price of the product...the operating rules here – place no restrictions on the prices charged by Acquirers and Issuers. Therefore, in my judgment, Visa and MasterCard do not engage in price maintenance."

Transcript of the Examination-in-Chief of Elzinga, at pages 2711-2713 (public).

405. In summary, there is no agreement, threat, promise or like means to influence upward or discourage the reduction of downstream pricing in the market, and any effect on pricing arising from the Challenged Rules is purely a function of input costs associated with the MasterCard network - as is the case with any other business.

(iii) There is no "Resale" of a MasterCard Product

406. Further, the MasterCard network and the application of the Challenged Rules do not involve conduct within the type of vertical supply to which section 76 was intended to apply because no product is "resold" to a downstream supplier.

407. For the same reason that the Commissioner struggles to identify the "price" that is being maintained (discussed below), she is unable to identify the "product" she alleges is resold, the price of which is alleged to be maintained.

408. Ms. Leggett made this point in her evidence. As she said, contrary to the characterization in the Commissioner's Application, the four-party credit card payments system does not consist of vertical relationships among Merchants, Acquirers, Issuers and the respective card networks whereby a product or service is produced by one party and then sold through a distribution chain, given the following:

(a) first, the credit card networks do not sell any product or service to Acquirers that Acquirers, in turn, sell to Merchants;

(b) second, the credit card networks do not sell any product or service to Merchants that Merchants, in turn, sell to their customers;

(c) third, Issuers do not sell any product or service to Merchants that Merchants, in turn, sell to their customers; and

(d) fourth, while Acquirers do sell or rent certain products (such as point of sale terminals) and services (such as credit and debit payment processing services) to

Merchants, Merchants do not sell these products or services to their customers. Instead, Merchants use these products and services to allow their customers to pay for goods or services with a credit or debit card.

Witness Statement of Leggett at paras. 37-41.

409. The Commissioner's expert, Mr. McCormack, suggested in his first report that Acquirers are "resellers" of Visa's and MasterCard's services to Merchants. This is not the case. Mr. McCormack is correct when he states that the services that Acquirers provide Merchants are "centered on providing merchants with the ability to accept Visa and MasterCard branded credit cards for payment." However, this is plainly not a set of services that either Visa or MasterCard provide to Acquirers, and is therefore clearly not a set of services resold by Acquirers to Merchants. Mr. McCormack is incorrect when he states that Acquirers provide Merchants with "access to Visa and MasterCard's respective network processing systems" (although, even if this were so, it would not involve the "resale" of any product purchased by Acquirers from Visa or MasterCard to their Merchant customers). The fact is that as the Visa and MasterCard networks are operated, Acquirers have access to their network. Merchants do not. Acquirers connect to the Visa network, while Merchants are connected via electronic terminals supplied by their Acquirers to the proprietary system operated by their Acquirers.

McCormack Report at para. 159;
Witness Statement of Weiner at para. 39.

410. The product MasterCard provides to Acquirers is a suite of services to permit Acquirers to switch transactions and match MasterCard credit cards presented to their Merchant clients with Issuer accounts for authorization, clearance and settlement. MasterCard also provides services to Acquirers and Issuers such as brand marketing, product development and network/processing solutions involving the MasterCard network.

Witness Statement of Stanton at para. 33.

411. Acquirers at the same time have separate arrangements with Issuers pursuant to which they are connected for purposes of completing the payment for each transaction. Acquirers pay Issuers the interchange as part of their contractual arrangements.

412. Acquirers do not resell access to MasterCard's network services to Merchants. Acquirers provide a different suite of services or "product". These services include a guarantee of prompt payment, banking and depositing arrangements, deployment of terminals or other technology to accept card payments, implementation and project management services, assumption of risk, customer service support, replacement of equipment, flexibility of settlement/deposit arrangements, gift card processing, rewards processing, private label card processing and Merchant statement, training and training materials packages.

> Witness Statement of Stanton at paras. 34, 39 and 40.

413. While it is true that Acquirers are able to access the MasterCard network for authorization, clearance and settlement of transactions, and that one of the costs Acquirers incur relates to network fees paid to MasterCard for access to the network, Acquirers do not "resell" access to the network. The services provided to Merchants by Acquirers are not the same.

> Witness Statement of Stanton at paras. 34, 39 and 40.

414. The Commissioner has attempted to address this conceptual difficulty by arguing that, notwithstanding its express language, section 76 does not actually require that a product be "resold". The Commissioner argues that section 76 applies to an agreement or other conduct by a supplier that influences upward or discourages the reduction of the price at which that supplier's customer supplies or offers to supply a product within Canada. She argues that MasterCard supplies a product, which the Commissioner calls "credit card network services", indirectly to Merchants through Acquirers, and that the Challenged Rules influence upward or discourage the reduction of the price at which Acquirers supply a product within Canada.

> Reply of the Commissioner of Competition at para. 36.

[redacted]

415. The Commissioner's position is simply not supportable given the words used in section 76(1)(a)(i). In the 2009 amendments to the legislation, Parliament expressly amended the price maintenance provision to introduce the requirement that the conduct to influence pricing must relate to the price at which "...the person's customer or any other person to whom the product comes for resale" supplies or offers to supply a product.

Competition Act, R.S.C. 1985, c. C-34, s.76.

416. The fact that the Commissioner cannot neatly fit the roles of Visa and MasterCard as the operators of their respective networks within the wording of the price maintenance provision and within the concept of a "resale" of a MasterCard product illustrates the degree to which the Commissioner is seeking to improperly stretch the price maintenance provision to apply to the MasterCard network.

417. As an alternative argument, the Commissioner suggests that MasterCard does supply credit card network services which are "resold" by Acquirers to Merchants because, at a fundamental level, MasterCard has created a network to which it provides direct access to Acquirers on certain mandatory terms, which Acquirers then supply to Merchants.

Reply of the Commissioner of Competition at para. 37.

418. Again, this alternative argument mischaracterizes the relationship between Acquirers and Merchants in the MasterCard network. As noted above, Merchants do not access the MasterCard network. Merchants deal with their Acquirer, not MasterCard. Merchants connect electronically via point of sale solutions to the proprietary system operated by their Acquirers. Merchants have no ability to connect to the MasterCard network (unless they also issue or acquire MasterCard transaction, thereby acting as an Acquirer or Issuer, rather than as a Merchant).

Witness Statement of Stanton at para. 40.

419. The Commissioner's theory of why there is a resale also misses the mark from an economist's perspective. Price maintenance, as defined by economists, focuses on the terms under which an upstream firm's products are resold by a downstream firm. In

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other words, price maintenance applies to a commercial setting in which ownership of a product is transferred at least twice among vertically arranged agents.

Elzinga Report at para. 77.

420. The Commissioner's price maintenance allegations characterize the upstream relationship between MasterCard and its Acquirers and the downstream relationship between Acquirers and Merchants as a commercial setting where there are successive sales of the same product. As Professor Elzinga notes, the shoe does not fit. Card acceptance services are performed only once for each transaction, not twice. Accordingly, in this case there can be no resale price maintenance.

Elzinga Report at para. 78.

(iv) Whose Price is Alleged to be Maintained?

421. In terms of the "price" in issue, the best the Commissioner has been able to do is suggest a number of different "prices" which she contends may be influenced by the Challenged Rules. At various times in her pleadings, in her Reports and in her evidence at trial the Commissioner has suggested that the prices which have been influenced are one or more of MasterCard's network fees, the interchange, the merchant discount or the prices paid by consumers, as follows:

(a) "The Merchant Restraints influence upward or discourage the reduction of the Card Acceptance Fees paid by merchants for Credit Card Networks Services". [emphasis added]

Notice of Application at para. 69.

(b) "…the Merchant Restraints also influence upwards or discourage the reduction of the prices charged by merchants for the supply of products to their customers" [emphasis added]

Notice of Application at para. 78.

[redacted]

(c) "…the Merchant Restraints eliminate important competitive constraints on the pricing of credit card acceptance services in Canada. As a result, Card Acceptance Fees are higher than otherwise, and, because merchants lack the most effective steering tools, use of costly credit cards is increased, driving merchant costs – and retail prices – higher still". [emphasis added]

Frankel Report at para. 183.

(d) "…The Merchant Rules adversely affect competition in the market for the supply of Credit Card Network Services in Canada. This adverse competitive impact leads to higher prices (i.e. higher Acquirer Fees)." [emphasis added] ("Acquirer Fees" are defined as the total fee per transaction paid by Acquirers, comprised of the sum of the interchange fee and the network fee).

Winter Report at paras. 13 and 17.

422. The Commissioner's difficulty in deciding what "price" is alleged to have been maintained arises from the fact that she has approached the test for resale price maintenance backwards. She starts with the (incorrect) contention that MasterCard has market power and is using the Challenged Rules to restrict competition by preventing Merchants from steering consumers away from using MasterCard's credit cards (a subsection 76(1)(b) argument), then suggests that the effect of this restriction is to cause the prices or fees of one or more participants within the MasterCard network to be higher than they would be absent the Challenged Rules (which she argues should satisfy subsection 76(1)(a)).

423. The theory of the Commissioner's expert, Professor Winter, is that the Challenged Rules adversely affect competition, thereby influencing upward the "prices" that Visa and MasterCard charge Acquirers for the services Visa and MasterCard provide. Professor Winter's theory is that the price maintenance requirement is allegedly met because the increase in the "prices" charged to Acquirers is passed on to Merchants as higher merchant fees.

Winter Report at paras. 22, 79, 85, 107(a) and 119.

424. As Professor Church explains in paragraph 27 of his report, Professor Winter's application of section 76 is backwards, which he terms a "reverse order of causality". Professor Church notes 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 as a result of the price maintenance.

Church Report at para. 27;
Summary of Expert Report – Jeffrey Church, Exhibit RM-493.

425. If Professor Winter's approach were to be accepted, 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. Indeed, accepting the causality advocated by Professor Winter makes the requirement of price maintenance redundant and turns the price maintenance provision into one applicable to any conduct that results in an adverse effect on competition in an input market. A second unfortunate consequence appears to be equating pass-on from a higher input price to price maintenance; it should not be an issue for downstream firms to respond to higher input prices by raising the price of their products.

Church Report at para. 29;
Summary of Expert Report – Jeffrey Church, Exhibit RM-493;
Transcript of Examination-in-Chief of Church at pages 2861-2862 (public).

426. There is another problem with Professor Winter's approach. He ties interchange rates (which are not received by MasterCard) and network fees (which are paid to MasterCard) together as "Acquirer Fees" and suggests these prices (or costs) to Acquirers are being maintained. However, he doesn't explain to what extent these Acquirer Fees are allegedly being influenced upward by higher interchange and to what extent this is alleged to be due to higher network fees. The result is that his analysis of incentives for undercutting the Acquirer Fee is, at best, ambiguous.

Church Report at para. 42.

[redacted]

427. To the extent Professor Winter relies on an alleged increase in network fees, Justice Strathy in the Tim Horton's case confirmed that one cannot be found to have maintained their <u>own</u> prices. Strathy J states at paragraph 585 of his decision:

> "Section 61 does not prohibit a manufacturer or supplier from increasing the price at which it sells the product. As I have said earlier, it does not prohibit a supplier from making a large profit on a product it sells to someone downstream. It prohibits a person who produces or supplies a product from attempting, by means of agreement to influence upward or discourage the reduction of the price at which another person sells the product. The provision is designed to protect the public by prohibiting an upstream supplier from preventing competition among retailers, thereby increasing the price paid by the ultimate consumer. It does not prohibit the upstream supplier from increasing the price at which it supplies the product to a downstream purchaser."

Fairview Donut Inc. v. TDL Group, supra at para. 585.

(v) The Commissioner's Theory Lacks a Limiting Principle

428. There is clearly no express, or even implicit, agreement, promise or threat to maintain fees or prices in the MasterCard network. Accordingly, the Commissioner bases her Application on the theory that, regardless of what the Challenged Rules say, what the direct and immediate effect of the rules are or what was intended by them, one "effect" of the Challenged Rules is to influence upward or discourage the reduction of all or one of the interchange rate, network fees, the merchant discount or Merchant's prices. The Commissioner's experts take the position that by precluding Merchants from imposing surcharges or refusing certain cards, the Challenged Rules have the indirect effect of restraining Merchants from effectively encouraging customers to use credit cards with lower merchant discount fees or other lower cost methods of payment at the point of sale, thereby limiting Merchants' ability to exert pressure on Acquirers and MasterCard on their side of the market.

Winter Report at para. 22.

429. It is respectfully submitted that the price maintenance provision was never intended to operate as a "catch all" provision whereby all the Commissioner needs to do is prove anti-competitive conduct, and then speculate as to ways in which the conduct is affecting how various participants in the relevant market set their pricing, or how they would react were the conduct to be discontinued. If the Commissioner cannot satisfy the subsection 76(1)(a) requirement that MasterCard, by agreement, threat, or promise or like means, has attempted to influence upward or discourage the reduction of prices of a downstream supplier of its product, there has been no resale price maintenance as required by the statute.

430. As Professor Elzinga put it:

> "If the indirect effect that the interchange rate has on card acceptance fees is a form of "price maintenance", then so is the price charged by suppliers of any input. In terms of the underlying economics, nothing is added by saying an input cost increase "maintains" a price over and above saying a cost affects or influences a price."

> Elzinga Report at para. 83.

431. The only aspect of the Challenged Rules that speaks specifically to pricing at all is the NSR, but rather than seeking to influence upwards or discourage the reduction of prices, the NSR does the opposite: it <u>precludes</u> Merchants from surcharging and <u>permits</u> them to discount.

> Witness Statement of Stanton at paras. 69 and 73.

(vi) The Commissioner's Theory of Causation is Highly Speculative

432. The Commissioner's entire case is built upon assumptions and speculation as to how participants within the credit card networks and consumers would generally react to the removal of the Challenged Rules. For her theories to work:

- Merchants must surcharge (or reject cards) or credibly threaten to do so;

- Surcharging must actually work, or be perceived to be working, in steering customers to other payment mechanisms;
- Merchants must seek to surcharge in order to steer, rather than as a revenue source;
- Credit card companies must decide to reduce interchange from among various options in response to the threat;
- Acquirers must decide to reduce merchant discount rates as a result; and
- The retail market must be perfectly competitive.

433. The Commissioner's theory is therefore based on the assumption that Merchants, consumers, credit card companies, Acquirers and Issuers will react in the way she speculates that they will. This point was illustrated by the fact that Mr. Houle of Air Canada uses the word "speculative" almost a half dozen times in his oral testimony.

> Transcript of the Examination-in-Chief of Houle at pages 480-545 (public).

(vii) There is No Joint Price Maintenance

434. The Commissioner has focused on the conduct of Visa and MasterCard as if they operated and exercised market power together. This is not the case. Visa and MasterCard are fierce competitors. Further, section 76 of the *Competition Act* does not contemplate or permit the Commissioner to treat Visa and MasterCard as joint actors. The section, by its words, requires that their respective positions and conduct each be considered separately.

> Witness Statement of Stanton at para. 56;
> *Competition Act*, R.S.C. 1985, c. C 34, s.76.

435. Subsection 76(1) of the *Competition Act* states:

> [on application by the Commissioner, 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 had discouraged the reduction of, the price at which the person's customer or any other person to whom

[redacted]

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."

Competition Act, R.S.C. 1985, c. C 34, s.76(1).

436. Subsection 76(2) of the *Competition Act states that:*

> "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."

Competition Act, R.S.C. 1985, c. C 34, s.76(2).

437. In other areas of the *Competition Act* there is the possibility of a combined case. We may not yet know just what level or nature of joint conduct is necessary for joint abuse of dominance under section 79 of the *Competition Act*, but we know it can exist. The statute clearly says "one or more persons control" in the Abuse of Dominance provision. The statute does not say "one or more persons engage in resale price maintenance". Section 79 (in part) reads as follows:

> "79. (1) Where, on application by the Commissioner, the Tribunal finds that
>
> (a) **one or more persons** substantially or completely control, throughout Canada or any area thereof, a class or species of business…" [emphasis added]

Competition Act, R.S.C. 1985, c. C-34, s.79.

438. There can also be parallel conduct giving rise to orders under the tied selling, exclusive dealing or market restriction provisions in section 77 of the *Competition Act*. The statute says that the conduct can attract a remedial order when it is engaged in by a major supplier, or is widespread in a market. Section 77(2) (in part) reads as follows:

[redacted]

> "77. (2) Where, on application by the Commissioner or a person granted leave under section 103.1, the Tribunal finds that exclusive dealing or tied selling, because it is engaged in by a major supplier of a product in a market **or because it is widespread in a market**,..." [emphasis added]

Competition Act, R.S.C. 1985, c. C-34, s.77.

439. Neither MasterCard nor Visa, alone, has sufficient market power to have an adverse effect on competition. In the retail payment market, MasterCard has roughly [redacted]% of transaction volume and Visa roughly [redacted]%. In payment cards, MasterCard is roughly [redacted]% and Visa is [redacted]%. Even if the Commissioner's artificially and narrowly defined credit card market is accepted, MasterCard has only about a [redacted]% share.

Witness Statement of DeVita at para. 20, [redacted]

440. The Competition Bureau's own Abuse of Dominance Guidelines provide that "a market share of less than 35% will generally not give rise to concerns of market power or dominance." So, naturally, the Commissioner uses the phrase "MasterCard and Visa combined". She has to.

"Enforcement Guidelines on the Abuse of Dominance Provisions", Industry Canada (July 2001) at page 2.

441. When a firm has market share below 50%, no *prima facie* finding of dominance arises.

Canada (Director of Investigation and Research) v. Laidlaw Waste Systems Ltd. (1992), CT-91/2 (Comp. Trib.) at pages 63-64.

442. It is clear from the Competition Bureau's new draft 2012 Abuse of Dominance Provisions Enforcement Guidelines that, even if there was such a thing as "joint price maintenance" (which is not admitted, but expressly denied), parties cannot be found to jointly exercise market power when they compete vigorously with each other:

> "Before a group of firms can be considered jointly dominant, three sources of competition that may defeat the profitability of a price increase must be assessed: competition from existing rivals outside the allegedly jointly dominant group; competition from potential rivals (i.e., entrants) outside

[redacted]

> the allegedly jointly dominant group; and competition from within the allegedly jointly dominant group — if the firms in the allegedly jointly dominant group are, in fact, competing vigorously with one another, they will not be able to jointly exercise market power."
>
> "The Abuse of Dominance Provisions (Sections 78 and 79 of the Competition Act) Enforcement Guidelines" (draft), Competition Bureau Canada (Gatineau: 2012) at page 10.

443. This is similar to the Bureau's existing 2001 Guidelines, which say:

> "In joint dominance cases, there are three sources of competition that can defeat the profitability of a price increase. These are competition from existing rivals outside the allegedly jointly dominant group; competition from potential rivals (i.e. entrants) outside the allegedly jointly dominant group; and competition from within the allegedly jointly dominant group."
>
> "Enforcement Guidelines on the Abuse of Dominance Provisions", Industry Canada (July 2001.

444. There can be no doubt, from all of the evidence in this case, including internal documents which the Commissioner has focused on for other reasons, that MasterCard and Visa do compete vigorously with each other

445. Had Parliament intended to permit the Commissioner to treat MasterCard and Visa as joint actions for purposes of section 76, it could have done so. Parliament chose not to.

3. Adverse Effects on Competition

(a) The Test for Adverse Effects on Competition

446. There are no reported cases interpreting the meaning of "is likely to have an adverse effect of competition" under section 76(1)(b) of the *Competition Act*. However, the same wording appears in section 75(1)(e) (the refusal to deal provision) and has been the subject of judicial scrutiny.

447. The two leading Tribunal decisions dealing with this phrase under the *Competition Act* are *B-Filer* and *Nadeau*. These cases establish that the determination of whether conduct

[redacted]

is or is likely to have an adverse effect on competition requires a comparison of the competitiveness of the market with and without the challenged conduct.

> *B-Filer Inc. v. Bank of Nova Scotia,* 2006 CarswellNat 6422 (Comp. Trib.) at paras. 196-197;
> *Nadeau Poultry Farm Limited v. Groupe Westco Inc.*, 2009 CarswellNat 5934 (Comp. Trib.) at para. 368.

448. The Tribunal in *B-Filer* noted that "competitiveness" refers to the degree of market power that prevails in the market. This competitiveness finds its expression by the manner in which firms compete. The Tribunal stated:

> "Adverse effects in a market are generally likely to manifest themselves in the form of an increase in price, the preservation of a price that would otherwise have been lower, a decrease in the quality of products sold in the market (including such product features as warranties, quality of service and product innovation) or a decrease in the variety of products made available to buyers. The question to be answered is whether any of these or other competitive factors can be adversely affected absent an exercise of market power."

> *B-Filer Inc. v. Bank of Nova Scotia, supra* at para. 206.

449. In *Nadeau* the Tribunal found that the phrase "is likely to have" means the event is probable and not merely possible.

> *Nadeau, supra* at para. 368.

450. The Tribunal in *Nadeau* found that "…for a refusal to deal to have an adverse effect on competition in 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". This creation, enhancement or preservation of market power is the threshold for determining an adverse effect.

> *Nadeau, supra* at para. 3.

451. The Tribunal in *Nadeau* also noted that market power requires the ability to set prices above a competitive level for a considerable period of time, but recognized that there are

[redacted]

generally difficulties in determining this directly. Factors that should be considered include market share and market concentration; barriers to entry; impact on prices; the effect of the refusal on rivals' costs; impact on quality and variety of the product; possible foreclosure of supply to others in the market; and impact of possible elimination of an efficient competitor.

Nadeau, supra at para. 369.

452. As discussed below, MasterCard does not have market power and the Challenged Rules have not had and will not have an adverse effect on competition. The Challenged Rules are pro-competitive. Further, MasterCard's market share of the payment services market is far below any recognized threshold for market power. It does not even have sufficient market share in the narrow market the Commission urges the Tribunal to adopt. There is insufficient evidence of barrier to entry. In fact, the evidence is that the Discover credit card network and PayPal are entering in Canada. Meanwhile, American Express is already entrenched in Canada and will be poised to reap the benefits of any restrictions on the ability of MasterCard and Visa to protect their brands and increase output in their respective networks.

Witness Statement of DeVita at para. 45.

(b) The Rules in Issue are Pro-Competitive

(i) They Expand Output

453. The Challenged Rules are pro-competitive. They are designed to expand output, benefit Cardholders and promote efficiency. They are designed to make MasterCard an attractive form of payment for both Cardholders and Merchants. Professor Elzinga confirmed in his evidence that Visa and MasterCard are "out to expand" output, to capture more and more transaction volume.

Witness Statement of Stanton at para. 87;
Transcript of Examination-in-Chief of Elzinga at pages 2702-2703 (public).

[redacted]

454. In order to increase positive network effects in a two-sided market, companies may impose requirements on one side of the market, side A, that do not benefit them directly, but which indirectly benefit them as they increase the benefit to the other side, side B. As stated by David Evans and Richard Schmalensee in "*The Industrial Organization of Markets with Two-Sided Platforms*", the HACR provides an example of this. They state that:

> "Card systems generally require merchants that agree to take the system's branded cards agree to take all branded cards that are presented by shoppers. ... For at least some merchants the private cost of this requirement outweighs its benefits (generally we would expect that merchants would privately want a choice to take whatever card they wanted.) However, this rule makes the system's branded card more valuable to its cardholders, who have the assurance that their card will be accepted for payment at merchants that display the system's acceptance mark. By increasing the number of cardholders it makes the card a more valuable payment device for merchants to accept."

> Competition Policy International, Vol. 3, No. 1 Spring 2007, "The Industrial Organization of Markets with Two-Sided Platforms", David Evans and Richard Schmalensee at page 178.

(ii) They Protect Consumer Interests

455. The Challenged Rules protect Cardholders by ensuring the prices they pay at point of sale are no greater than advertised. Even more importantly they protect Cardholders from the embarrassing situation of having their credit card declined after dinner or on a trip. They build consumer confidence in the universality and utility of their cards. Professor Elzinga's opinion is that the Challenged Rules should be characterized as "cardholder assurances".

> Transcript of Examination-in-Chief of Elzinga at pages 2703-2704 (public);
> Witness Statement of Stanton at para. 87.

(iii) They Balance the System

456. A key component of balancing the Cardholder and Merchant sides of the networks is building confidence that a credit card will be accepted, without hassle or surcharges.

[redacted]

Cardholder confidence increases output and, as discussed above, brings benefits to Merchants and Cardholders.

457. Without the Challenged Rules, smaller Issuers and Acquirers would be impacted disproportionately because the credit card business is a scale business. With a material reduction in volumes or values, smaller Issuers and niche Acquirers would be priced out of the market. The result would be a reduction in the number of Issuers and Acquirers, weakening competition. Such a reduced competitive environment is less conducive to product innovation.

Jairam Report at paras. 80 and 85.

(iv) They Protect Legitimate Franchisor Interests

458. The Challenged Rules are no different than any restraints found in a typical franchise agreement, like the Shoppers Drug Mart agreement referred to above. The Challenged Rules are designed to ensure Cardholders have a consistent experience which avoids the potential for free-riding that devalues brand equity. They protect the brand, to the benefit of all participants in the network.

Transcript of Examination-in-Chief of Elzinga at page 2728 (public).

(v) They Protect MasterCard from Reputational Damage

459. The Challenged Rules are designed to protect the MasterCard brand and maximize transaction volume. The remedies sought by the Commissioner would undermine the Visa and MasterCard brands and result in reduced consumer demand for their respective networks.

Elzinga Report at para. 194.

(vi) The Commissioner's Experts have not Analyzed the Total Welfare Effects of the Rules

460. Professor Winter agreed that he had not considered the total consumer welfare in the preparation of his report.

[redacted]

Transcript of Cross-Examination of Winter at page 2019 (public).

461. This is one of the fundamental problems with the Commissioner's position. Her singular focus on one-side of the two-sided market, and on one cost of one participant on that side, ignore both the clear benefits of the Challenged Rules to the networks as a whole and the benefits Merchants receive from accepting credit cards associated with strong network brands.

(c) Retailers are not Required to Accept MasterCard Cards, but They Benefit from Doing So

462. A fundamental tenant of the Commissioner's case is that Merchants are required to accept credit cards. All this means is that they are better off accepting credit cards than not. The Commissioner's experts concede the point that Merchants make more money accepting credit cards than not accepting credit cards. The Merchants do not have to accept credit cards, but they want to.

Transcript of Cross-Examination of McCormack at page 648 (public).

463. Furthermore, given that there are more than 2 million Merchant locations in Canada and only 700,000 or 800,000 accept credit cards, many do not. Of course, most big Merchants do accept credit cards because they believe they are better off doing so than not.

Transcript of Cross-examination of Weiner at 2309 (public).

464. However, not all Merchants do accept MasterCard or Visa and they do not have to. Costco does not MasterCard or Visa. Until 2 weeks ago Tim Hortons did not accept Visa. Many universities do not - some of them used to, but have stopped. A large beverage retailer said it was genuinely considering dropping acceptance. These Merchants decided they were better off not accepting credit cards.

Transcript of Examination-in-Chief of Jairam at page 3345 (public);
Transcript of Examination-in-Chief of Van Impe at page 1671 (public).

[redacted]

465. There is no doubt that credit cards bring a great number of benefits to Merchants. Mrs. Van Impe of the University of Saskatchewan clearly articulated some of the advantages: prompt payment, guarantee of payment, protection from bad debts, accounting and Administrative cost advantages. It is not surprising Merchants want to accept credit cards. However, that is different from some sort of nefarious requirement that they do.

Transcript of Cross-Examination of Van Impe at pages 1684-1686 (public).

466. A few years ago the grocers took up credit card acceptance because they thought it was good for their business.

Transcript of Examination-in-Chief of Jewer at page 1731 (public).

467. Visa and MasterCard, by making their credit cards more and more attractive to a wider and wider group of Merchants, are not doing something anti-competitive and are not forcing people to use something they do not want to do. They are doing exactly what competition law seeks to achieve. They are improving their products to expand output. To get people to want to accept cards. Merchants do not have to accept credit cards, but it is a good deal for them, so they do.

(i) Merchants are Better Off Accepting MasterCard than not doing so

468. [redacted]

[redacted]

(ii) Virtually all Cardholders Have a Debit Card

469. 74% of transactions at Sobeys are cash or debit.

Transcript of Examination-in-Chief of Jewer at page 1734 (public).

470. The evidence of Mr. Gauthier was that nine out of ten people own an Interac debit card and chequing account.

> Transcript of Examination-in-Chief of Gauthier at page 3038 (public).

(iii) Many People Have Credit Cards

471. There are 32.4 million Visa credit cards in Canada and 17 million active MasterCard credit cards in Canada.

> Sheedy Report at para. 7.

472. 87% of Canadians own a general purpose credit card and 37% own a store credit card. 77% of those who have a credit card own a Visa card and 60% own a MasterCard card and 20% own an Amex card.

> Transcript of Examination-in-Chief of Gauthier at page 3038 (public).

473. Further, Mr. Gauthier's evidence was that 77% of consumers who have a credit card own a Visa card; 60% own a MasterCard and 20% own an American Express card.

> Transcript of Examination-in-Chief of Gauthier at page 3038 (public).

(d) Two-Sided Market and Need to Balance Each Side

(i) What is a Two-Sided Market?

474. One point on which there is agreement (because the Commissioner's experts acknowledged it) is that what we are dealing with clearly is a two-sided market. Dr. Frankel prefers "marketplace" – but it comes to the same thing.

> Transcript of Examination-in-Chief of Frankel at pages 878-879 (public);
> Transcript of Cross-Examination of Carlton at page 1278 (public);
> Carlton Report at para. 33.

475. Their evidence acknowledging the existence of the two-sided market included the following:

[redacted]

"A credit card company depends for its success in the market, upon attracting both cardholders and merchants to the network. The total volume of transactions on which the credit card company collects its Network Fees depends on both the number of cardholders using the credit card company's credit cards and the average volume of transactions by each cardholder, which in turn depends, in part, upon the number of merchants accepting the credit card company's credit card (see best in service)."

Winter Report at para. 32.

"I don't ignore the fact that there is a two-sided . . . I like calling it a two-sided marketplace. It is undeniable there are these two complementary products. Cardholders and merchants interact with each other…"

Transcript of Examination-in-Chief of Frankel at pages 878-879 (public).

"Customers care how many merchants are taking a credit card and merchants care how many customers there are who are carrying this credit card, and the two will influence each other so that is what a two-sided market is."

Transcript of Examination-in-Chief of Carlton at page 1257 (public)

476. However, despite these acknowledgements, a fundamental flaw in the Commissioner's experts' analyses and thus a fundamental flaw in their assertion of anti-competitive harm is their failure to account for the two-sided nature of the market.

Transcript of Examination-in-Chief of Stanton at page 2439 (public).

477. One of the Commissioner's experts, Professor Winter, presented two theories to attempt to link the Challenged Rules to an alleged adverse effect on competition: that the Challenged Rules "suppress competition" and result in "cost externalization". Professor Winter argues that these effects reduce the incentives Visa and MasterCard have to reduce their "Acquirer Fees" (which he defines as the sum of the network access fee charged to Acquirers by MasterCard and Visa and the interchange fee). The reduction in the incentive to lower Acquirer Fees results, according to his theory, in a softening of

[redacted]

competition between Visa and MasterCard in the provision of network services to Acquirers, resulting in an increase in the price of network services to Acquirers.

> Winter Report at para. 72;
> Church Report at para. 31.

478. However, as Professor Church explains in his evidence, one major difficulty with Professor Winter's approach is that while he recognizes that credit cards are two-sided platforms, his competition analysis is done only with regard to the services provided by Visa and MasterCard to acquiring banks. The core of Professor Winter's argument is that the Challenged Rules reduce the incentive of Visa or MasterCard to lower their Acquirer Fees (interchange and network fees) because the Rules reduce the extent to which volume is increased by doing so. However, neither Visa nor MasterCard earns revenue or profits directly from interchange. In evaluating any alleged market power of Visa or MasterCard it is their margin that is relevant to assessing their incentives. Professor Winter's discussion of incentives for undercutting the Acquirer Fee is therefore ambiguous at best because he does not make clear whether he means a reduction in the interchange fee or the network access fee for Acquirers.

> Church Report at para. 42.

479. There are two important aspects of the two-sided platform that are worth emphasizing:

(a) Visa and MasterCard provide services simultaneously to both Acquirers and Issuers, i.e. are engaged in a two-sided business, and competition in this business depends on the interdependence of the acquiring and issuing sides.

(b) The interchange rate is a balancing mechanism between Issuers and Acquirers. Interchange paid by Acquirers to Issuers simply allocates the recovery of network access fees and other costs between the Issuers and Acquirers – the two sides of the market. It is a mechanism to internalize the usage externality between Cardholders and Merchants. Visa and MasterCard do not earn revenue or profits directly from interchange.

[redacted]

Church Report at para. 41.

480. As discussed in greater detail under the analysis of the relevant market below, Professor Winter's report misses the point that the relevant product market for assessing competition between Visa and MasterCard is not the provision of network services to Acquirers. Visa and MasterCard compete for transaction volume by setting rates that have the effect of inducing Merchants to accept their cards and providing incentives for consumers to carry their cards and use them. By focusing only on the Acquirer side of the platform, Professor Winter's analysis does not recognize the ability for card platforms to increase transaction volume on the Issuer's side of the platform. A credit card network can also increase its volumes by decreasing its network access fee for Issuers, thereby increasing the number of Cardholders and the number of Cardholders that utilize its cards.

Church Report at para. 46.

481. As stated in "Some Empirical Aspects of Multi-sided Platform Industries":

> "[an] important characteristic of two-sided markets is that the demand on each side tends to vanish if there is no demand on the other – regardless of what the price is." Therefore, "there would be no demand by households for payment cards if they could not use them anywhere and no demand by retailers for payment cards if no one had them."

"Some Empirical Aspects of Multi-sided Platform Industries", Review of Network Economics, Vol. 3, Issue 3, September 2003, David Evans, p. 195.

482. The authors of "Markets with Two-Sided Platforms" explain that:

> "Many two-sided platforms in practice subsidize one side and earn profits on the other. Moreover, the standard result that the percent markup of price over marginal cost is inversely related to the elasticity of demand does not hold for either customer group. Anti-trust analysis, tools, and techniques require modification when two-sided platforms account for a significant portion of supply. Failure to account for the consequences of inter-linked demand between the two sides can lead anti-trust analysis into serious error." (at p. 667)

[Two-sided platforms] "play an important role throughout the economy by minimizing transactions costs between entities that can benefit from getting together." (at p. 667)

"In these businesses, pricing and other strategies are strongly affected by the indirect network effects between the two sides of the platform. As a matter of theory, for example, profit maximizing prices may entail below-cost pricing to one set of customers over the long run and, as a matter of fact, many two-sided platforms charge one side prices that are below marginal cost and are in some cases negative. These and other aspects of two-sided platforms affect almost all aspects of anti-trust analysis – from market definition, to the analysis of cartels, single firm conduct, and efficiencies." (at pp. 667-668)

"A market is two-sided if the platform can affect the volume of transactions by charging more to one side of the market and reducing the price paid by the other side by an equal amount; in other words, the price structure matters, and platforms must design it so as to bring both sides on board." (at p. 669, citing Jean-Charles Rochet & Jean Tirole, "Two-Sided Markets: A Progress Report", 35 Rand J. Econ. 645 (2006))

Generally, "one can think of two-sided platforms as arising in situations in which there are externalities in which transaction costs broadly considered prevent the two sides from solving this externality directly. The platform can be thought of as providing a technology for solving the externality in a way that minimizes transaction costs." (at p. 669)

"Any method for payment works only if buyers and sellers are willing to use it." (at p. 671)

"To see the intuition behind pricing consider a platform that serves two customer groups A and B. If [the platform] raises the price to members of group A fewer As will join. ...Since members of group B value the platform more if there are more A's, fewer B's will join the platform at the current price for Bs. That drop-off depends on the indirect network externality which is measured by the value that B's place on A's. But with fewer B's on the platform, As also value the platform less, leading to a further drop in their demand. There is a feedback loop between the two sides. Once this affect is taken into account, the effect of an increase in price on one side is a decrease in demand on the first side because of the direct effect of the price elasticity of demand and on both sides as a result of the indirect effects from the externalities." (at p. 674)

[redacted]

"The platform, of course, would like to find the prices that maximize its profits by taking these same sort of considerations into account…for two-sided platforms, three results appear to be robust: (1) the optimal prices depend in a complex way on the price sensitivity of demand on both sides, the nature and intensity of the indirect network effects between the two sides, and the marginal costs that result from changing output of each side; (2) the profit maximizing, non-predatory price for either side may be below the marginal cost of supply for that side or even negative; and (3) the relationship between price and cost is complex, and the simple formulas that have been derived for single sided markets do not apply." (at p. 676)

"All payment card systems require merchants that take their cards for payment to take any of their cards for payment, regardless of who presents it or which entity issued it. Some merchants would benefit from being selective – taking cards only from people who lack cash, for example. But this would reduce the confidence that cardholders have that their cards will be taken at stores that display the acceptance mark." (at p. 677)

"*NaBanco* argued that the interchange fee violated section 1 of the Sherman Act because it was a price set collectively by competitors. Visa argued that unlike classic price fixing, the ability to set an interchange fee was a mechanism to allocate costs between the issuing and acquiring sides of the business and enhanced output by, among other things, limiting opportunistic behaviour by individual members and avoiding the chaos of bilateral negotiations among thousands of member banks. The Eleventh Circuit concluded:

> "Another justification for evaluating the [interchange fee] under the rule of reason is because it is a potentially efficiency creating agreement among members of a joint enterprise. There are two possible sources of revenue in the Visa system: the cardholders and the merchants. As a practical matter, the card-issuing and merchant-signing members have a mutually dependent relationship. If the revenue produced by the cardholders is insufficient to cover the card-Issuers costs, the service will be cut back or eliminated. The result would be a decline in card use and a concomitant reduction in merchant-signing banks' revenues. In short, the cardholder cannot use his card unless the merchant accepts it and the merchant cannot accept the card unless the cardholder uses it. Hence, the [interchange fee] accompanies 'the co-ordination of other productive or distributive efforts of the parties' that is

[redacted]

> 'capable of increasing the integrations efficiency and no broader than required for that purpose'." (at pp. 684-685, citing *National Bankcard Corp. v. Visa USA Inc.*, 779 F. 2d 592 (Eleventh Circuit, 1986) at p. 602)

"The Link between the customers on the two sides [of the platform] affects the price elasticity of demand and thus the extent to which a price increase on either side is profitable. It therefore necessarily limits market power, all else equal." (Evans gives the example of an increase in price on side A reducing the value that customers on side B receive from the platform which in turn reduces the price that side B will pay and the number of customers on side B, which then in turn reduces demand on side A and thus the price that customers on side A will pay." (at p. 688)

"The constraints on market power that result from interlinked demand also affect market definition. Market definition assists in understanding constraints on business behaviour and assessing the contours of competition that are relevant for evaluating a practice. In some cases, the fact that a business can be thought of as two-sided may be irrelevant. That could happen either because the indirect network effects though present are small or because nothing in the analysis of the practices really hinges on the linkages between the demands of participating groups. In other cases, the fact that a business is two-sided will prove important both by identifying the real dimensions of competition and focusing on sources of constraints." (at p. 689)

"The economics of two-sided platforms is useful for assessing whether there is an efficiency rationale behind an agreement over prices. In *NaBanco*, the court found that the collective setting of the interchange fee helped balance the demands between cardholders and merchants (it helped internalize an externality) and eliminated the need for bilateral negotiations (it reduced the transactions cost of internalizing the externality)." (at p. 690)

"[The honour all cards rule for payment cards] makes the system's branded card more valuable to its cardholders, who have the assurance that their card will be accepted for payment at merchants that display the system's acceptance mark. By increasing the number of cardholders, it makes the card a more valuable payment device for merchants to accept." (at p. 692)

Markets with Two-Sided Platforms, Issues In Competition Law And Policy 667, Ch. 28, David S. Evans and Richard Schmalensee (ABA Section of Anti-Trust Law, 2008).

[redacted]

483. With respect to credit card networking, Cardholders must want to use their credit cards. If a Merchant advertises that they accept MasterCard credit cards but rejects a Cardholder's particular card at point-of-sale, or if Cardholders are surcharged, or if the rewards for using their credit cards are not attractive, the Cardholder will stop using their credit cards and Merchants will stop accepting them. That is the story of EnRoute.

484. The fact that this is a two-sided market is the key economic aspect of the case. One cannot understand the importance of the balancing devices that are used – including, of course, interchange, but also including the Challenged Rules – without understanding the two-sided market issue. There are rules that balance in favour of both the Cardholder and Merchant side of the market. Those rules that balance in favour of Merchants, like the rule requiring prompt payment, and the rule requiring a guarantee of payment, whether the consumer is bankrupt or not, are not challenged but all of MasterCard's Operating Rules are balancing devices. Professors Elzinga and Church confirmed that such balancing devices are supported by economic theory.

> Elzinga Report at paras. 20 and 212;
> Church Report at para. 41;
> Transcript of Examination-in-Chief of Stanton at pages 2441-2442 (public);
> Transcript of Examination-in-Chief of Leggett at pages 2586-2591 (public).

485. When the potential for competition on both sides of the credit card network is considered, it is hard to see how the Challenged Rules can have an anti-competitive effect. With the Challenged Rules, competition between Visa and MasterCard reduces the network access fee for Issuers until network revenues equal network costs. The Challenged Rules would not affect market power of Visa and MasterCard. Hence, the Challenged Rules cannot have an adverse effect on competition: they do not enhance, create or maintain market power.

> Church Report at para. 49.

486. Once it is recognized that Visa and MasterCard can compete for transaction volume not only by lowering the Acquirer Fee but also by reducing the network fee of Issuers, then

[redacted]

consistent with Professor Winter's analysis of competition between Visa and MasterCard without the Rules, competition with the Rules results in a competitive outcome.

> Church Report at para. 55.

487. The adoption of the Challenged Rules by Visa and MasterCard is not, therefore, based on creating, maintaining or preserving market power and there is not an adverse effect on competition. Instead they are examples of non-price restraints that network operators impose on participants on one side of the platform to avoid negative externalities that reduce the incentive of participants on the other side of the platform to join or use the network. Economics and competition policy now recognize the importance of non-price competition. For the "market" to get the correct mix of price and non-price competition may require vertical restraints, depending on the extent and nature of market policies.

> Church Report at para. 56;
> Transcript of Examination-in-Chief of Church at page 2900 (public);
> *Summary of Expert Report - Jeffrey Church*, Exhibit R-493.

488. Professor Winter's "cost externalization" hypothesis is linked to his contention that non credit card users "subsidize" credit card users. However, the distributional effects of conduct – without something more – does not make conduct an issue for competition policy. It must also be an enhancement, preservation or maintenance of market power. The impossibility of having the evidence to assess the effect on aggregate consumer welfare of the rules is an additional consideration that militates strongly against the use of competition policy to regulate the rules. It is not enough to simply identify the possibility of a cross-subsidy. Professor Winter must prove it reduces aggregate consumer welfare and prove that it results in an adverse effect on competition within the relevant market. Professor Winter has failed to do so.

> Church Report at para. 59.

489. A recent decision of the U.K. Office of Fair Trading ("OFT") is helpful in demonstrating how a two-sided market can and should be considered in assessing alleged competitive restraints. On June 1, 2012 the OFT issued a press release announcing that it had cleared

[redacted]

the acquisition of the Topper newspaper by the Daily Mail General Trust. The press release indicates that an OFT investigation had found that, despite the proposed merger leading to a high combined share of supply of local newspapers and local paper advertising space in Nottingham, there was sufficient evidence that other competitive restraints would protect customers from price increases or reductions in quality. In particular, the OFT determined that all types of advertisers may be protected by the two-sided nature of the market, meaning that the merged entity would need to take into account the impact on advertisers, on the one hand, and on readers, on the other, when taking pricing or other business decisions, which may be referred to as indirect network effects, into account. This is precisely the consideration that the Commissioner's experts have ignored and which should be front and centre in any analysis of the impact of the Challenged Rules on competition, if any.

U.K. Office of Fair Trading Press Release, June 1, 2012.

(ii) The Role of the Operating Rules

490. Certain of the MasterCard Operating Rules minimize negative impact and provide Cardholders ease and confidence in using their MasterCard card. If an Acquirer or Issuer of the network does not abide by the rules of the network, there is a risk that the consumer experience will be denigrated and the quality control that a consumer has come to associate with the use of a MasterCard credit card will not have been lived up to.

Witness Statement of Stanton at paras. 62-63 and 84.

491. MasterCard, as is common in other franchise situations, strives to ensure that the members of its network meet certain quality control standards. Some of these standards (e.g. the NSR and HACR) primarily benefit Cardholders, while others (e.g. timely settlement) primarily benefit Merchants. They are all designed to maximize the attractiveness of the network, overall, to balance it, and thereby to maximize its usage.

492. The MasterCard Operating Rules and the Challenged Rules are designed to expand output, benefit Cardholders and promote efficiency. The MasterCard Operating Rules

are efficiency enhancing and consumer protection rules, designed to make MasterCard an attractive form of payment. Reasons for adoption of the Challenged Rules have nothing to do with any sort of price maintenance.

Witness Statement of DeVita at para. 51;
Witness Statement of Stanton at para. 63.

493. Even if the Challenged Rules, and in particular the NSR, are removed, MasterCard's default interchange rates or network fees will not necessarily be reduced.

Witness Statement of DeVita at para. 62.

(e) The Default Interchange Rate, Interchange Monies and Network Fees

(i) Interchange Rates

494. The interchange rate is an amount retained by an Issuer on any given credit card transaction before payment is made to an Issuer. MasterCard does not receive interchange monies (they flow from Acquirer to Issuer), and MasterCard does not earn revenue on interchange amounts. However, MasterCard manages default interchange rates to balance the network–to maximize its appeal on one hand to Merchants and Acquirers, and to Issuers and Cardholders on the other.

Witness Statement of Stanton at para. 88.

(ii) Why Does Balance Matter?

- **Feedback Effects: If a Card is Used More, it is More Valuable to a Merchant**

495. MasterCard and Visa get the balance right through trial and error. The credit card companies' experts have admitted they have balanced incorrectly from time to time. Their goal is to get the most consumers to carry and use their cards because they make their money at the maximum number of transactions.

Transcript of Examination-in-Chief of Stanton at pages 2454-2455 (public).

496. It is a problem if the credit card companies get the balance wrong. If the interchange is too low or the rewards are too small, or its network's credit cards are not accepted at all locations, or the Cardholders are charged too much for using their cards, fewer people will use their cards. If fewer people use their credit cards, fewer Merchants will choose to accept those cards. If fewer Merchants accept the cards, fewer consumers will carry them. And so on. This is the feedback effect.

- **The Lesson of EnRoute**

497. As noted above, Mr. Broughton, owner of the C'est What? Pub, clearly illustrated this point. Mr. Broughton told the Panel that he accepts MasterCard and accepts Visa, but he does not accept EnRoute and Diner Club cards. Why? He testified that he used to accept them, but so few people were using them – maybe one or two a month – that there was no value to his continuing to support those networks, and he stopped.

Transcript of Cross-Examination of Broughton at pages 365-366 (public).

498. The lesson of EnRoute is that when there is insufficient balance in the two-sided system, the system can fail. MasterCard and Visa do not want to become EnRoute.

499. The more people carry and want to use Visa and MasterCard credit cards, the more valuable they are to Merchants. The economists refer to this as the "network effect". It means that giving value to Cardholders makes the card more valuable to Merchants because the credit card is more popular with consumers.

Transcript of Examination-in-Chief of Church at page 2845 (public).

500. By contrast, if consumers are discouraged from using or otherwise decide to stop using Visa or MasterCard's credit cards, the less valuable the cards are to Merchants, and eventually they have no value at all and the Merchants cease acceptance.

(f) Discounting and Surcharging

(i) Surcharging is, Mathematically, the Same as Discounting

501. The experts of both the Commissioner and the Respondents are agreed that, mathematically, surcharging is the same as discounting.

> Transcript of Cross-Examination of Carlton at pages 1324-1325 (public);
> Transcript of Examination-in-Chief of Elzinga at page 2706 (public);
> Transcript of Cross-Examination of Frankel at page 1009 (public).

(ii) If Discounting is Effective, it Eliminates the Commissioner's Concerns

502. The Commissioner's expert conceded on examination that if cash discounts were practical, there would be no concern here <u>at all</u>.

> Transcript of Cross-Examination of Carlton at pages 1325-1327 (public).

503. Under the Challenged Rules, Merchants can discount for cash or debit to steer customers to a preferred payment method. This form of steering is transparent because consumers then know the actual prices of the goods or services and do not face increased prices at the point of sale. The Federal Government explicitly recognized these positive features of cash and debit discounting in its consultations regarding the Code of Conduct. In the summer of 2009, the Canadian Federation of Independent Business ("CFIB") proposed a code of conduct for the credit and debit card industry which was (according to CFIB) designed to increase transparency and fairness for small businesses that accept credit and debit cards. CFIB's proposed code also expressly proposed that Merchants be permitted to surcharge consumers who pay with a credit card. In its Code of Conduct (which came into effect in August 2010), the Federal Government provided for the right to discount and, significantly, rejected the Merchants' request to be able to surcharge credit card transactions.

> Witness Statement of Leggett at para. 61.

504. Discounting is a valid method by which Merchants can steer consumers to other payment methods. Perhaps the most succinct statement on this was from Mr. Symons of IKEA, who said "Discounting is just another option. Surcharging is an option".

505. Merchants have long been able to discount for cash, debit, and other forms of payment to steer customers away from credit cards. However, Merchants generally do not discount because, among other things, they benefit greatly from card acceptance and typically embed the cost of card acceptance into their retail prices.

Witness Statement of Leggett at para. 62.

506. On cross-examination, one of the Commissioner's witnesses, Mario de Armas of Wal-Mart, conceded that certain Wal-Mart rollbacks are a form of discounts. Under these rollbacks, Wal-Mart is able to negotiate a deal with the manufacturer so it is buying an exorbitantly large volume of a product, and as a result is able to get a lower unit price which it then passes on to the customers in the form of lower prices.

Transcript of Cross-Examination of de Armas at page 321 (public).

507. It was suggested by a number of the Commissioner's witnesses that the ability of Merchants to discount as an alternative to surcharging is limited because doing so would require Merchants to advertise an "inflated" price—that is, the price for credit card transactions—and discount from that "inflated" price. However, Merchants already build the cost of acceptance into the prices they charge consumers. There is no justifiable reason why Merchants would have to raise prices merely to discount those same prices.

[redacted]
Witness Statement of Sheedy at para. 70;
[redacted]

508. There is, are fact, a myriad of instances where Merchants have offered discounts to consumers in order to compete with each other. A common example is through issuing coupons. While this is not a costless exercise, it is done routinely. Other examples are

found in perusing the aisles and shelves, other advertisements, offering loyalty rewards or special deals and other promotions. It is not clear why discounting for using a lower cost payment method would be difficult to implement.

> Witness Statement of Sheedy at para. 71;
> Transcript of Cross-Examination of Daigle at page 423 (public);
> Transcript of Cross-Examination of de Armas at pages 323-327 (public).

509. On cross-examination Mr. Daigle of Shoppers Drug Mart admitted that Shoppers Drug Mart Inc. operates its Optimum discount card, which is the biggest discount program in the country. He also admitted that Shoppers Drug Mart Inc. regularly provides discounts to customers who pay by cash, debit and credit and who have an Optimum card. Further, Shoppers Drug Mart provides discounts through such promotions as "Seniors Day" and discount flyers.

> Transcript of Cross-Examination of Daigle at pages 426-429 (public).

510. [redacted]

> [redacted]

511. Ms. Li of WestJet admitted that WestJet discounts prices for flights regularly as well as offers individuals the opportunities to participate in a promotional program whereby individuals can earn points which translate to dollars which are usable on WestJet flights.

> Transcript of Cross-Examination of Li at page 1544 (public).

512. [redacted]

> [redacted]

[redacted]

513. Mr. Shirley of Best Buy admitted that Best Buy gives discount points. They could do so for payment with cash or Interac – but they choose not to. They choose, instead, to give extra points for use of the Best Buy affinity <u>credit card</u>. [redacted]

[redacted]

Transcript of Cross-Examination of Shirley at page 1648 (public).

514. The fact is that each of Wal-Mart, Shoppers Drug Mart, Air Canada, WestJet, Sobeys and Best Buy offer programs pursuant to which they offer customers greater discounts if they use their branded credit cards than if they use another form of payment. Discounting can be done, and is done. The Merchants seem to think discounting works to steer customers <u>to</u> credit cards. It is therefore odd that they would, at the same time, argue that discounting does not work to steer customers <u>away</u> from credit cards. Professor Elzinga compares discounting and surcharging in real-world consequences and explained that discounts are pro-consumer; whereas, surcharging is anti-consumer. He further stated that the average consumer "sees discounting all the time". In the form of coupons, inventory clear-outs, end of year sales etc.

[redacted]

Transcript of Cross-Examination of de Armas at pages 321-327 (public).

515. Counsel for Visa and MasterCard asked Benôit Gauthier of Circum Network Inc. to conduct research (the "Gauthier Study") to investigate consumer reaction to various payment steering mechanisms. The Gauthier Study examined consumer reaction to a diverse set of payment steering mechanisms being offering discounts, imposing surcharges, informing and asking consumers to switch and altering the HACR. The results of the survey are set out in Professor Mulvey's Report.

Mulvey Report at para. 19.

516. The Gauthier Study indicated that:

(a) in addition to cash most consumers surveyed possess a credit card (93%), have a chequing account (91%) and at least one general credit card (87%). About one-quarter of respondents (27%) possess a store specific credit card. Payments for purchases up to $25 are dominated by debit cards (38%) and cash (34%). Consumer use of various modes of purchase varies according to the purchase value. As the purchase value increases, the use of cash decreases in favour of premium and standard credit cards.

Mulvey Report at para. 20.

(b) Knowing that money is a positive motivator to many consumers, Merchants regularly offer financial incentives such as sale prices, deals and discounts to influence consumer decision making. Discounts also yield the most positive levels of consumer sentiment. Comparatively, consumers love discounts and display little affection for other steering mechanisms.

Mulvey Report at para. 24.

(c) Discounts achieved the highest "steering success rates" in moving consumers away from paying using credit cards.

Mulvey Report at para. 25 and page 10.

(d) Rebates earned the highest effect rating of all the steering methods and confirmed that positive sentiment translates into goodwill and future shopping intentions. Unlike surcharging and requests that consumers use other payments, the rebate scenarios did not have an adverse impact on future store patronage.

Mulvey Report at para. 26.

(e) Cardholders judged discounts as the most acceptable type of steering mechanism.

Mulvey Report at para. 27.

517. Discount steering mechanisms were the most effective at keeping customers in the store and completing the purchase. Discounting would be a more effective method for

Merchants to adopt in order to steer customers to alternative methods of payment unless there was an agreement among all competing Merchants to surcharge.

> Mulvey Report at para. 28.

518. The result of the foregoing is that discounts are highly effective steering mechanisms that move consumers away from credit card transactions and do so in a manner that elicits positive feelings, supports and improves future store patronage, and is acceptable to consumers. Accordingly, Professor Mulvey concluded that discounts would be as or more effective than surcharging to steer Cardholders to use a payment method other than credit cards to make a purchase.

> Mulvey Report at para. 29.

519. [redacted]

> [redacted]

520. Professor Mulvey, the only marketing expert called as a witness by anyone in this case, acknowledged that Merchants discount all the time, in all sorts of ways, and discounting is effective at steering consumers as discussed below. Professor Mulvey's reaction to the Merchant assertion that they must advertise the single lowest price was as follows:

> "It is bogus. It is just so contrary to what is done in reality it just didn't hold any water."

> Mulvey Report at para. 24.
> Transcript of Re-Examination of Mulvey at page 3275 (public).

521. This conclusion is consistent with the admission of Mr. Shirley of Best Buy on cross-examination that Merchants may employ varying strategies when pricing.

Transcript of Cross-Examination of Shirley at page 1642 (public).

522. With respect to the assertions of the Commissioner's experts that surcharging is more effective than discounting in steering Cardholders away from credit toward alternative payment methods, the Gauthier Study indicates that surcharges are only moderately successful in moving Cardholders to other forms of payment in that they induce 50% - 59% of consumers to shift their payment mode to Merchant preferred methods.

Winter Report at para. 115;
Carlton Report, footnote 16;
Mulvey Report at para. 31.

523. Surcharges are akin to a tax so it comes as no surprise that they yielded the highest level of negative affect among consumers. Simply put, Canadian consumers hate the idea. According to an Angus Reid surcharge survey, more than 4 in 5 Canadians oppose an initiative of surcharging consumers for using their credit cards.

Mulvey Report at para. 32 and Chart 2.

524. Merchants who impose surcharges are most likely to incur lost sales in both the present and the future as dissatisfied customers walk out and complete their immediate and future purchases elsewhere.

Mulvey Report at para. 34.

525. Card discrimination methods steer 45% to 51% to other payment methods, but payment acceptance is very important to about 32% of Cardholders who chose to walk out instead of completing the purchase.

Mulvey Report at para. 38.

526. While not a marketing expert, the Commissioner's economist, Dennis Carlton nevertheless claims at paragraph 70 of his Report that the evidence shows that surcharging is more effective than discounting at influencing consumer's choice of payment method. This assertion is not borne out by the Gauthier Study or other evidence in this proceeding. The Gauthier Study indicated that discount scenarios out-perform

analogous surcharge scenarios across all performance indicators. Compared to surcharges, discounts are more successful at:

(a) switching consumers to an alternative form of payment at the same retailer;

(b) generating positive reactions from consumers;

(c) increasing the likelihood of future retail patronage;

(d) meeting or exceeding consumers' standards of acceptability; and

(e) keeping customers in the store to complete transactions.

For these reasons the Gauthier Study indicates that discounts are more effective than surcharges overall.

Mulvey Report at paras. 39-40.

527. The Gauthier Study further indicates that Cardholder behaviour when faced with steering mechanisms is dependent upon transaction value. As purchase values increase, Cardholders' willingness to use cash declines in both rebate and surcharge scenarios. The Gauthier Study indicates that:

(a) rebate scenarios become more effective at steering Cardholders as the purchase value increases. In contrast, surcharge scenarios are effective at steering Cardholders until the purchase value exceeds a threshold.

(b) few Cardholders (about 4%) use their premium credit cards when faced with the surcharge. In contrast, some consumers (about 20%) are willing to forego a rebate offered by the retailer and persist in their desire to use a premium card.

Mulvey Report at paras. 44 though 45.

528. Cardholders in the rebate scenario rarely leave the store regardless of the purchase value. In contrast, Cardholders in the surcharge scenario are very much inclined to leave the

[redacted]

store when faced with the surcharges on premium card use, even for small purchases under $25.

Mulvey Report, Chart 6, Panel B at para. 46.

529. The Gauthier Study indicates that rebate scenarios are more effective at directing consumers to debit – the lowest cost payment option; that rebate scenarios are marginally more effective at getting consumers to pay cash for smaller purchases under $75; most importantly, the adoption of a surcharge strategy can backfire and cause great harm to a Merchant's business. Firms that impose surcharges should expect that many consumers will choose to leave the store instead of paying a surcharge which can result in immediate and long term consequences as customers take their business elsewhere.

Mulvey Report at para. 47.

530. Professor Mulvey also strongly disagrees with the contention of Professor Winter at paragraph 111 of his Report that Merchants cannot and do not discount because they are limited in their ability to advertise differential discounts based on payment methods. He points out that Merchants frequently advertise prices that are discounted at the point of sale and also use multi-dimensional prices to influence consumer demand. The scope of pricing schemes extend well beyond a unidimensional price model. Examples include: high/low pricing; discounting; limited time pricing; buy three get one free; midnight madness sales; saving on shipping; pricing based on what competitors are doing; simple discount ("$139, $20 off today"); tensile pricing ("As low as" or "Starting at" or "Save up to 50% off"); partitioned pricing ("$70 for a dress shirt, plus $12 shipping and handling"); unit pricing ("$2.49 for a 16oz can of tuna = 15.5 cents per ounce"); manufacturer suggested retail price ("MSRP = $300, sale price = $200); price bundling ("$750 for a computer, printer, monitor, and software"); hi-low pricing ("Orange juice for $5 this week, $7 next week…"); invoice external reference prices ("$500 over invoice"); no interest pricing offers ("Pay no interest for 12 months"); payment plan ("$1 per issue for a 1-year 52-issue magazine subscription"); price matching ("We'll match competitors' lowest advertised price"); promotional pricing ("Buy one, get one free");

[redacted]

promotional packs ("Get 6 bottles for $5); rebates ("Send proof of purchase and get a $75 rebate"); and coupons ("$.50 off a can of soup").

> Mulvey Report at para. 51;
> Transcript of Re-Examination of Mulvey at pages 3275-3277 (public);
> [redacted]
> Transcript of Questions from the Tribunal to Symons at pages 405-406 (public).

531. The Commissioner has suggested that if surcharging and discounting were equivalent in terms of steering customers to alternate payment mechanisms, Visa and MasterCard would have no basis to allow discounting but oppose surcharging. Accordingly, she infers, surcharging must be more effective at steering than discounting, regardless of the evidence put forth by Professor Mulvey, the only marketing expert in this case.

> Carlton Report at para. 69;
> Winter Report at para. 115.

532. These comments ignore the actual reasons for Visa's and MasterCard's objection, namely the deep concerns that Visa and MasterCard share with respect to Merchant surcharging, which are perfectly justified because apart from steering effects, surcharges pose a much greater threat to brand reputation by undermining consumer trust. MasterCard and Visa are interested in defending brand equity, which is bound up in the ease of use and ubiquitous acceptance.

> Mulvey Report at paras. 53-54.

533. Surcharges undermine the value that Visa and MasterCard offer their Cardholders and impose a great threat to brand value for a variety of reasons:

(a) Surcharges will generate ill will because consumers' reference point for completing credit card transactions based on a lifetime of experiences is 0%. Surcharging would break out a "normal cost of doing business" as an itemized charge.

(b) Surcharging creates price uncertainty as consumers will not understand the true price until they arrive at the register.

[redacted]

(c) Surcharges represent penalties to Cardholders.

(d) Consumers may be confused as to the reason for the surcharge and who is imposing the charge.

(e) Surcharge gouging is an issue in Australia.

(f) Masked surcharge responsibility causes confusion.

Mulvey Report at para. 56.

534. A lack of transparency may prevent consumers from knowing that Merchants are wholly responsible for surcharging. They may blame Visa and MasterCard for the surcharge rather than the Merchant – a confusion which Merchants will take advantage of.

Mulvey Report at para. 55;
Transcript of Cross-Examination of Broughton at pages 361-362 (public).

535. The Commissioner obtained no information directly from consumers. The Commisioner did not interview consumers. The Commissioner did not conduct surveys of Cardholders.

Read-in Brief of the Respondents, Tab 2.

536. Faced with an absolute absence of evidence from Canadian Cardholders, and survey evidence and a corresponding Report from the Respondents, the Commissioner resorted to providing expert evidence on survey techniques from a consultant with no Canadian experience.

537. While the Commissioner has attacked the reliability of the survey evidence, such attacks have largely been on the basis of inapplicable concepts. For example, Mr. Kemp testified that "cheap talk" would reduce hypothetical bias. However, the evidence indicates that "cheap talk" varies in its effectiveness, but is most effective when that script presents a compelling case for avoiding hypothetical bias for public goods where respondents are relatively inexperienced with the goods being valued, and for moderate to high bid

levels-all contexts where hypothetical bias is likely to be greatest and all of which are contexts inapplicable to this case or the Gauthier Survey.

> Transcript of Cross-Examination of Gauthier at page 3205 (public);
> Kemp Report at para. 6.12.

538. This misdirected attack is unsurprising in light of the fact that a preponderance of the publications on Mr. Kemp's publication list relate to public goods rather than private goods.

> Transcript of Cross-Examination of Kemp at page 1820 (public).

539. Another of the Commissioner's complaints about the Gauthier Survey and Mulvey Report is that it did not rely on pre-survey design methodology, ignoring the 29 years of experience of Mr. Gauthier and the years of experience of Mr. Mulvey.

> Transcript of Re-Examination of Gauthier at page 3230 (public).

540. In fact, most of the literature and hypothetical bias, a primary complaint of Mr. Kemp, relates to willingness to pay and public goods and therefore much of the literature is inapplicable.

> Transcript of Re-Examination of Gauthier at page 3237 (public).

541. Mr. Kemp's attack on the ordering effects of the survey questionnaire ignore other important aspects of questionnaire development, particularly the logic of the question flow, the understandability of the question flow and the fact that the respondent is able to carry through the questionnaire without getting confused.

> Transcript of Cross-Examination of Gauthier at page 3151 (public).

542. Notwithstanding these attacks, the Gauthier survey evidence and Mulvey Report remain unrebutted and represent the only evidence obtained from Cardholders.

(g) Merchants do not Seek "Transparency", they Seek Bargaining Leverage

543. This case is not about transparency. Interchange is transparent. MasterCard's interchange rates are publicly available on the internet through a Google search. As Mr. de Armas of Wal-Mart acknowledged in response to a question from Mr. Justice Phelan, Wal-Mart does not publicize all of its input costs (such as hydro, costs of water or costs of a product) to their customers, nor would their customers expect them to. MasterCard's interchange rates are, nevertheless, available.

> Witness Statement of DeVita at para. 29;
> Transcript of Questions by the Tribunal of De Armas at page 334 (public).

544. [redacted]

> [redacted]

545. Mr. De Armas admits that what Wal-Mart wants through elimination of the Challenged Rules is the ability to negotiate more effectively and gain leverage. [redacted]

> Transcript of Cross-Examination of De Armas at page 310 (public);
> [redacted]

546. The Code of Conduct explicitly addresses transparency. It requires that Merchants be told clearly what their fees are, and requires that interchange rates be published on the internet. It requires that Merchants be able to get out of their agreements if the fees change. The Merchants have a lot of "transparency", to the extent that they want it. The Government turned its mind to transparency and provided a regime.

> Witness Statement of DeVita.

[redacted]

547. In a number of places and a number of times during the hearing, Merchant witnesses spoke about wanting to be able to surcharge to achieve "transparency", because customers do not know what fees the Merchants pay to the credit card company. However, the Merchants acknowledge on cross-examination and in response to questions from the Panel that they are absolutely at liberty to tell their customers (the consumers) exactly what they pay for credit card acceptance. They are also at liberty to tell them that they would prefer another payment mechanism. The Challenged Rules do not prohibit that. Merchants do not tell their consumers these things, by and large. Nor do they tell them what they pay for gas or electricity or sewers or other input costs. They are free to, but they do not.

> Transcript of Re-Examination of de Armas at pages 328-329 (public);
> Transcript of Re-Examination of de Armas at pages 334-335 (public);
> Transcript of Examination-in-Chief of Daigle at page 397 (public).

(h) Cross-subsidization is a Non-Issue

548. During the hearing, the Commissioner sought to make the point that the Challenged Rules create a cross-subsidy whereby the costs of Cardholders' use of their credit cards is subsidized by consumers using other payment methods. Her theory is that Merchants are forced to raise their prices generally to cover their costs of accepting Visa and MasterCard credit cards.

549. This theory does not support the Commissioner's theory of price maintenance. The Commissioner seeks to prohibit the NSR so that Merchants can impose a surcharge on consumers who wish to use their credit cards. The effect of this would, she says, be to eliminate the cross-subsidy as Cardholders would be paying the (alleged) additional cost to Merchants of accepting the cards, meaning Merchants could reduce their prices generally.

550. However, permitting surcharging does not deal with the basis upon which the Commissioner has brought this case, being to preclude price maintenance. Her experts have contended that the "price" being maintained is, to use Professor Winter's term,

[redacted]

Acquirer Fees, being the combination of Network fees Acquirers pay Visa and MasterCard plus interchange. The fact that Merchants surcharge would not, in itself, reduce interchange. On the Commissioner's theory, interchange would only be reduced as a *quid pro quo* for Merchants not surcharging. In the absence of surcharge due to Visa and/or MasterCard's agreement to reduce interchange (one of a number of possible responses they could make) Merchants would not be recovering any additional surcharge revenue, and the only way for the Merchant to avoid the cross-subsidy for any additional costs of credit cards would be to give a discount to consumers using other payment methods. In other words, they would still need to discount to some degree even if they are permitted to surcharge.

Transcript of Examination-in-Chief of Symons at page 1599 (public);
Elzinga Report at para. 261.

551. Another point to consider is that there is no dispute that all sorts of cross subsidies exist every day: free parking, free gift wrapping, free childcare – whatever stores offer that some people benefit from and some do not. IKEA chose to cross-subsidize British buyers of light bulbs whether they used credit cards or not. Cross-subsidies are ubiquitous. It is the natural give and take of things. It is not a matter for antitrust law.

Transcript of Examination-in-Chief of Elzinga at pages 2736-2737 (public).

552. The Challenged Rules do not create market power, hence the question of whether there is a cross-subsidy is not a matter for competition policy. Cross-subsidy, in Professor Church's view, should not be determinative for competition policy because the aggregate effect may be impossible to measure.

Summary of Expert Report - Jeffrey Church, Exhibit RM-493.

553. A classic example of a cross-subsidy of which we are all aware from our daily lives is a giant shopping center. Shopping centers have rules for everything, including free parking and seasonal gift wrapping. Shopping centres, incidentally, are another example of a two-sided market. Professor Carlton agreed that franchisors have similar rules that bind their franchisees. These are rules which both cost the franchisee money and force "cross

[redacted]

subsidies" within the customer base. The Shoppers Drug Mart Franchise Agreement has similar rules that amount to cross-subsidization. That is what we have in this case – a collective decision benefitting the collective: The MasterCard or Visa brand.

Transcript of Cross-Examination of Daigle at page 454 (public);
Transcript of Examination-in-Chief of Carlton at pages 1386-1391 (public).

554. Cross-subsidies exist as between debit, cash and credit. Air Canada and WestJet do not want to be bothered with cash or debit in the cabin because it is too costly to deal with. [redacted] Indeed Professor Elzinga noted that the Bank of Canada's own analysis put it at rough parity with cash or debit, once bad debts were considered.

Transcript of Cross-Examination of Li at pages 1554-1555 (public);
[redacted]
Transcript of Examination-in-Chief of Elzinga at pages 2722-2725 (public).

555. The evidence is clear from sources including Dr. Frankel and Dr. Winter that virtually everyone in Canada has a credit card and a debit card. They may choose not to use it all the time, but they have it. So, even if one assumes all of the Commissioner's facts, a consumer paying cash subsidizes another one who uses a credit card but tomorrow the alleged subsidy may be just the reverse. So, the alleged cross-subsidy arising when paying by cash or debit is the consumer's choice, more so than in the example of the consumer who does not own a car to park in the lot, or who does not have a child to put into the IKEA ball room. It may or may not net out, but it largely flows from the choices we all make as to how we want to pay for something. As Dr. Elzinga stated, it has nothing to do with competition law or antitrust law.

Transcript of Examination-in-Chief of Gauthier at page 3038 (public).

[redacted]

556. Professor Winter's logic would suggest that to properly address his cross-subsidy concern, all forms of payment have to be differentially "surcharged". This illustrates clearly that the "cross-subsidy" issue is a red herring.

> Transcript of Cross-Examination of Winter at page 2095 et seq. (public).

557. So that alleged cross-subsidy, something common throughout the economy, is small and uncertain as a factual matter once one takes into account the real costs of other payment methods. Credit cards bring lots of value to Merchants. Ms. Van Impe of University of Saskatchewan agreed. The merchant discount rate of 2% or so is pretty visible; more so than the cost of cash. The off-setting benefits of credit cards should also be considered. Mr. Dunn's evidence is that the alleged cross-subsidy does not exist. In fact, to the extent that a subsidy does exists at all, credit card customers are subsidizing cash customers. This is essentially due to the bad debt losses, which exceed interchange amounts. But for the credit card, on those bad debt sales, the Merchant either would not make the sale at all (because the customer did not have the money) or suffered the bad debt loss itself (if the store had made the sale on its own store credit). Those are sales the Merchants make – and gets paid for – only because of use of a credit card. So, you have a situation in which the Merchant cost of acceptance of credit cards is effectively eliminated, when you take that into consideration, the 2% or 3% in bad debt loss. There is no subsidy flowing to the credit Cardholder from cash customers even before thinking about the cost of cash. That is what Mr. Dunn's evidence shows.

> Transcript of Cross-Examination of Carlton at page 1319 (public);
> Transcript of Examination-in-Chief of Van Impe at pages 1688 and 1679 (public).

558. As such, the whole cross-subsidy aspect of the Commissioner's case ceases, if it was ever relevant, to stand up to scrutiny when examined critically.

[redacted]

(i) Relevant Market and Market Power

(i) Whatever Market Definition is Accepted does not Change the Outcome of the Case

559. Without created, enhanced or preserved market power, MasterCard cannot be said to have adversely affected competition in a market. The analysis of whether MasterCard's Challenged Rules have or are likely to have an adverse effect on competition in a market must therefore begin with identifying the relevant market, and then determining whether MasterCard has market power within that market.

> *Nadeau, supra* at para. 369.

560. The Commissioner has urged the Panel to accept her narrow definition of the relevant market. She says the relevant market is the market for the supply of credit card network services in Canada, which is defined as "…a network that provides infrastructure and services enabling Merchants to obtain authorization, clearance and settlement of transactions". MasterCard disagrees strongly with this definition of the market in this case. MasterCard competes vigorously with many different payment methods, and submits that the relevant market is the Canadian market for payment services.

> Notice of Application at paras. 6 and 80.

561. It is no secret as to why the Commissioner has chosen this narrow definition of the relevant market. Were the proper market used, being the market for payment services, there could be no question that MasterCard does not enjoy market power. However, even if the Commissioner's definition of market were to be accepted, MasterCard does not have market power within that market, as discussed below.

562. What is odd about the Commissioner's theory as to the relevant market; however, is that while the Commissioner argues for this narrow market, the remedy she seeks is to steer consumers to other payments. It is difficult to reconcile how consumers could be effectively steered to these other payment methods if they were not of the same market.

[redacted]

563. The Commissioner's experts also inconsistently describe the applicable market. For example, Dr. Carlton applies a market related to services provided to Acquirers by Visa and MasterCard and then services provided to Merchants by Acquirers and then services provided by Visa and MasterCard.

Transcript of Cross-Examination of Carlton at pages 1297-1300 (public).

564. Another point to consider is that MasterCard does not even participate in the market as defined by the Commissioner's expert Dr. Frankel. Dr. Frankel stated in his examination-in-chief the following:

> "I have concluded that the relevant market in this case is no broader than credit card network services, which I sometimes call credit card acceptance services. By that, I mean that services are supplied by acquirers to merchants to permit them to accept general-purpose credit card transactions."

Transcript of Examination-in-Chief of Frankel at page 848 (public).

565. This statement is significant because, if that is the relevant market, the Commissioner cannot make out her case because MasterCard does not even participate in that market. It does not provide any services to Merchants.

(ii) Payments Market v. Credit Card Market

566. MasterCard contends that the relevant market is the market for payment services.

567. In the United States, the market for payment services has been found to be the appropriate market in the context of assessing the market in which credit card companies participate. The District Court in *National Bancard Corporation v. Visa U.S., Inc.* held that consumers readily substitute among credit cards, debit cards, cash, cheques and other methods of payment. Nevertheless,

> "…all payment service … taken together were sufficient to provide, at the least, several close substitutes for a Visa card in any possible context. Cash, for example, might be a good substitute for a face-to-face transaction involving small dollar amounts, while

[redacted]

> checks would be better for larger transactions involving long-distance exchanges."

National Bancard Corp., v. Visa U.S.A., Inc., 596 F. Supp 1231 (United States District Court, S.D. Florida) at pages 1257-8.

568. In "The Persistence of Anti-Trust Controversy and Litigation in Credit Card Networks" the authors review the history of cases assessing the proper market definition. They state that:

> "The trial court in NaBanco …. found that the relevant product market included all forms of payment, including checks and cash, which compel the conclusion that Visa lacked market power. Second, the court found that "even if NaBanco had established that Visa had power in a relevant market and that [the interchange fee] had substantial anti-competitive effects, Visa established that [the interchange fee] is necessary to offer the Visa card - a pro-competitive benefit which offsets any anti-competitive effects.
>
> ….
>
> The court [in NaBanco] apparently believe that if interchange were set at an anti-competitive level, then merchants could, and would, stop accepting credit cards. Indeed, the court found that if the credit card interchange fees were set too high, competition from debit cards, which had much smaller interchange fees, would drive credit card fees down.
>
> The NaBanco court apparently was swayed, as well, by Visa's proffered pro-competitive justifications. The court held that, in an emerging market for credit card services, a collective setting of interchange fees was necessary to encourage issuing banks to issue cards and acquiring banks to acquire merchant accounts…Thus the court concluded that Visa had every incentive to set interchange fees at a level that would establish an equilibrium between the issuer and merchant sides of the business.
>
> ….
>
> Wal-Mart's 1996 class action challenging the honour all cards rules of Visa and MasterCard, Judge John Gleeson of the U.S. District Court for the Eastern District of New York certified a class of all merchants who accepted either Visa or MasterCard products. The Court found that the relevant market at its broadest in the provision of general purpose credit and charge card services. The Court rejected the merchant's argument that as a matter of law the two defendants should be considered collectively for

> the purpose of evaluating their degree of market power. The Court acknowledged evidence of concerted activity with regard to their debit card strategies, but cited evidence that the defendants competed with one another as well. Therefore, the Court declined to find, as a matter of law, a conspiracy or other concerted activity that would justify treating the defendants as a single entity.
>
> K. Craig Wildfang and Ryan W. Marth, *Anti-Trust Law Journal*, "The Persistence of Anti-Trust Controversy and Litigation in Credit Card Networks," Journal No. 3 (2006) at pages 680-695.

569. Professor Winter purports to use the hypothetical monopolist test to define the relevant market in this case. His conclusion is that the relevant market is the narrower market for the supply of credit card network services which he defines as services provided by a payment network to Merchants, including "authorization, clearing and settlement of credit card transactions".

570. However, Professor Church's evidence is that Professor Winter's definition of the relevant market fails to account for or appreciate the implications that credit card networks are two-sided platforms.

> Winter Report at paras. 52-64;
> Church Report at para. 62.

571. As discussed above, there is no disagreement between the experts regarding the fact that payment networks are two-sided platforms. The product is a transaction that requires participation by a buyer using a card and a Merchant accepting the card. Visa and MasterCard compete against each other and against other payment platforms. They do this by making use and acceptance of their cards attractive to Cardholders and Merchants by, among other things, establishing the costs paid and benefits received by Issuers and Acquirers. Issuers pay a network access fee to Visa and MasterCard but receive an interchange fee paid by Acquirers. Acquirers pay a network access fee to Visa and MasterCard and pay interchange to the Issuers. The price for a transaction is the sum of the two network access fees paid to the card networks. The assessment of market power by Visa and MasterCard in defining their relevant market depends on the profit margin of Visa and MasterCard. The interchange fee paid by Acquirers to Issuers simply allocates

the recovery of network access fees and other costs between Issuers and Acquirers – the two sides of the market.

> Church Report at para. 63;
> Transcript of Cross-Examination of Winter at page 1963 (public).

572. It is not possible in a payment network for the number of transactions on the Acquirer's side to fall without the number of transactions on the Issuer's side to fall by the same amount. The two sides are perfect complements: the network must provide transaction services to both sides for a transaction to be completed. Merchants would not demand Acquirer services on a network unless their customers demanded Issuer services on the same network.

> Church Report at para. 64.

573. According to Professor Winter's theory of the case, in the absence of the Challenged Rules, Merchants would surcharge and an increase in the acquirer fee by Visa would result in a substantial substitution by Cardholders, rendering the increase in the Acquirer Fee unprofitable. But the competition between Visa and MasterCard is for transaction volume, not just the provision of credit card network services to Acquirers. Competing for transaction volume involves competing for Issuers as well.

> Church Report at para. 65.

574. 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, not just the acquirer fee suggested by Professor 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. It also identifies that the relevant demand elasticity is the aggregate elasticity of demand being the sum of the demand elasticity on both sides of the platform, not just on one side.

> Church Report at para. 66.

[redacted]

575. Since it is the sum of elasticity across the two sides that matters, the potential for substitution on transaction volume will be higher than only looking at one side of the market.

576. The result of the foregoing is that the application of the hypothetical monopolist test to a payment platform identifies a different relevant price in two different avenues of substitution, Merchant substitution and Cardholder substitution, as the price of a transaction on a payment platform rises while Merchant price elasticity might be quite inelastic (as argued by Professor Winter), Cardholder price elasticity and network effects for both might be quite elastic, leading to a large decrease in volume for a small increase in the Acquirer Fee.

Church Report at para. 69.

577. The failure of Professor Winter to appreciate the implications of credit cards being two-sided networks affects his market definition assessment as well. Applying the hypothetical monopolist test to a two-sided platform is complicated. It is complicated for a number of reasons, but in order to understand why it is complicated, it is worthwhile to step back and ask, What's the premise of the hypothetical monopolist test?

578. The premise of the hypothetical monopolist test is to identify the set of substitutes that must be under the control of a firm, so that a small but significant non-transitory increase in price is profit maximizing, because what makes a price increase not profit maximizing is the discipline exerted by consumers' willingness to substitute. So if a firm has control of some products goes to raise the price and enough consumers can substitute away, then that increase in price is not going to be profitable because of the lost sales that the form loses on -- the lost profits the firm loses on volumes that are diverted.

Church Report at para. 61.

579. The discipline that is imposed on the hypothetical monopolist is both the number of sales that are lost and the lost margin on those sales. Multiply the two together, and we find out

what the lost profits are. When that loss exceeds the gain from an increased revenues on sales still made, a price increase is not profitable.

Transcript of Examination-in-Chief of Church at pages 2884-2893 (public).

580. In this case, it is important to recognize that there is a margin made on both sides, so if a transaction is lost because *either* the Merchant *or* the consumer decides not to use their card because the price has gone up, *both* margins are foregone. Moreover, there is the potential for substitution on both sides. Because of network effects, a small decrease in demand on one side may affect the other side significantly – for example, a reduction in the number of consumers may then boomerang back and reduce the number of Merchants, which then boomerangs back and reduces the number of consumers. So feedback effects may be important. One needs to take into account both the *total* margin and the response on *both* sides of the network, because if the possibility for substitution on one side is ignored, and the feedback effects are ignored, then there is the potential to define the market much too narrowly.

Transcript of Examination-in-Chief of Church at pages 2884-2893 (public).

581. The Commissioner's expert, Dennis Carlton, has pointed out how difficult it is to define price in the definition of a two-sided market, and how important that definition is in determining the proper market. In Market Definition: Use and Abuse, he states:

> "To take a concrete example, suppose two shopping malls want to merge. ... We start out by recognizing that a mall owner puts together a portfolio of stores that complement each other and whose existence he coordinates by lowing the rent of one type of store to stimulate demand (and elevate rent) at another....which nearby malls must a hypothetical monopolist control in order for it to be profitable for the merged firm to raise the "price" by, say 5%. But ..., one must define what "price [sic] means. Is it the rent of one particular store, average rent or total rent that has to rise? In the earlier discussion of market definition when the market contained multiple products, I recognized the ambiguity in the definition of "price" but said that I doubted that it should matter much, though I indicated a preference to focus on the products of the merging firms, rather than all products in the market. But here, there is no one type of retail store to focus on. *Therefore, one should focus on an aggregate measure of rent.*

> Moreover, we know that because of the two-sided nature of the market it is unlikely that it is optimal for the hypothetical monopolist to raise rents to all stores 5%. ... Failure to allow the hypothetical monopolist to set rents optimally could lead one to a misleading market definition. For example, one might conclude that post-merger there is no market power (i.e., a very broad market in which the post-merger mall owner has a small share) when with the optimal pricing the market is narrower and the mall owner has a large market share reflecting market power created by the merger. *My sense is that this problem of using the right "price" will make market definition in two-sided markets more difficult than in the typical case and will therefore further limit the reliability of market definition and market share."*
>
> Dennis W. Carlton, *Economic Analysis Group Discussion Paper*, "Market Definition: Use and Abuse" (2007) at pages 30-31. [emphasis added]

582. Dr. Winter purports to apply the hypothetical monopolist test but fails to properly do so for three reasons. First, he actually applies something else called break-even critical sales loss analysis ("BECSL"). Second, he does not properly apply even the BECSL test. Finally, he ignores the Cardholder side of the platform.

Transcript of Examination-in-Chief of Church at pages 2884-2893 (public).

583. Break-even critical sales loss analysis asks: What is the loss in sales that would make a SSNIP unprofitable? That is not the same thing as asking if a SSNIP is profit *maximizing*, which is the relevant question for the hypothetical monopolist test.

Transcript of Examination-in-Chief of Church at pages 2884-2893 (public).

584. Second, in this particular application, the BECSL is misapplied. What Professor Winter does is calculate the SSNIP as 5 percent of the 200 basis point acquirer fee, which is 10 basis points. His hypothetical monopolist retains the *entire* 10 basis point increase. Its profit margin more than doubles to 19.72 from 9.72, and the volume loss, therefore, must be greater than 50 percent for profits not to increase. But the margin to Visa and MasterCard is *not* increased when interchange increases, since interchange flows through to Issuers. The basic fundamental trade-off behind break-even critical sales loss analysis is missing when you don't recognize what role interchange is playing. So when you

[redacted]

increase the interchange fee as part of this hypothetical monopolist exercise, you have to recognize that, from that part of the increase, there is no higher margin, *only* lost sales.

> Transcript of Examination-in-Chief of Church at pages 2884-2893 (public).

585. Finally, Professor Winter performed his BECSL analysis only on the Merchant side of the platform. As noted above, this means that the effects of lost margin on the Cardholder side of each lost transaction is missing. Even if the right measure for the hypothetical monopolist test (which it is not), the properly calculated BECSL on Professor Winter's assumed numbers is 5.81 percent. This means that a 5 increase in acquirers fees would be unprofitable if any more than 5.81% of transactions were lost as a result. This implies a much wider market than Professor Winter's incorrectly calculated 50% reduction in sales.

> Transcript of Examination-in-Chief of Church at pages 2884-2893 (public).

586. The Commissioner's theory of anti-competitive harm is based on the Challenged Rules restricting substitution by consumers to other forms of payment if they were subject to surcharges. Without consideration of the implications of the two-sided platform, conclusions on the relevant market for a two-sided platform based on a one-sided analysis are susceptible to a misidentification of the relevant market. They will mischaracterize the extent of competition, and in particular ignore that competition occurs on both sides of the platform, and therefore exclude important sources of competitive restraint, resulting in too narrow a market.

> Elzinga Report at paras. 147-148;
> Church Report at para. 71.

587. Another of the Commissioner's experts, Dr. Frankel, contends that Merchants who accept MasterCard credit cards cannot effectively substitute for other payment methods because credit cards have distinct attributes for consumers, including deferred payment, revolving credit, protection against fraudulent transactions and the ability to make purchases remotely, and further credit cards cost more to process than debit cards.

[redacted]

Frankel Report at para. 66.

588. It is true that credit cards have features that other payment methods do not. However, many products do not sell for the same price and have differing characteristics but nonetheless belong to the same market. For instance, there are many different varieties of beer, yet there are still sufficiently good demand-side substitutes that the relevant product market for analyzing the conduct of brewers is all beer.

Elzinga Report at paras. 158-159.

589. Jurisprudence from the United States suggests that the fact that the various forms of payment exhibit differentiated features does not relegate them to separate relevant markets for antitrust purposes; indeed, markets are commonly comprised of differentiated products that are nonetheless substitutable for one another. For example, in *United States v. E.I. du Pont de Nemours & Co.*, the Court rejected the government's argument that relevant product market should be defined as cellophane and not flexible packaging materials simply because of cellophane's differing characteristics. Similarly, in *United States Football League v. National Football League*, the Court defined the relevant product market to be comprised of products that are reasonably interchangeable substitutes from a buyer's point of view, stating "[t]his does not mean that products must be identical to be in the same relevant market").

United States v. E.I. du Pont de Nemours & Co., 351 U.S. 377 (Supreme Court of the United States) at pages 394-95;
United States Football League v. National Football League, No. 84 Civ. 7484, 1986 WL 10620, at 6 (S.D.N.Y. July 31, 1986) at page 6.

590. Further, as noted above, in the seminal case *National Bancard Corp. v. Visa U.S.A., Inc.* ("*Nabanco*"), National Bancard Corp. sued Visa, alleging that interchange fees amounted to an unlawful restraint of trade. The district court in *Nabanco* properly defined the market as including a variety of payment systems in the following terms:

> "The cross-elasticity of both demand for and supply of VISA and other payment devices is quite high. Both cardholders and merchants who testified at trial considered the VISA services equivalent or sufficiently close to a variety of payment systems used in retail sales, including other

[redacted]

> credit cards, travelers cheques, cash, ATM cards, personal checks, and check guarantee cards. While each of these different payment service devices was not considered to be a close substitute for a VISA card for purchases of every possible product at every possible price, all payment services taken together were sufficient to provide, at the least, several close substitutes for a VISA card in any possible context. Cash, for example, might be a good substitute for face-to-face transactions involving small dollar amounts, while checks would be better for larger transactions involving long distance exchanges. Testimony by VISA experts also confirmed substitutability between VISA and other, technologically innovative, payment devices including but not limited to regional ATM cards, debit cards, as well as retail proprietary cards and new multi-purpose cards like the Sears/Merrill Lynch cards now available."

National Bancard Corp. v. Visa U.S.A., Inc., 596 F. Supp. 1231 (S.D. Fla. 1984), aff'd, 779 F.2d 592 (11th Cir. 1986) [*Nabanco*].

591. The Eleventh Circuit Court of Appeals confirmed the trial decision in *NaBanco* that the relevant market consisted of "all payment devices (including cash, checks, and all forms of credit cards) and that VISA did not possess power in that market."

Nabanco, ibid. at page 603.

592. Similarly, *Visa U.S.A. Inc. v. First Data Corp.*, concerned First Data Corp.'s attempt to implement, without Visa's prior approval, a "private arrangement" among Visa members by which First Data Corp. would authorize, clear and settle Visa transactions, bypassing the Visa system.

Visa U.S.A. Inc. v. First Data Corp., No. C 02-01786, 2006 WL 1310448 (N.D. Ca. May 12, 2006), 2006 WL 1310448 (United States District Court).

593. In responding to First Data Corp.'s counterclaim which alleged, among other things, that Visa's honour-all-cards rule was anticompetitive, the United States District Court for the Northern District of California framed the relevant product market as both credit card network processing services and debit card network processing services. This definition is supported by the demonstrated increase in debit cards to settle transactions at the expense of cash and credit cards.

[redacted]

Visa U.S.A. Inc. v. First Data Corp., 2006 WL 1310448 (United States District Court).

(iii) There are Many Options in the Payments Market

594. MasterCard competes vigorously for transaction volume in the market for payment services. There are many other alternative payment methods readily available and frequently used by consumers other than credit cards. In 2009, cheques accounted for 18% of the dollar value of all consumer and small business transactions in Canada, while cash accounted for 7%. Automated funds transfers through the Canadian Payments Association accounted for 48%. According to Professor Elzinga, Visa and MasterCard's shares total 12% of a market that embraces these payment alternatives (not including either proprietary cards or Discover), which is markedly below the threshold that would signal significant market power.

Elzinga Report at para. 153, Exhibit "1".

595. Professor Elzinga's conclusions that the broader market for payments is the appropriate market are supported by a 2009 Bank of Canada survey which demonstrated that cash dominates for payments below $25, and above that amount credit and debit cards are the preferred payment instruments but neither dominates. Even when the survey sample was limited to "credit card intensive users" the probability of using a debit card remained higher than the probability of using a credit card for transactions less than $50.

Elzinga Report at para. 156.

596. In his testimony, Professor Elzinga referred to the Canadian Currency Museum as an example of the practical approach that needs to be taken in interpreting the relevant product market, which in his opinion should include all payment services, including cash, cheques and debit cards.

Transcript of Examination-in-Chief of Elzinga at page 2697 (public).

597. [redacted]

[redacted]

[redacted]

[redacted]

598. The witness statement of Paul Jewer, Chief Financial Officer for Sobeys Inc., filed by the Commissioner, illustrates the absurdity of excluding other payment methods, and particularly the use of Interac debit, from the definition of the relevant market. In Sobeys 2011 fiscal year, [redacted] of sales were made using Interac debit, [redacted] were made using cash and [redacted] were made using a credit card ([redacted] were made using Visa credit cards and [redacted] were made using MasterCard credit cards).

> Witness Statement of Jewer at para. 24; [redacted]

599. In light of the foregoing, it is simply not reasonable to suggest that MasterCard competes in a different market than these other methods of payment, or that consumers do not have other payments that can be readily substituted for MasterCard credit cards, when MasterCard's credit cards are used only [redacted]% of the time at a major Merchant such as Sobeys.

600. The competition between MasterCard credit cards and other forms of payment has been recognized by this very Tribunal. In *B-Filer, supra*, this Tribinual stated:

> "We further note Dr. Mathewson's observation that virtually all Interac Online participating merchants accept credit cards. In this context, we observe that the questionable viability of Interac Online suggests the possibility that Canadian internet merchants are satisfied with these payment means and that these means compete with Interac Online"

B-Filer, supra at para. 229.

601. Also, as pointed out by David Evans in Essays on the Economics of Two-Sided Markets, internet based payment methods are rapidly expanding." These new technologies are gaining market share at the expense of other payment service providers, including MasterCard.

David S. Evans, *Essays on the Economics of Two-Sided Markets*, More Than Money: The Development of a Competitie Electronics Payments Industry in the United States (2010), p. 18.

602. As noted above, in support of her much narrower definition of the market, the Commissioner purports to apply the "hypothetical monopolist" test, in which a relevant market is defined as the smallest set of products over which a hypothetical single provider could profitably impose a significant increase in price. Under this approach, if in the face of a small but significant increase in price by a hypothetical monopolist customers would substitute other products in sufficient amounts to render such a price increase unprofitable, the proposed relevant market should be expanded to include such substitutes.

Reply of the Commissioner of Competition at para. 8;
Notice of Application at paras. 83 and 88;
Elzinga Report at para. 143.

603. The Commissioner argues that there are no effective substitutes for credit card network services available to Merchants and competition from other payment methods would not be sufficient to prevent a hypothetical monopolist from profiting from maintaining supra-competitive prices for credit card network services provided to Merchants. The Commissioner asserts that even a large increase in card acceptance fees would not provide a meaningful incentive for Merchants to cease accepting the respondents' credit cards, because of the threat of losing sales to rivals that accept such credit cards, and otherwise losing business.

Notice of Application at paras. 82-83.

[redacted]

604. However, Professor Elzinga points out that the Commissioner's approach to applying the hypothetical monopolist test is flawed because she is only considering whether Merchant decisions could defeat a hypothetical increase in interchange rates. In other words, the Commissioner is only considering one side of the two-sided market. In doing so, the Commissioner draws the contours of market competition too narrowly.

Elzinga Report at para. 145.

605. In fact, as Professor Elzinga notes, the relevant decision maker in determining what payment method will be used is the consumer, not the Merchant. While Merchants may decide whether to accept Visa or MasterCard credit cards as a method of payment generally, consumers are the ones who decide at the point of sale whether to use a credit card or another method of payment. In other words, the competition that is relevant is the competition for consumer's choices among different methods of payment. As Professor Elzinga explains, the proper application of the "one-sided hypothetical monopolist test" would mean investigating how tenaciously consumers would cling to their credit cards if it meant being surcharged at the point of sale.

Elzinga Report at paras. 146-147.

606. The key issue in this case is whether the services provided by Visa and MasterCard to their Acquirers are in the same relevant market as the services provided by a hypothetical monopolist of the services provided by Acquirers to Merchants. More simply; could and would Merchants substitute directly the Visa or MasterCard services? The answer would appear to be "no", not least because Acquirers provide access to all cards and many other services, as well, that Visa and MasterCard do not supply.

Transcript of Examination-in-Chief of Church at page 2860 (public).

607. A properly defined market should include all substitutes that supply a meaningful constraint on the pricing of a prospective monopolist. In this regard, if the proposed market were expanded just to include debit cards, MasterCard's share of consumer and small business transactions in Canada by dollar volume was only [redacted]% in 2009.

[redacted]

(iv) MasterCard's Market Share

608. According to Professor Elzinga's Report, transactions in Canada in 2009 using Visa or MasterCard credit cards for consumer and small business transactions was [redacted]% (not including either proprietary cards or Discovery), which is markedly below the threshold that would signal significant market power.

[redacted]

609. Further, as set out above, in 2010 MasterCard's share of dollar value purchase volume amongst payment cards in Canada was only [redacted]%, and amongst credit cards was [redacted]%.

610. Even if the Commissioner's very narrow definition of the market were to be accepted, the Commissioner overstates MasterCard's market share within that market.

611. The Commissioner ascribes to Visa "at least 60% " and to MasterCard "at least 30%" of purchases made on credit cards in Canada. Accordingly the Commissioner concludes that Visa and MasterCard together have more than 90% of the share of the market. The result, she contends, is that MasterCard and Visa have market power.

Notice of Application at para. 89.

612. However, there is no basis whatsoever for treating Visa and MasterCard as one entity for purposes of assessing their respective market shares in the credit card market. There is no allegation of collusion as between Visa and MasterCard. Visa and MasterCard compete vigorously in every aspect of the payment card business. They compete to persuade Issuers to issue their cards. Their Issuers compete to persuade consumers to carry and use their cards. They compete for Merchant acceptance of their cards. It is simply not correct to infer that MasterCard and Visa do not compete or have regard to the competitive reaction of the other with respect to interchange rates.

Elzinga Report at para. 140.

[redacted]

613. Professor Elzinga notes, therefore, that lumping MasterCard and Visa together to get some sort of 92% market share, in the market that the Commissioner posits, makes no sense. This evidence was unchallenged and untouched in cross-examination.

614. Further, as discussed above, section 76 of the *Competition Act* does not provide for the Respondents to be treated as joint actors, Each of Visa and MasterCard must be considered with regard to whether they individually enjoy market power and have engaged in resale price maintenance conduct.

> *Competition Act*, R.S.C. 1985, c. C-34. s.76.

615. The market share of 30% of transaction volume of the credit card network services market ascribed by the Commissioner to MasterCard is not sufficient to be indicative of MasterCard enjoying market power, particularly in the absence of evidence of barriers to new entry or expansion.

616. In *American Professional Testing Service, Inc. v. Harcourt Brace Jovanovich Legal and Professional Publications*, Harcourt's failure to show high entry barriers defeated a claim of attempted monopolization despite the defendant's high market share. Even if Harcourt has a high market share, neither monopoly power nor a dangerous probability of achieving monopoly power can exist absent evidence of barriers to new entry or exclusionary conduct is not sufficient to prove Harcourt's dangerous probability of success; other proof of market power is required.

> *American Professional Testing Service, Inc. v. Harcourt Brace Jovanovich Legal and Professional Publications.* 108 F.3d 1147, C.A.9 (Cal.), 1997 at paras. 31-32.

617. The Competition Bureau's own policies state that a single firm with market share of less than 35% will not give rise to concerns about market power.

> "The Bureau's general approach in evaluating allegations of abuse of dominance is as follows:

[redacted]

- A market share of less than 35% will generally not give rise to concerns of market power or dominance.

- A market share of 35% or more will generally prompt further examination.

- In the case of a group of firms alleged to be jointly dominant, a combined market share equal to or exceeding 60% will generally prompt further examination."

"Enforcement Guidelines on the Abuse of Dominance Provisions", Industry Canada (July 2001) available at http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapj/aod.pdf/$FILE/aod.pdf at pages 14 and 15.

(v) Barriers to Entry and Entry

618. The Tribunal, in *Laidlaw*, held that market power, with reference to market share and barriers to entry, is required for the analysis of competition in the context of proceedings under the *Competition Act*.

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

Canada (Director of Investigation and Research) v. Laidlaw Waste Systems Ltd. (1992), CT-91/2 (Comp. Trib.) at pages 63-64.

[redacted]

619. One of the places where antitrust agencies and courts get things wrong, very frequently, is the question of entry.

620. A Competition Bureau-sponsored study of merger remedy effectiveness concluded that underestimation of the likelihood of entry into the relevant market is a significant factor in forward-looking remedies under the merger review provisions of the *Competition Act*.

> "Entry or the lack of entry was important in all three cases. For the Corus-WIC merger, the CRTC policy changes resulted in considerable entry in the post merger period and this was of sufficient magnitude to offset any negative effects of the merger. Bureau staff correctly noted the likelihood of entry, but its importance in hindsight seems underweighted relative to its actual importance in the market. **To be fair, it would have been difficult for the Bureau to predict how much entry would occur or the timing of this entry. However, it might have been useful to investigate further the extent to which the previous CRTC policy had limited entry.** Interviews of past entrants and a review of CRTC decisions may have been helpful in determining just how important the relaxation of the CRTC entry policy would be.
>
> **In the Fording case, entry was very important in the post-merger outcome. As with the radio merger, the importance of entry was underestimated** but in this case it would have been even more difficult to predict the rising coal prices induced by surging demand in China and that led to entry. In neither case is it the merger itself that likely caused entry to occur. **Thus while for the purposes of antitrust analysis entry is usually thought of as a response to increased concentration, entry for other reasons can be just as important, though possibly harder to predict. Thus as a general rule it is likely worth investigating the likelihood that entry may occur in the future as a result of other market changes.** In this case, had the merger been a year or so later, there would have been much more information about changing world markets that would have been very relevant. [emphasis added]
>
> …"
>
> M. Neumann and M. Sanderson, "Ex Post Merger Review: An Evaluation of Three Competition Bureau Merger Assessments", CRA, 2007, section 7.2.

621. The Tribunal has ruled in previous matters that without barriers to entry, the finding of market power is impossible.

[redacted]

> "In the absence of barriers to entry, even a single seller cannot exercise market power. Any attempt by the incumbent to price above the competitive level will attract immediate entry by competing sellers. We have concluded that Tele-Direct has a large share of the relevant market. Proof of easy entry would overcome the initial determination that Tele-Direct has market power in the supply of telephone directory advertising."
>
> *Director of Investigation and Research v. Tele-Direct* (1994), CT-9413 (Comp. Trib.)

622. In the American context, the requirement to prove barriers to entry is significant and well-accepted.

> "In the extreme case of costless and instantaneous entry, even a 100 percent market share entails no power at all. Because market share is just a way of estimating market power, which is the ultimate consideration, easy entry and the absence of barriers" matter even though the defendant has a large market share."
>
> Phillip E. Areeda, et al., *Antitrust Law: An Analysis of Antitrust Principles and Their Application*, Vol 2B (3d), (Aspen Publishers: 2007).

623. The Commissioner has argued that an indication of Visa's and MasterCard's combined market power is that the barriers to entry into the market for credit card network services are "significant" and that there has been no entry into the market for at least twenty years.

> Notice of Application at para. 92.

624. MasterCard does not dispute that a significant financial investment would be required to enter into the general purpose credit card industry in Canada today. However, no evidence has been led by the Commissioner to indicate why the need for financial capital would be any more of a barrier to entry, or to expansion in the market, than it was when MasterCard entered the industry in Canada.

625. In fact, Professor Elzinga notes that Discover and Interac represent two potential entrants into the credit card industry.

> Elzinga Report at paras. 177-181.

626. There is evidence before the Tribunal that Discover is entering Canada – not only in acquiring transactions but in issuing. PayPal has already entered, both online and point of sale. That is two things which we can <u>see</u>.

> [redacted]
> Transcript of Examination-in-Chief of Weiner at page 2310 (public);
> Transcript of Examination-in-Chief of Stanton at page 2451 (public);
> Transcript of Examination-in-Chief of DeVita at pages 2484-2487 (public).

627. We also have evidence of the accelerated pace of competition from new technologies, mainly mobile phone payments. The future is always uncertain, but the report of the Payments Task Force is focused on the rapidly changing landscape.

> Transcript of the Questions from the Tribunal to Leggett at pages 2662-2664 (public);
> Transcript of Examination-in-Chief of Elzinga at pages 2717-2718 (public);
> Transcript of Examination-in-Chief of Dunn at pages 3453-3454 (public).

628. PayPal's recent entry into Canada is further evidence of the market's dynamic. PayPal is no longer just used to buy something on eBay; the company has signed up 1,200 Home Depot stores to its point-of-sale infrastructure. Clearly MasterCard, Visa, Interac debit and the other forms of payment with which they compete are not insulated from vigorous competition from new entrants.

> Transcript of Examination-in-Chief of Elzinga at pages 2717-2718 (public).

629. Contrary to paragraph 36 of his report, Mr. McCormack stated that he is unsure if any Merchants, aside from those online, accept PayPal and that he failed to read or address the article referenced by Mr. Weiner entitled "New PayPal Service Takes a Bite Out of Basic Credit Card Companies". When examined on his reply report, he further stated that he does not disagree with Mr. Weiner's statement that "the suggestion that PayPal is only a complement to general purpose credit cards and not a substitute for them is incorrect..."

> McCormack Report at para. 36;
> Transcript of Cross-Examination of McCormack at pages 676-684 (public);
> Weiner Report, Exhibit "E".

630. Dr. Askanas asked Professor Elzinga what percentage of transactions go on PayPal over credit cards versus directly to people's bank accounts. Right now, about two-thirds of PayPal transactions are bank-account-related or direct-debit. The bigger point, of course, is that that is what it is *today*. A few years ago, it was zero percent. A couple of years from now, we don't know what it is going to be, but we do know it is growing. PayPal is a competitor which has entered *both* sides of the two-sided market. It has solved the alleged "chicken-and-egg problem". It has Cardholders (in this case, PayPal subscribers) and it has Merchants (for example the 1,200 Home Depot locations). PayPal is not merely a potential competitor, it is an on-the-ground, *entered* competitor.

> Transcript of Examination-in-Chief of Dunn at page 3453 (public);
> Transcript of Examination-in-Chief of Elzinga at pages 2718-2719 (public);
> Transcript of Questions from the Tribunal to Elzinga at pages 2827-2828 (public).

631. In summary, regardless of which definition of the relevant market is used, MasterCard does not enjoy market power and there is no evidence that the Challenged Rules create, enhance or preserve any such market power. MasterCard's operation does not raise barriers to entry, nor does it raise the costs of rivals. They are efficiency-enhancing consumer protection rules, designed to make MasterCard an attractive form of payment and a more effective competitor.

4. An Order Ought Not Be Made

632. The Tribunal retains discretion to avoid making the order requested by the Commissioner. Although no cases have been decided under section 76, section 75 is similar in its function and there is useful case which interprets that section. The Tribunal has made it clear that even if the elements of section 75 are established, the Tribunal retains discretion as to whether or not to make an Order. The Tribunal has stated that once it is satisfied that the Commissioner has proven, through the evidence presented, all of the elements of section 75 of the *Competition Act*, the Tribunal has the discretion to

issue an order requiring the supplier to resume supplying to the buyer. There are several factors that are relevant to the Tribunal's discretion for relief under section 75.

> *Chrysler Canada Ltd. v. Canada*, (1989) 27 C.P.R. (3d) 1 (Comp. Trib.); aff'd (1991) 35 C.P.R. (3d) 25 (Fed. C.A.) at paras. 67-68.

633. Where the court finds than an order under section 75 would expose the applicant to legitimate and continuing risks such that it is not commercially reasonable nor consistent with the purpose of the *Competition Act* to make an order under section 75 then the court may refuse to do so.

> *B-Filer Inc. v. Bank of Nova Scotia*, 2006 CarswellNat 6422, 2006 Comp. Trib. 42 (Comp. Trib.) at paras. 232-235.

634. For the purposes of section 75 of the *Competition Act* the court <u>may consider other factors that 'militate' against the exercise of any discretion in the applicant's favour</u>.

> *B-Filer Inc. v. Bank of Nova Scotia*, 2006 CarswellNat 6422, 2006 Comp. Trib. 42 (Comp. Trib.) at para. 243.

(a) Generally

635. Leaving aside the questions of whether or not the Commissioner can manage to squeeze the Challenged Rules within the definition of resale price maintenance and further persuade the Tribunal that all payment methods other than credit cards should be excluded from the relevant market, it is important to ask why the Commissioner feels the remedies she seeks are necessary.

636. The many benefits of using credit cards do not appear to be in dispute. In fact, in making her case that credit cards should be treated as a separate market from other payment methods, the Commissioner relies upon the fact that credit cards offer unique and significant benefits to consumers that other payment methods do not provide.

637. For Cardholders, the benefits include convenience of not carrying cash or cheques, a source of unsecured credit, interest-free periods, easy record keeping, fraud protection, charge back protection and rewards. In addition, thanks in large part to the Challenged

Rules, Cardholders can go out for dinner, or out with clients or friends with certainty that if a Merchant advertises that it accepts MasterCard credit cards, their credit card will not be declined at the end of the evening and they will not be hit with unexpected additional charges for using their card.

> Witness Statement of Stanton at paras. 14-19, 62-87.

638. Many benefits also flow to Merchants from the use of credit cards, some of which are the result of the Challenged Rules which the Commissioner now attacks, including increased sales and the value of sales made, as consumers spend more when they are not constrained by cash on hand; customer satisfaction; speed of checkout; improved efficiency by minimizing cash handling and payment reconciliation; reduction of handling and depositing costs; protection from theft and pilfering; automatic currency conversion; and protection from credit risk.

> Witness Statement of Stanton at para. 44;
> Witness Statement of DeVita at para. 13.

639. The fact that Merchants find significant benefits from using MasterCard credit cards is evidenced by the strong growth in Merchant acceptance from 2006 to 2011 [redacted]

> Witness Statement of DeVita at para. 14.

640. The Commissioner presented ten witnesses including many of the largest retailers in Canada, all of whom complain that their costs associated with accepting MasterCard credit cards are too high. They want to be able to surcharge and discriminate against their customers who wish to pay using MasterCard credit cards on the assumption that this will force MasterCard to lower interchange and thereby lower interchange costs on their side of the network.

641. These witnesses do <u>not</u> want to stop accepting MasterCard or Visa credit cards. They make money by accepting these credit cards. They said the following:

(a) [redacted]

(b) [redacted]

(c) Mr. Houle (Air Canada) admitted American Express is the most expensive card, on average, but Air Canada continues to accept it;

Transcript of Cross-Examination of Houle at page 504 (public).

(d) [redacted]

(e) [redacted]

(f) Mrs. Van Impe (University of Saskatchewan) admitted that other Universities had decided to stop accepting MasterCard and Visa credit cards. [redacted] Merchants could do this if they wanted. They could do as Costco has done and accept debit or alternate payment methods only. They have not done this because they want

[redacted]

the benefits of MasterCard credit cards. They just want to reduce their costs of doing so.

Transcript of Examination-in-Chief of Van Impe at page 1671 (public);
[redacted]

642. On the other hand, consumer groups, including the Consumers' Association of Canada, oppose the remedies sought in this Application.

Witness Statement of Stanton at para. 134, Exhibit "L".

643. In other words, this is a contest between Merchants and consumers. The Merchant industry has fought for the remedies sought in this Application. Consumer groups have strongly opposed them. The Commissioner has chosen to side with the Merchants.

644. However, the Merchants themselves seem to want to have it both ways. They want to reduce their costs by forcing a reduction in the merchant discount rates they pay, but at the same time they do not appear to be interested in giving up the benefits they realize by accepting MasterCard credit cards. Most telling is the fact that while four of the ten witnesses lined up by the Commissioner, representing mainly major Canadian retailers, raise complaints that their employers are unfairly limited in their ability to steer their customers to other payment methods, their employers have at the same time entered into co-branding agreements or other special arrangements with MasterCard which impose greater obligations to support the use of MasterCard credit cards, and have expressly accepted MasterCard interchange rates.

645. The Witness Statement of Candice Li, filed on behalf of WestJet, states at paragraph 22, "To the best of WestJet's knowledge, Interchange Fees are set by Visa and MasterCard, and are non-negotiable by the Merchant, except where certain limited opportunities exist, such as the issuance of a co-branded credit card." She also states that WestJet sees no additional benefit from "premium cards".

Witness Statement of Li at paras. 22 and 28.

646. [redacted] WestJet has chosen not to accept cash in the cabin, and only accepts MasterCard, Visa, American Express and WestJet vouchers.

Witness Statement of Stanton at paras. 115-116, [redacted]
Witness Statement of Weiner at para. 44.

647. The Commissioner has also filed the witness statements of Craig Daigle and Paul Jewer of Shoppers Drug Mart Inc. and Sobeys Inc. respectively in which they complain that their employers do not have the ability to effectively encourage or incent customers to use lower cost methods such as cash, Interac debit and lower cost credit cards. However, each of Shoppers Drug Mart and Sobeys have also entered into Strategic Alliance Agreements with MasterCard.

Witness Statement of Daigle at para. 33;
Witness Statement of Jewer at para. 49;
Witness Statement of Weiner at para. 42;
Witness Statement of Stanton at para. 118, [redacted]

648. [redacted]

[redacted]

649. [redacted]

[redacted]

[redacted]

650. Wal-Mart's witness, Mr. de Armas, also complains that Wal-Mart is constrained from effectively encouraging customers from using lower-cost methods of payment. However, MasterCard has a Customer Business Agreement with Wal-Mart Canada Bank which enables Wal-Mart Canada Bank to issue MasterCard credit cards carrying the Wal-Mart brand. [redacted]

Witness Statement of DeVita at para. 42, Exhibit "E".

651. While it is not surprising that Merchants would prefer to reap all the benefits of the MasterCard network and at the same time try to exert pressure on their side of the network to reduce their costs, this does not mean such a result is fair or pro-competition.

652. In terms of whether any action is required at all, it is also very important to bear in mind that the Challenged Rules do <u>not</u> prohibit Merchants from steering their customers to lower cost methods of payment. They expressly permit Merchants to do this through various methods, including offering discounts to customers for doing so. This practice is also expressly permitted in the Code of Conduct.

Witness Statement of DeVita at para. 52, Exhibit "G".

653. There has been considerable evidence filed by both sides regarding whether discounting is as effective as surcharging in steering customers toward using other payment methods. The Commissioner has argued that the fact that MasterCard has argued so strenuously against the removal of the NSR indicates that it accepts that surcharging is a more effective method of steering than discounting. The Commissioner fails to recognize that MasterCard's primary concern is, and always has been, about preserving the strength of its brand and increasing transaction volumes with its credit cards. Surcharging can be extremely damaging to both. That is the reason for MasterCard's strong objections.

Witness Statement of Stanton at paras. 71, 72 and 142.

[redacted]

654. The evidence also indicates that merchant discount rates are neither unfair nor getting higher.

(a) First, MasterCard's expert Peter Dunn conducted an analysis of MasterCard's default interchange rates with volumes and losses reported by MasterCard's Canadian Issuers over the past five years. In that period, MasterCard's Acquirers paid as much as 40% less in interchange than the costs Issuers have incurred to provide for guaranteed payment, prompt funding and processing of transactions (all of which benefit Merchants). Further, in every quarter since the fourth quarter of 2008, Issuers credit and fraud losses and processing losses (not including other costs) have exceeded the monies received by Issuers for interchange.

Dunn Report at para. 18, [redacted]

(b) Second, studies indicate that the average merchant discount rates available to Merchants now are generally similar to or below those paid in 2003, even though premium cards did not exist in 2003. This reflects increased competition by Acquirers for business of all sizes of Merchants, and the awareness of Merchants of lower cost offerings by Acquirers.

Dunn Report at paras. 20-25.

655. The Commissioner's argument that the introduction of premium cards has increased input costs to Merchants ignores the significant fact that Merchants also enjoy increased benefits from the use of such cards. [redacted]

[redacted]

656. There is no doubt that people with premium cards are, on average, better customers. They spend more on average. The evidence is unambiguous on this point.

Transcript of Cross-Examination of Daigle at page 416 (public); [redacted]

657. Those people are going to get the best deal – either from Visa, or MasterCard or from Amex – or someone else who is not regulated. You heard from Mrs. DeVita on the point. Mrs. DeVita told you what American Express cards offer richer rewards. Forbidding MasterCard from being able to compete with people who are not regulated in that regard is a bizarre turn of events.

Transcript of Examination-in-Chief of DeVita at pages 2484-2486 (public).

658. Assuming, again, that there is a credible threat of Merchant action, and that it is meaningful, and that it is widespread, and that MasterCard or Visa decide they have to respond in some way – the Commissioner's theory is that the response will lead to lower interchange. That actually is not the logical result. Lowering interchange will make the card less attractive to the Issuers and the Cardholders.

659. If MasterCard's goal is to create a situation in which the Merchant is indifferent as between cards, and therefore is unlikely to cease to accept some of them, or indeed to surcharge some of them, that does not have to be achieved by lowering interchange.

660. It can be achieved by raising interchange on core cards, either all the way up to the top level or to some blended level.

Transcript of Examination-in-Chief of Sheedy at page 2177 (public).

661. Now, that is somewhat less efficient for the system than the arrangement now. It is a somewhat less precise, balancing. It is somewhat less efficient way for MasterCard to seek to go after the key transactor segment which you heard about – and of course, less efficient for the economy. It is less efficient, but it is certainly better than lowering interchange and giving less resources to attract Cardholders. And, it achieves the same

goal of making Merchants indifferent as to which cards are accepted or whether they surcharge some and not others.

662. In other words, there are tremendous risks of unintended consequences when you alter the system. You make the market less efficient. You raise interchange. You keep out smaller, aggressive, innovative Issuers. You reduce efficiency.

663. The foregoing shows that there is no pressing need to take any steps to reallocate costs within the MasterCard network as the Commissioner seeks to do.

(b) Repeal of No Surcharge Rule is Unlikely to Have a Meaningful Effect on Interchange Rates or Merchant Discounts

664. Recall that in terms of the Commissioner's theory on existing harm, the Commissioner's expert, Professor Winter, has proposed two theories to attempt to link the Challenged Rules to an (alleged) adverse effect on competition. First, he argues that the Challenged Rules suppress competition by reducing the incentive to lower network fees and interchange, which costs are absorbed by Acquirers and passed on as a higher "price" to Merchants in the form of the merchant discount. Second, he argues that the Challenged Rules result in Merchants passing on higher retail prices to all customers, whether or not they used a MasterCard credit card.

> Winter Report at paras. 81-93;
> Church Report at paras. 31-34.

665. With respect to suppression of competition by reducing incentives to lower network fees and interchange, the Commissioner (and her expert) again fail to appreciate the nature of MasterCard's business and its role in the network. In particular, they fail to consider that MasterCard does not receive interchange. While MasterCard sets a default interchange rate to facilitate dealings between Issuers and Acquirers, its interest does not lie in setting the highest interchange rate possible. MasterCard's economic interest is in maximizing output (transaction volume) which it pursues by setting rates that have the effect of inducing Merchants to accept their cards <u>and</u> provide incentives for consumers to carry

its cards and use them. MasterCard and Visa compete on both the Acquirer and Issuer sides of the network.

Church Report at paras. 38-39.

666. Accordingly, even if surcharging and other discriminatory practices by Merchants were permitted, this does not mean MasterCard, Issuers or Acquirers would respond by lowering the default interchange rate, which the Commission notes is the biggest cost input for Acquirers which Acquirers may seek to recover in setting their merchant discount rates in order to recover lost transaction volume. MasterCard could instead take steps to increase transaction volume on the Issuer side of the platform by increasing Interchange and/or reducing its network fees on the Issuer side, thereby making MasterCard credit cards more attractive to Issuers and consumers.

Witness Statement of DeVita at para. 63;
Witness Statement of Stanton at para. 140;
Church Report at paras. 45-46.

667. Mr. Sheedy has provided evidence that Visa would also not necessarily reduce its interchange rates if, for example, it became apparent that Merchants were specifically surcharging Visa's premium card products. In fact, Visa's response could actually be to raise the interchange rates on its non-premium credit card products (or move to a blended rate), to remove the incentive for surcharging Visa's premium card products.

Witness Statement of Sheedy at para. 79.

668. Further, with respect to Merchant retail prices, there is little, if any, evidence that Merchants in Canada would in fact lower their prices if permitted to surcharge.

Transcript of Cross-Examination of Daigle at pages 445-446 (public);
Transcript of Cross-Examination of Houle at pages 535-536 (public);
[redacted]
Transcript of Questions from the Tribunal to Broughton at page 375 (public);
Transcript of Cross-Examination of Li at pages 1570-1575 (public);
[redacted]

[redacted]

669. The Commissioner's experts speculate that if the Challenged Rules were suspended, Merchants could, by selectively accepting certain credit cards or surcharging, discriminate against or among MasterCard's credit cards. Contracting transaction volume, they say, would pressure MasterCard to reduce its default interchange rates. In turn Acquirers would then reduce merchant discounts and Merchants would lower their retail prices.

Carlton Report at para. 44.

670. First, if the removal of the Challenged Rules operated in the way the Commissioner says it would, the result would be an increase in prices (through surcharging) for Merchants' customers, and a subsequent decrease in transaction volume within the MasterCard network as consumers are compelled to move to other methods of payment. Either result is arguably anti-competitive in effect.

671. Second, any hypothetical reduction in transaction volume driven by the Acquirer side of the network may result in any number of responses, including a reduction in interchange, an increase in interchange on other credit cards, a decrease in Acquirer or Issuer Network Fees or perhaps even changes to the suites of services MasterCard, Issuers or Acquirers provide within the network. Given that the Commissioner's proposed remedy is intended to rebalance the allocation of costs within MasterCard's two-sided network for the benefit of Merchants (but not consumers), there are any number of potential responses that could result in adjustments other than a reduction in interchange and/or merchant discounts.

Witness Statement of Stanton at paras. 136-137;
Witness Statement of DeVita at para. 62.

672. Further, there is good reason to believe that, even if there were to be a reduction in interchange rates, there would be little or no savings passed on to consumers on that side of the MasterCard network. Professor Elzinga points out the following in his Report:

(a) many Merchants have some degree of market power due to their size, location or some other distinguishing characteristics; when costs fall, a firm with even modest market power may not pass the entire savings on in the form of lower prices;

(b) savings realized by Merchants would be small in relation to the prices generally charged for goods and services. An analysis by David Evans, Howard Chang and Daniel D. Garcia Swartz of interchange capping in Australia concluded that Merchants had tended not to pass through the reduction in the merchant discount in the form of lower prices;

(c) if Cardholders did not have the option to make purchases using their premium cards, those Cardholders might choose a different payment system that is not costless for Merchants. For instance, payment in cheques can result in a cost of up to $3.00 per cheque, and even payment by cash can result in costs of handling, bank fees and risk of theft; and

(d) were the Commissioner's remedy to be implemented, American Express would not be impacted and accordingly to the extent customers shift from Visa or MasterCard, Merchants would likely pay higher card acceptance fees as the fees imposed by American Express are generally higher than those associated with acceptance of Visa or MasterCard.

Elzinga Report at paras. 100-102.

673. There is no coherent theory as to why retail prices would be lower if MasterCard's Operating Rules were suspended. The Commissioner's experts, Professor Carlton and Dr. Frankel, argue that the Challenged Rules raise prices to consumers, but do so based on two inconsistent assumptions. First, they assume that a single Merchant has no choice but to accept MasterCard credit cards because failure to do so would mean a loss to their competitors who accept them. Accordingly, the threat to drop MasterCard would only be credible if all the Merchant's competitors also dropped MasterCard. However, they assume that the same Merchant <u>could</u> unilaterally force down merchant discounts for a

[redacted]

particular card by surcharging that card. The Commissioner's experts do not explain why the threat to drop is not credible but the threat to surcharge is credible.

> Carlton Report at paras. 45-46;
> Frankel Report at paras. 69-70, 141 and 147;
> Elzinga Report at paras. 103-106.

674. [redacted]

> [redacted]

675. With respect to Australia, the Commissioner called evidence suggesting that a few Merchants negotiated lower interchange with Visa or MasterCard. The Commissioner says this is as a result of threatening surcharge. It is difficult to tell, of course, when there are a number of moving pieces to the puzzle of the negotiation.

676. [redacted]

> [redacted]

[redacted]

677. But, Australia provides an opportunity for an example in another way, because there is both surcharging permitted and regulated maximum interchange. Often in these examples it a question of not being able to do a comparison because one cannot know what the rate would be. In Australia, we have got a regulated mandated maximum average rate. Card companies are allowed to charge a certain maximum interchange, and no more. They may charge less, and they may charge up to the maximum, but they may charge no more. So, after a decade of surcharging being allowed in Australia, where are Visa and MasterCard's interchange rates? They are at the regulated maximum. They could not be higher because the regulation prohibits it. They could be lower, if surcharging were effective to lower interchange rates, but they are not lower. That is the cold hard fact. There is no evidence that surcharging, even when undertaken for one or two decades, lowers interchange. Indeed the evidence is expressly to the contrary.

> Witness Statement of Buse, Exhibit "A";
> Transcript of Cross-Examination of Frankel at pages 1178-1179 (public);
> Transcript of Cross-Examination of Carlton at page 1367 (public).

678. The Commissioner raises the argument that in other forums, particularly in Europe and in Australia, MasterCard has agreed that surcharging <u>can</u> constrain interchange. MasterCard is not taking an inconsistent position here. Surcharging can constrain interchange. If Merchants were to surcharge use of MasterCard's credit cards to such a degree that there was a material drop in transaction volume for MasterCard credit cards, MasterCard and Acquirers would each be concerned, and one option might be to seek to reduce the interchange rate to decrease costs on the Merchant side of the network.

679. However, it is not correct to assume that the only pressure MasterCard is concerned about is on the Merchant-side of the network and that surcharging would result in lower interchange. MasterCard must also be concerned about countervailing pressure from the Cardholder side of the network. Lower interchange means Issuers might increase costs to Cardholders, making MasterCard credit cards less attractive to them.

680. MasterCard does not want surcharging. Surcharging has anti-consumer impacts and it damages MasterCard's brand image. It exposes Cardholders to surprise charges at point

[redacted]

of sale. If it could, MasterCard might well consider reducing interchange rates if all it cared about was ensuring MasterCard credit cards are attractive on the Merchant side of the network. However, a decrease in interchange also has a negative effect on the Cardholder side of the market.

681. We know that surcharging has not lowered interchange. Then, what has it done? In a number of place where it is allowed it has become a problem, it has become a profit centre. Consumers in situations in which Merchants have some sort of market power are held up. Airlines, On-Line, Big Merchants who already have cheaper acceptance. So, surcharging does not work at lowering interchange, but it does work to create profit centres for Merchants.

> Transcript of Examination-in-Chief of Dunn at pages 3456-3457 (public);
> Transcript of Examination-in-Chief of Buse at pages 2117-2118 (public).

682. [redacted]

[redacted]

683. Given the balancing necessary in a two-sided market, intervention by regulators to alter the balance "may not unambiguously improve consumer and social welfare." As stated in the 2009 OECD Policy Roundtables, Two-Sided Markets:

> Interventions to reduce prices on one side of the market may have unexpectedly negative effects. Any change in the price balance away from the monopoly optimum with no reduction in the price level will hurt average consumers on at least one side of the market. ...
>
> The price level, i.e., the sum of all prices, rather than individual prices or the price structure, is the appropriate means of measuring the competitiveness of a market and should be the focus of policy analysis.
>
> In many countries, competition authorities regulate some of the prices associated with two-sided markets, such as interchange fees and interconnection prices. It is unclear on which basis they should intervene, and which standard should they use when setting regulated prices, though.

> In traditional industries, regulators set prices in line with incremental costs. However, this approach does not work well in markets where two-sided platforms operate, due to the presence of indirect network externalities and joint costs."

OECD, *Policy Roundtables*, "Two-Sided Markets" (2009) at pages 12-13.

(c) Abolishing the Rules will Likely Have Negative and Unanticipated Consequences

684. Almost exactly contrary to the Commissioner's position, it is the <u>order sought</u>, <u>not the Challenged Rules in issue</u> which are most likely to lead to an adverse effect on competition.

685. First, the Challenged Rules are a balancing device. Interchange balances the system. It provides benefits to the issuing side (i.e. consumers/Cardholders) because their demand for payment method is much more elastic than Merchants, who are "transaction hungry" (who want the deal however you want to pay for it). So, to maximize output on the system the networks have to transfer value to consumers. So interchange balances. Professor Winter said he agreed with that. He does not like the Challenged Rules, but interchange was fine. It balanced and maximized output.

Transcript of Cross-Examination of Winter at pages 2026-2031 (public).

686. But the Challenged Rules are <u>part of the balance</u>. If value is transferred by interchange, but then value is taken away by allowing surcharging, the balance is lost.

Dunn Report at para. 12.

687. Similarly, if all cards are not accepted, the card becomes less valuable. Again, this undermines the balance. The Challenged Rules optimize the balance. The order sought by the Commissioner throws off the balance. Getting the balance right maximizes output and efficiency, whereas getting it wrong reduces output, reduces efficiency – and thereby has an adverse effect on competition.

Witness Statement of Stanton at paras. 78-79.

688. That is the first and most obvious way why it is the order sought, not the Challenged Rules, that would have an adverse effect on competition. The order would make the payment system less competitive and less efficient and it would decrease output.

689. A second obvious way that the order sought adversely effects competition has to do specifically with the premium card category. The Panel heard MasterCard's explanation for why it introduced or targeted higher interchange cards – it was at a disadvantage to some of its competitors, particular American Express, in that area.

Witness Statement of Stanton at para. 108.

690. Again, the Commissioner's remedy is targeted particularly at these premium cards. If the order is made it will make MasterCard and Visa less effective competitors, in particular against American Express. It will reduce the competition that MasterCard and Visa have been pursuing in the premium card category.

691. Thirdly, as Mr. Livingston explained, if Merchants can dishonour some cards or can surcharge cards of smaller Issuer banks on credit unions etc., then these smaller Issuers are at greater risk than big banks. This will reduce competition between Issuers in favour of the big guys. It is the new, smaller, innovative Issuers – the Capital Ones, The President's Choice Financial – who have shaken up the marketplace. These are the Issuers at risk.

Transcript of Examination-in-Chief of Livingston at page 2538 (public).

692. Fourthly, Mr. Jairam told you more or less the same thing with respect to Acquirers. If the order sought is granted, Acquirer competition will be reduced. The big guys will do well, and the small guys will be squeezed out. That reduces competition.

Transcript of Examination-in-Chief of Jairam at pages 3354-3355 (public).

693. Fifthly, the evidence was that the order sought will benefit big Merchants over smaller Merchants. That will reduce competition.

694. Finally, we have evidence from Professor Elzinga that credit cards make consumers' demand more elastic. A consumer will buy from a greater range of Merchants because they have a credit card which provides guarantees – even if the consumer does not know the Merchant. Consumers will buy over the internet. Consumers will buy when an opportunity arises. So, competition <u>between Merchants</u> is heightened by credit cards. So far as credit cards are less useful, less prominently used, that competition will be diminished.

Elzinga Report at page 79.

695. Not only will there be unintended consequences, by way of excessive surcharging and the like, if the Order sought is made. In fact, there are a variety of specifically foreseeable aspects of diminished competition amongst Issuers, amongst Acquirers, amongst Merchants and amongst payment systems which will flow specifically from the order sought. The bigger guys will do better. And, the balance will be thrown off. Unless the goal is to damage and suppress the use of credit cards (in particular, of course, Visa and MasterCard credit cards) the Order being sought does not make sense. It does not benefit competition – it will injure competition.

696. Other more specific examples of all of the various consequences – unintended and negative consequences – likely to flow from the order sought by the Commissioner are set out below.

(i) No Surcharge Rule

697. Based on her understanding of what has happened in other jurisdictions, Ms. Leggett gave evidence that allowing Merchants to surcharge on credit card purchases would likely have the following adverse effects:

- ***Penalize consumers:*** Merchants would be able to impose what is effectively a financial penalty on consumers who pay by credit card.

[redacted]

- ***Likely no drop in retail prices:*** Surcharging would likely not lower retail prices for consumers. To the contrary, it would likely increase them. When the NSR was eliminated in Australia and the United Kingdom, many Merchants began excessive surcharging, effectively using surcharging as a new profit centre for Merchants. Prices went up, not down. There is nothing to indicate that the experience in Canada would be any different if surcharging were allowed here.

- ***Create a new profit centre for Merchants:*** Merchants' cost of credit card acceptance is an ordinary operating cost that they typically have already incorporated into their retail prices. Where this is so, surcharging is therefore not necessary for cost recovery — instead, it will give Merchants a new profit centre to exploit. This has been the experience in other jurisdictions where surcharging has been permitted.

- ***Create confusion at the point of sale and reduce price transparency:*** Cardholders will not know the price of goods and services until after they have presented their credit card to pay the Merchant. Reduced price transparency will make it harder for Cardholders to comparison shop and runs contrary to the Federal Government's overall policy of ensuring that Canadians have more rather than less price transparency.

- ***Unnecessary to promote switching to other payment methods:*** Merchants are already able to steer consumers to particular payment methods by offering discounts for cash, debit, or other payment methods. This was confirmed by the Department of Finance's Code of Conduct. Most Merchants do not discount for cash or debit.

- ***Lessen competition among credit card Issuers:*** If Merchants target particular types of credit cards for surcharging (such as premium cards), this would reduce the consumer demand for those cards. The likely result would be that credit card Issuers would provide fewer credit card products to Canadian consumers, ultimately reducing competition among Issuers and reducing choice for consumers.

Witness Statement of Leggett at para. 6;
Transcript of Examination-in-Chief of Elzinga at page 2735 (public).

698. Surcharging would penalize consumers. It would allow Merchants to charge consumers more when they use their credit cards, even if Merchants' costs of accepting credit cards are already embedded in their retail prices. Surcharging would cause consumers to pay Merchants more when they pay by Visa or MasterCard.

Witness Statement of Leggett at para. 44.

699. One of the Commissioner's economists, Professor Carlton in particular, says excessive surcharging cannot exist because competitive markets will prevent it.

Transcript of Cross-Examination of Carlton at page 1345 (public).

700. Yet, we know that it does exist, and that it is a big problem. Australia and the UK have a big problem with it. In Australia, the average excess surcharge is more than the actual merchant acceptance fee for Visa and MasterCard. The average surcharge is more than twice the acceptance fee, so either Professor Carlton is wrong in his theory, which could be, or the markets are far from perfectly competitive, which we know they are, or – some of each. In any case, excessive surcharging is a real public policy problem in major international jurisdictions, and it is a problem for MasterCard and Visa too. More importantly, it is a problem for consumers.

Transcript of Examination-in-Chief of Leggett at pages 2597-2605 (public).

701. If surcharging were allowed in Canada and Merchants commenced surcharging, there is no reason to believe that the experience in Canada would be any different than the experience in other jurisdictions where surcharging is allowed. In those countries where surcharging is allowed, Merchants have generally not reduced prices to consumers. In fact, the opposite has happened – prices have generally gone up, not down.

Witness Statement of Leggett at para. 45.

702. More recently, the U.K. Office of Fair Trading announced its intention to ban "excessive" surcharges in most retail sectors, including the travel sector. The discount airline EasyJet responded to the government's plan by restructuring and increasing its fees. Before the Office of Fair Trading's announcement, EasyJet imposed a booking fee that was the greater of £12.50 or 2.5% of the cost of the flight on credit card transactions. After the announced ban of "excessive" surcharges, EasyJet announced that all passengers would now pay a £9 "administrative fee" when booking a flight, regardless of the method of payment, plus an extra £4.95 or 2.5% on flights paid for by credit card. The United Kingdom's intended ban of "excessive" surcharges resulted in EasyJet imposing surcharges by another name – it did not result in consumers benefitting by lower prices.

Witness Statement of Leggett at para. 47, Exhibit 0.

703. If surcharging were permitted and Merchants did not disclose the surcharge other than at the point of sale, then consumers would not know the price of goods and services until they reach the point of sale to pay. A Merchant's advertised prices would no longer be the actual prices or the maximum prices. This would create potentially misleading advertised prices and would undermine price transparency. Further, the level of surcharging would likely vary from Merchant to Merchant. This would make it harder for consumers to comparison shop on price, particularly where surcharges are imposed as a percentage of the price.

Witness Statement of Leggett at para. 59.

704. Not surprisingly, Canadian consumers overwhelmingly oppose surcharging: in 2009, the Consumers' Association of Canada found that 90% of Canadians oppose surcharging.

Witness Statement of Leggett at para. 60, Exhibit "HH".

705. Surcharging would very likely reduce competition among credit card Issuers. If, for example, Merchants targeted for surcharging premium cards with higher MDRs, this would likely reduce consumer demand for those credit cards. Reduced consumer demand

[redacted]

for these products would in turn likely reduce competition among Issuers to design credit cards with material benefits and rewards for Cardholders.

Witness Statement of Leggett at para. 65.

706. The Australian experience certainly suggests that allowing surcharging in Canada would likely reduce competition among Issuers, resulting in reduced choice for consumers. When the NSR was eliminated in Australia, Issuers responded by reducing both Cardholder benefits and the range of credit cards products offered to consumers. Australian Issuers now offer less valuable rewards to their Cardholders. Since 2003, Australian Issuers have also increased fees to Cardholders to compensate for lower interchange fees. Accordingly, Cardholders in Australia now experience some or all of surcharging when using their credit cards, fewer credit card benefits and options, and higher card fees.

Witness Statement of Leggett at para. 66, Exhibits MM, NN.

707. Another reason that MasterCard is opposed to surcharging is that they are not particularly happy to be scapegoats for decisions Merchants take to add a surcharge. The Challenged Rules protect the brand from negative – and unfairly negative – reputational impacts. Dr. Elzinga told us this phenomenon had a name – "False Attribution". But, with or without a fancy name, we understand the problem.

Transcript of Examination-in-Chief of Elzinga at pages 2707-2709 (public).

708. Mr. Broughton was a little clearer in his evidence as to what he would do. He would call it a "credit card processing fee" perhaps. As noted, Mr. Shirley of Best Buy said Best Buy would never seek to confuse people but he was not so sure about his competitors. Is it any wonder why this is a legitimate concern for MasterCard and Visa, also? Is it any wonder that they have rules which attempt to protect their brands from being given an unfair negative reputation?

Transcript of Cross-Examination of Broughton at pages 362-363 (public);
Transcript of Cross-Examination of Shirley at page 1653 (public);
Dunn Report, Exhibit "H".

709. Professor Mulvey, the marketing expert, testified that MasterCard's (and Visa's) most valuable assets are their good names. He testified that consumers do not like surcharging – and that it will damage those brands.

Transcript of Examination-in-Chief of Mulvey at pages 3078-3079 (public).

(ii) Honour All Cards Rule

710. Eliminating the HACR could have the following adverse effects:

- ***Undermine the foundation of the credit card networks:*** the HACR, which guarantees the universal acceptance of credit cards (commonly known as "ubiquity"), is fundamental to the efficient and effective operation of a credit card network. Without the confidence and certainty of ubiquity, Cardholders will likely not use credit cards or will do so much less often.

- ***Create dissatisfaction for consumers:*** Honouring some but not all credit cards would cause consumer confusion and dissatisfaction, including foreign travellers who expect to be able to use their foreign-issued credit cards in Canada.

- ***Lessen competition among credit card Issuers:*** Eliminating the HACR would likely lessen competition among credit card Issuers by placing existing smaller Issuers at a competitive disadvantage relative to larger Issuers. This could ultimately lead to fewer choices for Canadian consumers.

Witness Statement of Leggett at para. 8.

711. Eliminating the HACR would harm Issuers and Cardholders and undermine a fundamental premise of the networks – universal acceptance or "ubiquity." The more broadly a payment network is available, the more people will want to use it, and the more efficient the system becomes. Without ubiquitous acceptance, consumers will use credit cards less often, thereby undermining the credit card payment system as a whole.

Witness Statement of Leggett at para. 69.

712. Reduced credit card acceptance would reduce credit card usage and would likely have adverse consequences for Cardholders, Merchants, and the broader Canadian economy. If the electronic payments system becomes less attractive to Canadians, the Canadian economy will ultimately suffer. Reduced credit card acceptance and usage would also likely diminish the payments industry's incentives to fund innovation. Eliminating the HACR would likely lower consumer spending and result in a less efficient and competitive Canadian retail sector.

Witness Statement of Leggett at para. 70.

713. Cardholders must have confidence that their credit card brand will be universally accepted domestically and internationally. The HACR provides this certainty. If Cardholders cannot be sure that their credit card will be accepted by a Merchant who advertises acceptance of their card brand, they will find themselves in the embarrassing position of having their card rejected at the point of sale, and they will be less likely to obtain and use credit cards. Eliminating the HACR would thus likely reduce consumers' choice of payment options.

Witness Statement of Leggett at para. 71.

714. Honouring some but not all cards would also likely cause consumer confusion and dissatisfaction, as it would be misleading for a Merchant to advertise acceptance of either the Visa or the MasterCard brand if that advertisement is only partially true. Four of five Canadians oppose surcharging consumers for using their credit cards.

Witness Statement of Leggett at para. 72;
Mulvey Report at para. 32.

715. The HACR is particularly important in our era of global commerce. When Canadians travel abroad, they expect Merchants to accept their Visa and MasterCard cards issued in Canada. Foreigners expect the same when they visit Canada. Eliminating the HACR would undermine those expectations.

Witness Statement of Leggett at para. 73.

[redacted]

716. Eliminating the HACR may also result in Merchants not accepting cards linked to competitors. For example, Air Canada could refuse to accept an RBC WestJet MasterCard belonging to an RBC customer. It may also be that Merchants may have an exclusive banking arrangement with one of the Canadian big five banks and, as a result, choose not to accept any rival Issuer's credit cards.

> Witness Statement of Leggett at para. 74;
> Transcript of Examination-in-Chief of Livingston at page 2538 (public).

717. Eliminating the HACR would likely lessen competition among credit card Issuers by placing existing smaller Issuers at a competitive disadvantage relative to larger Issuers. In particular, eliminating the HACR has the potential to reduce the capacity of smaller Issuers to promote and invest in product innovation, making it harder for them to compete. This could ultimately lead to fewer choices for Canadian consumers.

> Witness Statement of Leggett at para. 75.

718. Mr. Livingston outlined that if you make it harder, by removing the HACR, for new, innovative Issuers to get in, then you lose that key competitive force, or it is muted. This is a crucial point. It is what MasterCard has been doing for years in Canada. Introducing new, innovative Issuers – Issuers which bring disruptive business models, lower prices, better benefits – and do so based on unusual acceptance and non discriminatory treatment. Mr. Livingston put a face to the point. It is a key issue for the competitiveness of the market. The Commissioner did not even try to consider this negative competitive effect of her Application.

> Witness Statement of Livingston at paras. 30-32;
> Transcript of Examination-in-Chief of Livingston at pages 2535-2539 (public).

719. Eliminating the HACR would likely also impact competition among Merchants. For instance, larger Merchants could negotiate co-brand credit card arrangements with Issuers and thereby negotiate more favourable interchange rates. Larger Merchants could also make deals with certain Issuers whereby those Merchants would agree not to surcharge certain credit cards, or to surcharge certain cards at a lower rate than other Issuers' cards.

[redacted]

This would likely reduce competition among Merchants, to the detriment of smaller Merchants.

Witness Statement of Leggett at para. 76.

720. Credit cards, as a form of electronic payment, are instrumental to Canada's mobile payments platform. The HACR is equally critical to the continued development of mobile payments in Canada. Without widespread Merchant acceptance of credit cards, Issuers would have less incentive to invest in developing mobile payments, which would ultimately harm the Canadian economy.

Witness Statement of Leggett at para. 78.

721. [redacted]

[redacted]

722. Finally, of course, and critically, you heard Professor Winter's evidence – that the HACR is only relevant as it supports the NSR. Without a NSR, he does not worry about the HACR.

Transcript of the Cross-Examination of Winter at page 1957 (public).

(iii) Non-Discrimination Rule

723. MasterCard's NDR does not prevent discounting, steering to other forms of payment or giving points for discounts. The NDR, generally speaking, is designed to prevent Merchants from physically inconveniencing MasterCard Cardholders for using their MasterCard card.

Transcript of Examination-in-Chief of Stanton at page 2452 (public).

[redacted]

724. Signage promoting the use of other payment methods is not in contravention of the NDR. One example of Merchant steering can be found in the Canadian Federation of Independent Business' signage provided to Merchants in a campaign to encourage consumers to use payment types other than credit cards.

Witness Statement of DeVita, Exhibit "G".

725. When asked if he was aware that in Canada the Code of Conduct has essentially dissipated the effect of the NDR as far as things like discounts are concerned, the Commissioner's expert, Professor Carlton, admitted that it is his understanding that discounting is allowed.

Transcript of Cross-Examination of Carlton at pages 1273-1274 (public).

726. There is evidence from MasterCard's witnesses that the NDR is important to them, particularly as a smaller brand. The NDR is not a prohibition on discounting, nor is it a prohibition on steering. The CFIB's campaign materials, which were outlined in Mrs. DeVita's witness statement, were an attempt to steer Merchants away from credit cards. The CFIB asked MasterCard if there was a problem with the campaign, given the NDR. MasterCard told them no, that was not a problem under the Rules.

Witness Statement of Stanton at para. 130;
Witness Statement of DeVita at para. 59, Exhibit "G".

727. So, the NDR does not stop discounting; nor steering. It really prevents disparagement of the brand. It prohibits extreme unfair treatment of MasterCard's customers and MasterCard.

728. The NDR serves a useful protective purpose for MasterCard. It does nothing to prevent discounting or steering if Merchants want to do that. The NDR also does not prevent surcharging, it prevents "back of the lining".

(iv) Competitors, such as American Express, are Free to Employ the Same Rules and Will be Competitively Advantaged by the Order Sought by the Commissioner

729. It is very significant to note that American Express is not a respondent in this proceeding, notwithstanding that American Express is a direct competitor of MasterCard and Visa. It stands to be competitively advantaged to the detriment of MasterCard and Visa should the Commissioner's proposed remedies be granted.

(d) The Code of Conduct for the Credit and Debit Card Industry in Canada Addresses Same Concerns as Those Raised by Commissioner

730. The recently passed Code of Conduct, which followed extensive discussions and input with industry stakeholders, specifically addresses the same concerns that the Application purports to address, such as cost awareness, interchange awareness and differential discounting for different methods of payment. MasterCard and Visa both comply with the Code of Conduct.

> Witness Statement of Stanton at para. 131.

731. In arriving at the Code of Conduct, the Minister of Finance decided not to challenge the HACR or NSR, despite being urged to do so by stakeholders.

> Witness Statement of Stanton at para. 132;
> Transcript of Cross-Examination of Jewer at page 1750 (public).

732. In fact, even industry participants who represent Merchants do not support the relief sought by the Commissioner. According to The Globe & Mail, the Retail Council of Canada's President Diane Brisebois stated, "The Retail Council of Canada does not support surcharging, but wants the payment system regulated. This is another piece of the puzzle, and [the Code] provides the Minister with further evidence of a more robust regulatory framework". Similarly, Mr. Broughton expressed a preference for a "regulated solution" in his evidence before the Panel.

> Witness Statement of Stanton at para. 133, Exhibit "K";
> Transcript of Cross-Examination of Broughton at page 362 (public).

733. There is no doubt that there are regulatory questions about credit cards in the world. Parliament in the UK allowed for surcharging. The Reserve Bank of Australia allowed for surcharging, and regulated interchange as well. France decided not to allow surcharging. Australia and the U.K. are moving to limit surcharging. Again, a regulatory response to a perceived problem.

> *Review of Card Surcharging: A Consultation Document*, Exhibit RM-69;
> Transcript of Cross-Examination of Frankel at page 914 (public);
> Witness Statement of Buse, Exhibit "H".

734. MasterCard does not agree that there is a problem, or that any alleged problem should be dealt with either by regulation or by way of Competition Tribunal Order. We assume that the Merchants will continue to lobby the other way.

735. Mr. Jewer of Sobeys is active in the Retail Council of Canada. He noted that the RCC has been active in lobbying the Government. He candidly admitted that when the Code of Conduct was introduced, which addressed such things as ensuring that discounting was fully permitted; and ensuring that Merchants had full disclosure of interchange rates; and ensuring that if rates changed Merchants could get out of their contracts, the RCC was actively lobbying for it, and actively lobbied for the addition of the very things that the Commissioner is seeking here – that is, the right to dishonour some, but not all, MasterCard cards and the right to surcharge. Indeed, the RCC did not support the Commissioner's proceeding here. It wants regulatory action, not antitrust action.

> Witness Statement of Stanton, Exhibit "K".

(e) The Challenge was Commenced Only Months After the Code of Conduct was Implemented and is Therefore Premature

736. Given that the Code of Conduct was only recently passed, it is strange that the Commissioner has pressed this case forward now. The Code of Conduct works. Consumers do not support the Commissioner's position. Merchants who are interested in reducing their costs, reap great benefits from credit cards under the present rules and in many cases have agreed to promote use of co-branded cards. The Code of Conduct has

[redacted]

been warmly received and so far is working well. This Application is therefore misguided or, at best, premature.

737. The question of regulation, as opposed to some sort of attempt at antitrust intervention, has come up throughout this proceeding. It has come up in questions to the witnesses from the Panel; it has come up in evidence of what happened in Australia and the U.K., which of course was regulation; and it has of course come up as part of the discussion especially leading up to the Code of Conduct for the credit and debit card industry. Indeed, as Mr. Justice Phelan explored with Mrs. DeVita, the discussion is ongoing.

738. For all the reasons asserted herein, this is not an antitrust or competition law problem. It is certainly not a price maintenance problem, but it is not a competition law problem at all. A highly competitive two-sided market exists – continually seeking to achieve competitive equilibrium, continually innovating, and continually improving. Continually more and more attractive to more and more Merchants, and more and more consumers. Sounds like a competitive success story. It is not an antitrust problem, it is a well functioning market.

739. The issue you are exploring, here in the Tribunal, was squarely before the Minister of Finance, and he decided not to order surcharging, and not to allow Merchants to pick and choose among MasterCard cards. We say that was the right decision and we will continue to say that that was the right decision. The point is that it was a Government regulatory decision, it was not and is not – a competition law question.

> Transcript of Examination-in-Chief of Jewer at page 1750 (public);
> Transcript of Cross-Examination of Weiner at page 2320 (public).

740. Further, the Code has not been in force for two years yet. Indeed, some of it was not in force until after the proceeding was launched. Mr. VanDerHoeven told you that it has started to make a difference, but there is more to come. So, in addition to there being a regulatory issue – not an antitrust issue – this case is way, way premature.

> *Code of Conduct*, Exhibit RM-8.

PART IV - CONCLUSION AND ORDER SOUGHT

741. If the Order requested by the Commissioner is granted, MasterCard's competitors, such as American Express and Interac debit, who will not be subject to such Order, will be competitively advantaged. They will not be required to permit surcharging, nor will Merchants be permitted to decline cards related to those networks. While Interac currently permits Merchants to surcharge Interac debit usage, it will not be obligated to continue to do so in the future.

Witness Statement of Stanton at para. 129.

742. Even Visa, who presumably would be subject to the Competition Tribunal's Order, will be competitively advantaged over MasterCard because of its size.

Witness Statement of Stanton at para. 130.

743. Cardholders are opposed to any initiative whereby Merchants would be permitted to add a surcharge to purchases made with a credit card or reject certain forms of payment from customers. The Consumers' Association of Canada also does not support the relief sought by the Commissioner. This Application is also opposed by Acquirers (GPC) and Issuers (CBA and TD).

Witness Statement of Stanton at para. 134.

744. The Challenged Rules do not necessarily affect MasterCard's default interchange rates. If any particular Merchant surcharges MasterCard credit cards or does not honour all cards, it will not necessarily have the effect of lowering Canadian default interchange rates. Eliminating the Challenged Rules will not, in and of itself, have a generalized effect of lowering default interchange rates which are set at a level which is believed to maximize the volume of transactions on MasterCard credit cards. An increase or reduction of the default interchange rate has nothing to do with the level of competition in the payments market (although it will affect MasterCard's competitiveness and efficiency).

Witness Statement of Stanton at paras. 136 and 140.

745. Repeal of the NSR is unlikely to have a meaningful effect on default interchange rates or merchant discount rates but, to the extent that surcharges occur, Cardholders and the usefulness of MasterCard credit cards will be injured and Cardholders will be diverted to American Express and other forms of payment.

Witness Statement of Stanton at para. 137.

746. Repeal of the HACR could fundamentally undermine the MasterCard network; thwart small brands and small Issuers; and injure Cardholders. Without this Rule, Cardholders cannot have confidence that their card will be accepted. Even if very few Merchants actually fail to honour all cards, once it is known that they may not honour all cards, some confidence in the network is lost. If dishonoring cards becomes common, the situation is even worse. This would undermine the effectiveness of MasterCard as a payment device and result in diversion of Cardholders to American Express and other forms of payment.

Witness Statement of Stanton at para. 139.

747. The NDR is important to MasterCard in light of its market position vis-à-vis Visa as a smaller brand of general purpose credit card in Canada. Repeal of the NDR will permit disparagement of the MasterCard brand and unfairly discriminate against MasterCard as the smaller of the two four-party networks now operating in Canada.

748. If the Challenged Rules are eliminated, to the extent that Merchant leverage is increased (a position seemingly advocated by the Commissioner) it will disproportionately advantage large Merchants over small ones. Absent the Challenged Rules, large Merchants will be in a better position to bargain than small Merchants, who will thereby be relatively prejudiced.

Witness Statement of Stanton at para. 141.

749. The remedy sought by the Commissioner would, if it works the way the Commissioner envisions, decrease the efficiency, competitiveness and value to Cardholders of the MasterCard network. It would result in both uncertainty about acceptance and confusion about prices among Cardholders, which would undermine two core brand promises of MasterCard credit cards and would harm the welfare of consumers whose credit cards would no longer be as convenient or reliable as they were before.

Witness Statement of Stanton at para. 142.

750. The Application will not further the objectives of the *Competition Act*. The remedies sought will not assist small and mid-sized enterprises in participating in the Canadian economy and will not result in more competitive prices or product choices. If anything, the remedies sought will harm consumers and Merchants, create imbalances in the credit card networks and decrease competition in the applicable market.

751. For all of the foregoing reasons, MasterCard therefore requests that this Application be dismissed, with costs.

ALL OF WHICH IS RESPECTFULLY SUBMITTED BY

McMillan LLP,
of Counsel for MasterCard International Incorporated

June 20, 2012

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*;

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

B E T W E E N:

THE COMMISSIONER OF COMPETITION

Applicant

- and -

VISA CANADA CORPORATION and
MASTERCARD INTERNATIONAL INCORPORATED

Respondents

- and -

THE TORONTO-DOMINION BANK
THE CANADIAN BANKERS ASSOCIATION

Intervenors

APPENDIX "A" TO CLOSING ARGUMENT OF MASTERCARD

BRIEF SUBMISSIONS OF MASTERCARD INTERNATIONAL INCORPORATED IN RESPONSE TO SUBMISSIONS OF COMMISSIONER OF COMPETITION

McMILLAN LLP
Brookfield Place
181 Bay Street, Suite 4400
Toronto, Ontario M5J 2T3

Tel: (416) 865-7000
Fax: (416) 865-7048

Jeffrey B. Simpson
David W. Kent
James B. Musgrove

Counsel to MasterCard International Incorporated

INDEX

A. NO BAD DOCUMENTS

The Commissioner's argument, unlike virtually all cases before the Tribunal in the past, does not depend on even a single document which is credibly alleged by the Commissioner to establish anti-competitive intent or motive.

1. Nowhere – in any document or statement – despite the tens of thousands of documents produced by MasterCard and Visa, has the Commissioner been able to point out <u>a single</u> document suggesting exclusionary or anti-competitive effect or intent or flowing from, or desired to be achieved by, the Rules in issue. That is because there is no such document—no such intent, and no such effect.

2. Nowhere, in the tens of thousands of documents produced, is there a single document that suggests an attempt, or desire, to maintain the prices set by acquirers. None. Because there are no such documents, attempts or desires.

3. Nowhere, in the tens of thousands of documents produced, is there a single document which reflects the Commissioner's theory (Dr. Frankel's complex theory), that the Rules are designed to, or have the effect of, injuring competition.

4. No one, except the Commissioner's creative economists, ever imagined that the Rules were designed to reduce competition.

5. There are lots of documents which talk about balancing the system. But, there are no documents which reflect the Commissioner's theory. Because no one, other than the Commissioner and her Experts, has ever thought that was what the Rules were about.

6. Dr. Winter said that he doesn't much care about that – he doesn't care about intent – just effects.

> **"MR. HOFLEY:** So I was struck by the words, "The Merchant Rules are structured so as to eliminate competitive discipline..."
>
> There is no citation here to any kind of Visa or MasterCard documents which indicate that they're structured. By using the word "structured" here, were you alleging that there was an objective of these rules to reduce competitive discipline?

> **DR. WINTER:** Not at all. As an economist, in contrast to lawyers, I pay not very much attention to intent. My focus is entirely on the effects of business practice. It is the effects of the rules in this case. I intended to mean that the rules have the effect of eliminating or substantially reducing the important sources of competitive discipline. Whether they were structured that way with an intent, or whether that is an outcome and there was no conscious intent to increase prices, is just outside of my focus entirely. As an economist, I am focused on the effects of rules.
>
> Transcript of Cross-Examination of Winter, pages 1960-1961 (public)

7. In fact, Dr. Winter's lack of interest in intent may not conform to the legal requirements for price maintenance, which has been found to require that the conduct in issue be undertaken "for anti-competitive purposes".[1]

8. Whether or not anti-competitive intent is required, however, the lack of such documents is relevant more than intent. It is relevant to the <u>effect</u> of the Rules as well. If the Rules actually had the anti-competitive effect the Commissioner posits, the Respondents would, presumably, be aware of that. The lack of these documents is not just evidence of no evil <u>intent</u> – it is positive evidence that the Respondents themselves have not noticed the alleged anti-competitive <u>effect</u> of the rules. Dr. Winter agrees that <u>effect</u> matters. This lack of documents noting any anti-competition <u>effect</u> is a remarkably interesting dog that did not bark. The systems themselves, MasterCard and Visa, the very people you would think be <u>most</u> attuned to the alleged anti-competitive advantages of the Rules, did not merely not <u>intend</u> such advantages, they never <u>noticed</u> them. Maybe that is because they do not exist.

[1] *Fairview Donut Inc. v. TDL Group,* 2012 ONSC 1252, para. 601 [*Fairview Donut*]

B. <u>DISCOUNTING IS AN AVAILABLE OPTION</u>

The issue of discounting is important to the case. If discounting is an available option, any Order respecting surcharging is inappropriate.

9. Some of the Merchants who gave evidence said that they cannot discount because it would be very complex to figure out how to gross the prices up so as to discount down for cash.

> Transcript of Examination-in-Chief of Broughton, page 344-345 (public)
> Messers Houle, Shirley, Daigle, Symons and Jewer had similar comments

10. But of course, it is exactly the same exercise in reverse—how much do you reduce the price and then surcharge off of that – if you surcharge. We did not hear much of a complaint about the difficulty of <u>that</u> calculation from the Merchants. Perhaps because they have no intention of lowering their prices, despite the stated theory. It is a pretty simple calculation when you do not do it. They are not going to lower their prices; they are just going to surcharge. Some of the Merchants were cagey about it, but not all of them.

11. The Experts were unanimous – mathematically discounting and surcharging are the same.

> Transcript of Cross-Examination of Frankel, pages 1042-1043 (public)
> Transcript of Cross-Examination of Carlton, pages 1325-1326 (public)

12. Mr. Broughton said, pretty candidly, when Mr. Justice Phelan asked him if he would knock fifty cents off the menu, he said, in essence, ‘probably not’. [redacted]

> Question from the Panel for Broughton, page 375 (public)
> [redacted]

13. Some of the other retailers suggest that <u>of course</u> they would lower prices, but the fact is that they are allegedly worried about the complexity of calculations to allow cash discounts, but not very worried about the reverse complexities with surcharging – which of course is exactly the same, but in reverse. That suggests that they do not plan to cut prices. The Commissioner has regularly cautioned us about self-serving statements.

14. And of course, as MasterCard noted when the case commenced, the Consumers' Association of Canada isn't holding its breath as to Merchants cutting prices if they surcharge.

> Witness Statement of Buse, page 80 and 86
> Witness Statement of Sheedy, page 1713
> Witness Statement of Stanton, para. 134, Exhibit "L"

15. But, the question is, can Merchants want to discount; the question is can Merchants practically discount? They say it is tough. We heard something about this on the cross-examination of Dr. Frankel. It was tough-going – he was not a pushover.

16. Dr. Frankel, if you recall, had a habit of quoting folks who said surcharging might change behaviour, but not referring to the cash discounts side of what people had said. He does not believe discounting works. But, ultimately, he admitted a couple of things. He admitted that cash discounts were mathematically the same as surcharging – so did Dr. Carlton. He admitted that if cash discounts were practical, all of his concerns about the case go away. So did Dr. Winter. Those are big admissions. They are fundamental. If Merchants can effectively discount – not if they want to, but if they can – there is no case at all.

> **Winter**
>
> "If discounting at the Merchant level were as effective a means of pricing differentially across transactions as surcharging, then those threats would be just as powerful as the threat to surcharge a higher-priced card."
>
> **Carlton**
>
> "If discounting and surcharging were equivalent in everybody's mind, we would not be having this proceeding."

Transcript of Cross-Examination of Frankel, pages 1042-1043 (public)
Transcript of Cross-Examination of Carlton, pages 1325-1326 and 1267(public)
Transcript of Cross-Examination of Winter, page 2051 (public)

17. We know from the Merchant witnesses that at least large Merchants do not like cash discounts. Mr. Kwinter, in cross examination of Dr. Frankel, suggested that they probably do not like them because they figure they will cost them money. A surcharge is money in the pocket – a discount is money out the door. But, on the other hand, we know that Merchants do discount, even though they say that they do not.

Transcript of Cross-Examination of Frankel, page 1008 (public)

18. We know that Shoppers Drug Mart has its Optimum discount cards. It is the biggest, most successful discount program in the country. Mr. Daigle says they will not use it to discount for cash or debit or something else. But they sure could. The program actually does give extra points for use of credit cards. You get more points for using your credit card and your Optimum card than if you use cash. Shoppers Drug Mart could set it up the other way to give more points for cash or debit if they wanted to. They may choose not to – but they sure could.

Transcript of Cross-Examination of Daigle, page 405 and 408 (public)

19. The same applies to WestJet and its credit card.

Transcript of Cross-Examination of Li, page 1544 (public)

20. Best Buy gives discount points. They could do so for payment with cash or Interac – but they choose not to. They choose, instead, to give extra points for use of the Best Buy affinity credit card. The exact the same – the exact same – is true for Sobey's.

[redacted]
Transcript of Cross-Examination-in-Chief of Shirley, pages 1648-1651 (public)

21. These Merchants are the witnesses the Commissioner chose to call. These Merchants could use their programs to discount for cash, rather than for use of credit cards – if they wanted to – but they choose not to. Maybe they choose not to because, despite their

protestations, they know credit cards are a good deal for them. Maybe they have a sense of the cost of cash to them – so are in no hurry to discount for cash. They are happy to be paid by credit card. They would not mind taking a surcharge when they can, but most of them do not see much advantage in a discount for cash. We do not know – but what we do know is that they could discount for cash if they wanted to.

22. Professor Mulvey – the only marketing expert called by anyone in this case – said that this idea that one cannot discount for cash is not to be taken seriously. Merchants do it all the time, in all sorts of ways.

Transcript of Cross-Examination of Mulvey, page 3207 (public)

23. At paragraph 515 of her closing submissions, the Commissioner attacks Professor Mulvey for suggesting that the Commissioner's hand-picked witness's evidence, that discounting would be problematic was "bogus". While the Commissioner may prefer more refined language, when large, sophisticated Merchants who run complex discounting programs which give points for use of credit cards but not for use of cash or debit, and when they say they cannot discount for cash that is, if not "bogus", is at least "odd".

24. Having made no objection to the qualification of Professor Mulvey as an expert witness when he was introduced, the Commissioner now seeks to impugn his impartiality because he described some of the Commissioner's witnesses' evidence that "they could only charge the single lowest price" as "bogus". Professor Mulvey went on to explain, in a lengthy answer, that "pricing is a very creative area, and having the lowest price, yes, it is a strategy employed by some Merchants, but it is not the only way. They use different pricing mechanisms as a basis to have competitive advantage." In essence, then, the Commissioner attacks the impartiality of an expert witness (who has signed an affirmation of objectivity) simply because he has exercised his expert judgement and experience to strongly disagree with the Commissioner's selected Merchants, each of whom (unlike Professor Mulvey) has a stake in the outcome and none of whom has promised to be impartial. Cutting through self-serving anecdotal testimony is precisely

why expert evidence is so important – the Commissioner's manoeuvre to suppress it must be rejected.

Commissioner's Argument, para 515
Re-Examination of Mulvey, page 3275 (public)
Re-Examination of Mulvey, pages 3275-3277 (public)

25. Perhaps because Professor Mulvey's evidence was so powerful, and was uncontradicted, the Commissioner has attacked him aggressively. At paragraph 506 of the Commissioner's written argument, Professor Mulvey is attacked because he did not see a VISA Australia/New Zealand document. A document which appeared to show precisely nothing, since all it says is that Visa is performing "strongly" against "key health measures" – but we do not have any idea what that means. Further, surcharging in New Zealand is not meaningful, and in Australia is mostly found against American Express (note – a situation which would not be possible in Canada under the Commissioner's desired outcome, given that American Express is not a Respondent).

26. The Commissioner has submitted that the Tribunal should prefer the evidence of her selected Merchant witnesses, saying that they cannot offer discount for a form of payment, to the evidence of an expert who says that Merchants can offer cash discounts. That submission urges you to take anecdotes as persuasive evidence, and to take self serving statements, which the Commissioner cautions against in other contexts, over the common-sense evidence of discounting which we all observe around us. It also would require you to accept the evidence of Merchants who now actually do discount for a method of payment, saying that they cannot discount for a method of payment.

27. The Commissioner also attacks the Gauthier Survey, in part relying on the testimony of Mr. Kemp. However, Mr. Kemp's criticisms were either inapt, unsubstantiated or actually demonstrated to be wrong.

(a) Mr. Kemp was keen to apply inappropriately complicated survey tools, better suited to the complex willingness to pay decisions relating to public goods with which he was more familiar, to the relatively simple payment option decision that was being assessed here. Mr. Gauthier considered, and rejected, the more complex tools as being unnecessary.

(b) Moreover, his concern about hypothetical bias overstating results might (or might not) have been interesting in a survey with binary response options but was misplaced in the Gauthier survey with its multiple options – as Mr. Gauthier said, "Kemp says this approach overstates but overstates what? Tendency to keep paying by card, to switch, to walk"?

(c) Mr. Kemp also complained that respondents may have been confused, and that Mr. Gauthier could have conducted focus groups before conducting his survey. However he ignored the fact that Mr. Gauthier beta-tested his survey at the beginning. And Mr. Kemp's complaint is entirely undercut by the fact that he did nothing to test his hypothesis – if respondents were truly confused by the questionnaire (which was not borne out by the beta testing), he should have been able to determine this by conducting the qualitative research that he criticized Mr. Gauthier for failing to conduct. He chose not to.

(d) Finally, Mr. Kemp worried theoretically about ordering effects. But he had all of Mr. Gauthier's data, which permitted him to test for real effects. He did not do so. Mr. Gauthier did. It turns out that the hypothesized ordering effects were a mirage.

Commissioner's Argument, paras. 529-536
See, for example, Kemp, *Summary of Expert Report*, Exhibit CA-112, page 7
Gauthier *Summary of Expert Report*, Exhibit RV-499, p. 10; Gauthier transcript, pp. 3028-29 (public)
Gauthier *Summary of Expert Report*, Exhibit RV-499, p. 9; Gauthier transcript, p. 3027 (public)
Gauthier *Summary of Expert Report*, Exhibit RV-499, p. 14 and Gauthier transcript, p. 3035 (public)
Gauthier *Summary of Expert Report*, Exhibit RV-499, pp. 11-12 and Gauthier transcript, pp. 3031-33 (public)

28. The Commissioner goes on to criticize the Gauthier survey for failing to insert an endless number of highly particularized assumptions including, apparently, a scenario that asked "Do you mind paying a higher price to help cover the cost of your boss' free flight to

Bermuda". The Commissioner's flip example illustrates the specious nature of its complaint. The relief sought by the Commissioner is open and unconditional, and there was no consistent evidence from the Merchants that they would raise or lower prices in any consistent way, or at all, before surcharging or discounting. The payment mechanism choices offered respondents were simple. It would have been an error to begin importing endless (and potentially groundless) assumptions into the questions.

Commissioner's Argument, para. 532

29. Finally, the Commissioner asserts that the Gauthier Survey results showing potential walk-out rates of 34%-46% are "inconsistent" with Australian results. The Commissioner's assertions are misplaced. First, she relies on Mr. Kemp who describes the RBA as having reported that "30% of Merchants in Australia apply surcharges to some or all purchases made using credit cards." [**emphasis added**] But Mr. Kemp makes a critical error: the RBA actually reported that "30 per cent of Merchants imposed a surcharge on at least one of the credit cards they accepted".[**emphasis added**] In other words, Australian cardholders are not faced with surcharges at a Merchant that selectively surcharges a card they do not carry or use. Second, she ignores the differences between the Gauthier Survey and the Australian research. As pointed out by Professor Mulvey, the RBA's findings were based on transaction diaries that necessarily fail to capture transactions that were never attempted. Finally, the Commissioner completely ignores the *actual* findings reported by the RBA:

> Across the scenarios, the results suggest that around half of consumers that hold a credit card will seek to avoid paying a surcharge by either using a different payment method that does not attract a surcharge (debit card or cash) or going to another store. [**emphasis added**]

Commissioner's Argument, para. 534
Commissioner's Argument, para. 534
Reserve Bank of Australia, *Review of Card Surcharging: A Consultation Document* (June 2011), Exhibit RM-69, p. 2
Mulvey Transcript, pp. 3273-74 (public)
[redacted]

30. [redacted] Professor Mulvey also gave lots of examples with products being advertised with multiple prices. [redacted]

[redacted]
Transcript of Examination-in-Chief of Mulvey, page 3076 (public)

31. Visa and MasterCard are also a bit concerned about retailers who might be less honest than Mr. Shirley, too. We heard evidence as to why that might be so. Even without such games by Merchants, consumers are likely to be confused as to who is responsible for surcharging.

See Report, Expert Report of Dunn, Exhibit "H", page 56/PDF179 para. 108

32. On the discounting point, we also had one little key, throw away piece of evidence. That is the funny thing about trials, you never know, and you should have planned differently and called more evidence on this and that, but that is how it is. We did have one little throw away piece of evidence which reminded us of that icon of Canadian retailing, Canadian Tire. Mr. Daigle said that Canadian Tire does cash discounts. And of course, we know that. We all know about Canadian Tire money – that little Scottish guy on the money. They give it out for payment with cash. They have done it for years and years.

Transcript of Cross-Examination of Daigle, page 425 (public)

33. Canadian Tire must have figured out the impossible trick of pricing their goods in a way that allows for cash discounting – a trick that none of these other retailers could figure

out. They are not a mom and pop. A lot of mom and pop's do cash discounts all the time as we know. But there is an iconic Canadian example of widespread, full-fledged cash discounting. It is just silly to say Merchants can't discount. They may not want to, but they sure can.

34. [redacted]

[redacted]

35. There is no doubt that Merchants can offer cash or debit discounts. Any particular Merchant might not want to – it is up to them – but they can. It is an option. Cash discounting works – Canadian Tire works. According to Dr. Carlton; according to Dr. Winter, throw the case out.

C. THERE IS NO EVIDENCE THAT SURCHARGING LOWERS INTERCHANGE

The Commissioner's case theory turns on Merchants being able to surcharge or refuse cards - or threaten to do so, credibly - resulting in MasterCard and Visa lowering their interchange or network fees.

36. The Commissioner's theory is not that Merchants should be able to surcharge to recoup their costs. That is what Merchants want to do – in fact we say that some of them want to do <u>more</u> than just recoup their costs. But that is not the Commissioner's theory. The Commissioner's theory is that surcharging is pro-competitive because it will require MasterCard and Visa to lower interchange.

37. As support for this, the Commissioner put in evidence of various documents – prepared by experts for MasterCard in various jurisdictions – saying that surcharging <u>or discounting</u> – could put pressure on interchange.

38. MasterCard does not deny, before this Tribunal or anywhere else, that if surcharging were allowed, and if it were meaningful and widespread in a way that was likely to damage MasterCard, or there was a <u>credible</u> threat of that, MasterCard would have to think what to do about that. One of the things it might do is lower interchange.

39. [redacted]

40. [redacted]

[redacted]

[redacted]

41. [redacted]

[redacted]

[redacted]

[redacted]

[redacted]

42. MasterCard commends both of these documents to your careful reading. They are very nice expositions on some of the very issues that the Tribunal here is struggling with. They are compelling.

[redacted]

43. [redacted]

[redacted]

44. [redacted]

[redacted]

45. MasterCard does not agree that lowering interchange has anything to do with improving competition or competitiveness – just the opposite – for all the reasons discussed elsewhere. But, one of the things MasterCard <u>might</u> do, in the face of that <u>credible</u> threat, or fact, of widespread surcharging, would be to lower interchange. It would certainly have to think about it. Of course, Mr. Sheedy of Visa made the useful observation that, if a Merchant decides to surcharge – say even at 2% – there isn't enough interchange you could possibly cut to compensate for that – but leave that point for a moment.

Transcript of Examination-in-Chief of Sheedy, pages 2177-2178 (public)
[redacted]

46. During his examination, Mr. Stanton said that if the threat of surcharging were credible, such that MasterCard thought it could be injured by it, that "one scenario" was to reduce interchange. He noted, however, that another scenario would be to stand firm on interchange; and a third scenario would be to increase interchange to compensate the

[redacted]

47. So, MasterCard – and Visa – say that yes – at some extreme – if the big important Merchants were credibly going to surcharge at significantly high levels, and it was widespread, they would have to think about what to do. What they would do might involve lowering interchange; it might, however, involve raising it to keep the cardholders happier. It might not be either. They would have to think about it. There is nothing surprising about that. That's really the best evidence the Commissioner has. MasterCard and Visa would have to think about it – if there were a credible threat of wide-spread surcharging.

Transcript of Examination-in-Chief of Sheedy, page 2177 (public)
Witness Statement of Stanton, para. 136
Church Report, para. 49 and 55-56

48. These theories about what MasterCard might do, however enlightening, the really interesting point to note here – the factual point – is that MasterCard has not had to cross the bridge – to decide if it will raise interchange, or lower interchange, in the face of surcharging. It hasn't had to cross that bridge because even where surcharging has been mandated for long periods of time, the alleged "pressure" did not lead to that.

49. [redacted]

lowered interchange in the UK? Did the Commissioner call any evidence to that effect? No, she did not. Similarly for places like Sweden or Switzerland, she called no evidence.

> **Which? Super Complaint** - Dunn Exhibit "H" page 28 (PDF page 151)
> Symons Report, para. 60
> [redacted]
> Transcript of Examination-in-Chief of Dunn, pages 3456-3457 (public)

50. In Australia the Commissioner called evidence to suggest that a few Merchants negotiated lower interchange with Visa or MasterCard. The Commissioner says this is as a result of threatening surcharge. It is difficult to tell of course, when there are a number of moving pieces to the puzzle of the negotiation.

51. [redacted]

> [redacted]

> [redacted]

52. [redacted]

[redacted]

[redacted]

D. AUSTRALIA

The Tribunal was presented with a considerable amount of evidence and argument about Australia. Much of it is referred to elsewhere but we're here to try to pull it together.

53. The evidence was pretty clear on a number of things:

(a) Interchange rates for Visa and MasterCard are capped at 50 base points;

Transcript of Examination-in-Chief of McCormack, pages 593-594 (public)

(b) Surcharging has been allowed for almost a decade;

Transcript of Cross-Examination of Buse, page 2141 (public)
[redacted]

(c) Despite surcharging being allowed, interchange is at the cap for MasterCard and Visa. That is, it hasn't been pushed below the cap by surcharging;

Transcript of Cross Examination of Carlton, page 1367 (public)
Transcript of Cross-Examination of Frankel, page 1179 (public)
[redacted]

(d) Surcharging was relatively slow to start. Now about 30% or so of Merchants surcharge. Only 5% of transactions are surcharged;

Transcript of Cross Examination of Frankel, pages 1181-1182 (public)

(e) There has been surcharging on average at a rate of twice or more the Merchant discount;

Transcript of Examination-in-Chief of Leggett, pages 2646-2647 (public)
Exhibit RM-69

(f) This has become a public policy problem with significant over surcharging – certainly 5% is common;

Transcript of Examination-in-Chief of Leggett, page 2600 (public)

(g) The largest Merchants are the mostly likely to surcharge;

Transcript of Examination-in-Chief of Buse, page 2114 (public)
Witness Statement of Buse, para. 18

(h) Online Merchants are more likely to surcharge than normal client Merchants;

Witness Statement of Buse, para. 19
Transcript of Examination-in-Chief of Leggett, page 2602 (public)

(i) The RBA now considering capping surcharges.

Transcript of Examination-in-Chief of Leggett, pages 2650-2651 (public)
Exhibit RM-69
Transcript of Cross-Examination of Buse, pages 625-626 (public)

(j) Surcharging tends to be at a flat rate for all cards or a rate for Visa and MasterCard and a higher rate for Amex cards – there is no differential surcharge by card type or issuer;

Transcript of Examination-in-Chief of Leggett, page 2651 (public)
Transcript of Examination-in-Chief of Buse, page 2115 (public)

(k) American Express market share has grown faster than Visa or MasterCard since the regulation came in;

Transcript of Examination-in-Chief of Dunn, pages 3461-3462 (public)
Exhibit RM-522
Transcript of Examination-in-Chief of Leggett, 2597-2605 (public)
[redacted]

(l) Consumer card fees have increased since the reforms;

Transcript of Examination-in-Chief of Dunn, pages 3461-3462 (public)
Exhibit RM-522
Transcript of Examination-in-Chief of Leggett, pages 2597-2605 (public)
Transcript of Cross-Examination of Carlton, pages 1339-1340 (public)

(m) Consumer card rewards have decreased since the reforms;

Transcript of Examination-in-Chief of Dunn, pages 3461-3462 (public)
Exhibit RM-522

Transcript of Examination-in-Chief of Buse, pages 2112-2113 (public)
Transcript of Examination-in-Chief of Leggett, pages 2603-2604 (public)

(n) No one has been able to show that retail prices are lower than they would have been absent the regulation.

54. All of those facts are objectively proven. The most overwhelmingly powerful fact is that surcharging has not moved interchange rates lower than the cap, but the other facts also undermine the Commissioner's theory of the case.

55. Other things are proven and which the Commissioner would wish to note:

(a) the RBA believes that allow surcharging has or will lower retail prices;

(b) the RBA believes surcharging allows Merchants to send appropriate price signals;

(c) the RBA believes that the reforms were appropriate and should be continued, subject to the question of capping surcharges;

(d) there is growth in Australia for both Visa and MasterCard – but as noted, not as rapid growth as Amex.

56. The points which favour the Respondents are overwhelmingly factual. They are unambiguous. Much of what is on the Commissioner's side of the tally are the opinions and beliefs of the RBA as to the wisdom of their reforms and what they say and they have or will eventually do without the facts. Mr. Ackman in cross-examination, kept wanting to take witnesses to portions of RBA reports that expressed the RBA's opinion. Mr. Thompson did the same in cross-examination of Mr. Dunn with respect to OFT documents, and asked him to read the opinions of OFT.

57. There was no witness for the RBA. The RBA's written views may be noted, but nothing more. There is no means to test them by cross-examination. The facts suggest that the Australian experiment looks like an abject failure.

E. EXCESSIVE SURCHARGING

Excessive surcharging is a real problem which, the Commissioner's experts opine, should not exist.

58. There is a dispute as to whether excessive surcharging by Merchants is a potential problem or not. The Commissioner's economists, Dr. Carlton in particular, say it cannot exist because competitive markets will prevent it.

Transcript of Questions from the Tribunal to Carlton, pages 1339-1341 and 1425 (public)

59. [redacted]

[redacted]

60. [redacted]

[redacted]

[redacted]

61. This phenomenon also tells us that there is something fundamentally wrong with the Commissioner's theory, as articulated by her experts. Because, according to their theories, one will not see excess surcharging, and one will not see surcharging in online environments or where credit cards are the predominant method of payment – but that is exactly what the evidence shows. The Commissioner's theory is that surcharging will be useful to steer – to send price signals. It won't be a profit centre. It won't be used to extract money from consumers. Yet, the evidence shows just the opposite. The robustness of the Commissioner's theory, and the wisdom of acting upon it, is fundamentally undermined by the evidence from jurisdictions that allow surcharging by Merchants.

F. ALLEGED "PERVERSE" COMPETION

Mr. Thomson, both in his opening submissions, and his closing submissions, referred to competition for issuers and cardholders as "perverse" competition. It is only perverse competition if you have an inaccurate view of the marketplace.

62. It is undisputed that one of the many ways in which MasterCard, and Visa, compete with one another, and with other methods of payment, is by seeking to ensure that consumers want to use their cards.

63. We say, in fact, that that is where the most acute competition is, because cardholders – consumers are very elastic in their demand for payment services. Merchants are hungry for transactions; consumers have lots of options to choose from.

64. You have to entice consumers, amongst other things, with cardholder benefits; for issuers to offer cardholder benefits, the cardholders have to be valuable to the issuers. That brings us to Interchange.

65. The only basis on which competition for cardholders and Issuers could be argued to be "perverse" is if you do not see that the market is two sided. If you do not realize that you are competing for Issuers and cardholders then you may think that raising Interchange is the same as raising price. If you recognize that Interchange transfers value and balances the system, then it is not a price at all.

66. That is why characterizing competition for Issuers and cardholders – which, amongst other things, may cause Interchange rates to rise – is only "perverse" if your view of the market is mistaken. If you correctly understand that it is a two sided market, it is not only not perverse, it is perfectly sensible, predictable and indeed as Mr. Thomson himself pointed out, inevitable.

67. Mr. Thomson said it was inevitable in relation to the letter from Competition Bureau approving the move to duality. That letter specifically contemplated increased competition to benefit cardholders.

> "By allowing banks to issue multiple credit cards, consumers will benefit from increased choice and better service."
>
> Exhibit RM-446

68. The Competition Bureau in fact, as we see from this letter, clearly does understand the nature of competition in this marketplace - or at least did in 2008. As Mr. Thomson himself pointed out on the opening day of final argument it was perfectly predictable, indeed inevitable, that as the card companies honed their competition for issuers or parts of issuers' business they would make more attractive offers.

69. Card companies always had to make attractive offers to Issuers in order to balance the system. With the added pressure of day to day competition <u>within</u> various issuers who are issuing both Visa cards and MasterCard cards, the competition is still more acute, but that is not perverse. That is the exact competition the Competition Bureau sought, when it changed its view on duality in 2008. It is aggressive, effective competition, and it benefits consumers.

G. CREDIT CARDS ARE ECONOMICALLY POSITIVE

There was a suggestion during the proceeding that the profitable operation of the credit card systems is not socially beneficial. This is neither relevant, nor accurate.

70. From time to time in the course of this proceeding there has been something a little odd, in that the Commissioner's counsel has taken the witnesses – whether the witnesses for MasterCard and Visa, or various bank witnesses – to their annual reports to illustrate for the Tribunal how many billions of dollars of these entities earned. This is odd for a hearing of this nature before an economically literate Tribunal.

71. MasterCard for its part makes no apology for being a successful, profitable business. It makes no apology for competing aggressively and effectively to succeed. It makes no apology for innovating and making consumers, and Merchants, attractive offers. For introducing PayPass – the first contactless application in Canada. It makes no apology for bringing chip cards to Canada so as to reduce fraud losses, long before they came to the United States. MasterCard makes no apology for competing aggressively and successfully to introduce new innovative, scrappy and highly competitive issuers – President's Choice Bank, Canadian Tire Bank, CapitalOne. It makes no apology for succeeding in those efforts.

72. Nor does MasterCard make an apology for winning over new Merchants, or new categories of Merchants, to accept its cards. It makes no apology for opening up Tim Hortons, for example, to credit card acceptance. Tim Hortons would not have done so if it did not think if it was in its own best interest – and MasterCard convinced Tim Hortons that accepting credit cards was in Tim Hortons' interest.

73. MasterCard was surprised that the Commissioner was somehow trying to create an impression that being successful was a bad thing. Being successful is what drives competitive dynamic. In the words of a famous American case:

> "It is the possibility of success in the marketplace, attributable to superior performance, that provides the incentives on which the proper functioning of our competitive economy rests."[2]

74. There has also been some undertone of suspicion about credit cards generally in these proceedings. Suggestions that they are somehow a less appropriate means of payment than cash and debit.

75. It is undeniably true that some people borrow too much on their credit cards and get themselves into trouble. It is undeniably true that people got themselves into trouble by spending too much long before credit cards existed.[3]

76. It is also a fact that there is evidence before this Tribunal that, relatively speaking, Canadians are very good about this. In the United States most people don't pay off their balances every month. In Canada 65 to 70% of people do.

Transcript of Examination-in-Chief of Jairam, page 3358 (public)

77. It's also a fact that credit cards have been a great innovation – making people's lives more convenient. People carry less cash. People are able to smooth out their spending and not worry about whether the money is actually in the bank account this month. Merchants can make sales; consumers can enjoy goods – not put them on lay away. But it has been a particularly valuable innovation, not for the rich, but for those with somewhat less money – because they are the ones who really need that line of credit and really be able to smooth things out when they want to make a big purchase. Mr. Jairam specifically talked about this, as you will recall, pointing out that depriving these people of the benefits of credit cards would be particularly harsh.

> "[C]redit cards offer the way to streamline that kind of cash flow impacts. This is most relevant to the less affluent consumers who actually use that feature of credit cards, and some of them do have to then tap into the ability to defer payments and, therefore, pay on balances, as well.

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[2] *Berkey Photo, Inc. v. Eastman Kodak Company*, 603 F.2d (2^{nd} Cir., 1979)

[3] Dickens, C. Bleak House, *passim*

> Once surcharging is introduced and it becomes excessive, you would find the more affluent consumers being able to settle their balances or maybe use debit or use other payment instruments, but there could be less affluent segments which are really dependent on the cards to ease out cash flows who either have to bear these additional costs, or I guess, just have to stop making those purchases."
>
> Transcript of Examination-in-Chief of Jairam, pages 3357-3359 (public)

78. People can be personally irresponsible about finances, or about other aspects of their lives, with or without the credit cards – but credit cards have been a fantastic innovation, and particularly useful for those with modest incomes.

79. Finally, MasterCard notes that it is not just the credit card companies or the banks that are successful. The Merchants are, also wildly successful businesses. Walmart is bigger than <u>any</u> of the banks that appeared in this proceeding. There is nothing wrong with that either, and MasterCard is not seeking to suggest there is. That is how our system works. Profit, and the pursuit of it, enriches us all.

H. <u>CARDS ALLEGED TO BE UPGRADED WITHOUT ENHANCED REWARDS</u>

The Commissioner has alleged that the transition of cards to Premium Cards occurred without additional benefits. Both the basis for such an allegation and its relevance are unclear.

80. In the course of the hearing, and in her argument, the Commissioner sought to make much of the fact that MasterCard – when it introduced premium cards – allowed its Issuers, if they wished, and if they had an appropriate program, to give those cardholders who qualified for a premium card (by way of their spending on the card on an income) a premium card without the card being reissued and rebranded. She noted that the cardholder may not, in fact, have known of this. She makes much of this, suggesting that there is some impropriety. *There is none.*

81. The Commissioner suggests that both Merchants and cardholders got nothing more for using or accepting these cards. The nominal relevance of this point is, presumably, that <u>if</u> cardholders did not get more rewards, and did not *know* they got more rewards, how can Mr. Dunn argue, as he does, that getting more rewards resulted in greater spending on the card? That appears to be the <u>only</u> point this issue is relevant to. Notwithstanding that the Commissioner seems to suggest something improper or nefarious.

82. Even if the Commissioner were correct about this point factually – which she is not, for the reasons outlined below – even if she were correct about this, there would be nothing nefarious or improper. In fact, there would be nothing relevant to the proceeding, except the one point that it might undermine aspects of Mr. Dunn's analysis that for those cardholders (which of course are not all of the high-interchange cardholders), but for those cardholders, if they did not get more rewards, then more rewards would not be a good basis for concluding they spent more.

83. [redacted]

[redacted]

[redacted]

84. [redacted]

[redacted]

85. [redacted] [redacted] [redacted]

[redacted]

[redacted]

86. It is these three documents, all authored by Ms. Krstic, that form the basis of this allegation by the Commissioner.

87. Mr. Thomson put those documents to Mrs. DeVita in cross-examination. He did not, however, put them to Mr. Stanton, who was at MasterCard when these cards were introduced. Mrs. DeVita was not at MasterCard then. Mrs. DeVita's Witness Statement does not deal with this time period, or what happened during that time period. Mr. Stanton's does. Mr. Stanton knew what happened. Mr. Stanton's Witness Statement said – in relation to this matter (at para. 109): "*The default interchange rate payable in relation to use of high-spend and premium high-spend MasterCard credit cards was higher than that for core MasterCard credit cards, but issuers were also required to ensure that cardholders would receive additional benefits for using these products*"

[**emphasis added**]. Mr. Stanton was there at the time, and gave direct evidence on the point, not marginal notes on documents for internal discussions which were then put to a witness who wasn't there at the time. Mr. Stanton, who did know the story, was not cross-examined on it.

Witness Statement of Stanton, para. 109

88. [redacted]

89. She also noted, at page 1085 of the Transcript, that whether or not you got a new card depended on the issuer. A new card didn't have to be sent, but the issuer might well send one.

90. [redacted]

91. [redacted]

92. [redacted]

[redacted]

93. Unlike his approach to Mrs. DeVita, who was not at MasterCard at that time, Mr. Thomson did *nothing* on this point with Mr. Stanton, who knew the facts – and was President at the relevant time. Mr. Stanton swore in his witness statement that Issuers "were required to ensure that cardholders would receive additional benefits for using these products". He was not cross-examined on the point.

Witness Statement of Stanton, para. 109

94. [redacted]

[redacted]

[redacted]

95. So, when Mr. Thomson put the question to someone who <u>knew</u> about the point – although still not the person who had dealt with it in their Witness Statement – *that* was the answer he got.

96. [redacted]

[redacted]

97. In other words, the document which <u>established</u> the program made it clear that the issuer had to provide best-in-class rewards. Presumably, if the Issuer was already providing best-in-class rewards, they didn't have to improve them, but if they weren't, they did – to be in the Program.

98. And, of course, there is also the logical argument. Even if MasterCard did not have a requirement to offer best in class rewards (which, clearly, it did), insofar as Issuers do get superior interchange related to those cardholders, they are more valuable to the Issuer. The Issuer will be more anxious to keep them. The Issuer, by the function of market dynamics, will want to make the rewards better. Even if MasterCard does not mandate it,

that assumption underlies much of this case. Every economist who testified would agree to that.

99. The facts, MasterCard submits, are consistent with Issuers being required to improve the rewards for premium cards, unless the cards were already receiving enhanced rewards. Those facts are entirely consistent with Mr. Dunn's findings. Mr. Dunn's evidence, as set out in his expert report and also in the slides, was that the average ticket value on a core cards was lower than the average ticket value on high spend cards.

[redacted]

100. One explanation offered for this is that those people are richer. However, Mr. Dunn looked at the comparison with banks that did not issue the higher-spend cards. Those banks' core portfolios had higher ticket amount than the core portfolio of the banks that did – presumably because some rich people were in the group – and were pulled out of the core group by the banks that did issue premium cards. But, the average ticket size for the portfolios of the banks that issued the enhanced cards – for the enhanced portfolios – was higher still than either their core portfolio, or the core portfolio of banks which did not issue premium cards. There was no increase in ticket size for the banks which did not issue premium cards. There was such increase in portfolios with enhanced cards. That is what Mr. Dunn's work showed. His conclusion is that, yes being rich – if you are – helps on average ticket prices, but rewards help too.

[redacted]
Exhibit RM-522

101. Mr. Thomson, in his submissions to you on the first day of Final Argument in the case, suggested that in addition to these card holders being richer, the other reason they might spend more is that they consolidate spending on the rewards card. That is, of course, a perfectly logical conclusion to reach, but it does not go to Mr. Dunn's evidence.

102. With respect to the consolidation of spending, insofar as cardholders are going to consolidate spending on a card that gives them the best rewards, the evidence is

unambiguous: American Express offers the best rewards in Canada. It is also the most expensive for Merchants. American Express, which is not subject to challenge before this Tribunal. American Express, the brand that Mr. Stanton in particular said MasterCard had in mind as it launched its higher rewards cards – "Transactor" cards. If consumers are going to consolidate their spending on higher rewards cards then they will; and if it is not Visa nor MasterCard it will be American Express. So, consolidation of spending matters. It will happen, and Merchants do get benefits from those cards, because they would rather that cardholders used Visa or MasterCard cards than American Express cards.

103. But, the third point, and the reason that the question of consolidation of spending does not undermine Mr. Dunn's analysis, is that his analysis focuses not on total spending but on average ticket size. (That is, the amount of each individual purchase). You can consolidate spending and buy everything you buy on one card. You cannot consolidate ticket size; tickets are one – by – one transactions. Each transaction is an individual ticket. By consolidating all of those tickets you may aggregate and increase spending on those cards, but if the evidence is that ticket size increased, then that is not consolidation at all, that is some other phenomenon.

104. Mr. Thomson asked the Panel to write down the importance of not confusing correlation with causation. He then offered you an argument, purporting to explain away the correlation that he argued was found in Mr. Dunn's evidence – a consolidation. But when you look at it, that does not explain it away. Something else is causing that increase in ticket size. Consolidation does not occur in individual tickets.

105. Mr. Dunn's analysis was based on the numbers. Rewards cards had higher ticket sizes than non-rewards cards and—most importantly for this point, there was an increase in the size of ticket for banks that launched rewards cards, but not for banks that did not. It is very powerful evidence.

106. The idea that these cards were reissued with higher interchange but nothing else, is wrong. It is wrong, as a matter of fact, in that MasterCard mandated best-in-class

benefits. It is wrong as a matter of logic, because the Issuers would have to compete to keep those cardholders with higher interchange flowing to them, but also flowing to their competitors. They would have to give appropriate benefits in the fiercely competitive market –the Issuing market. And, Mr. Dunn’s work demonstrates that they result in larger purchases at the Merchants.

I. PREMIUM CARDS NOT DIFFERENTLY BRANDED

The Commissioner suggested that the fact that MasterCard allowed premium cards to be issued without distinctive branding was in some way improper.

107. The Commissioner suggested, during the evidence, that there was something improper about premium cards looking the same as core cards. That point has nothing to do with this, or any other, anti-trust case. There is not a single word about this in the pleadings or allegations. It is completely irrelevant.

108. Nor, when the Commissioner made her argument here before you, did her counsel articulate *why* it is relevant to anything in an anti-trust case. She just suggested that it was some sort of evil conduct that you should be concerned about. It was a smear tactic.

109. Another reason, however, why this issue has nothing to do with an anti-trust case is that it is clear from the facts that this *does* have to do with Regulation. The Code of Conduct for the Debit and Credit Card Industry mandates that when cardholders are moved from core to premium they have to agree. So, the Government turned its mind to the question, and decided to regulate. That's the point of the Code, section. The Commissioner noted no anti-trust problem; there was no impropriety; but the Government decided that it would regulate the cardholder. Fine. MasterCard complies with the regulations.

> **9. Payment card network rules will require that premium credit and debit cards may only be given to consumers who apply for or consent to such cards.**
>
> Witness Statement of Weiner, Exhibit "R"

110. The suggestion made by the Commissioner was that it is somehow improper that the cards look the same, even if they attract higher interchange. Again, not an allegation in the proceeding and not an anti-trust concern, but again some sort of sense of impropriety. Nor does the Code require that they look different.

111. [redacted]

[redacted]

[redacted]

J. TRANSPARENCY

The Commissioner's stated position is that the repeal of the no-surcharge rule is sought to promote "transparency".

112. In a number of places and a number times during the hearing, Merchant witnesses spoke of the need for surcharging to achieve "transparency", because customers do not know what fees which the Merchants pay to the credit card company.

> Transcript of Examination-in-Chief of de Armas, pages 328-329 (public)
> [redacted]

113. The first point to make about this is that the Code of Conduct is explicitly addressed to transparency. It requires that Merchants be told clearly what their fees are, and requires that the interchange rates be published on the internet. It required that Merchants be able to get out of their agreements if the fees changed.

> 1. **Increased Transparency and Disclosure by Payment Card Networks and Acquirers to Merchants.**
>
> 2. **Payment card network rules will ensure that Merchants will receive a minimum of 90 days notice of any fee increases or the introduction of a new fee related to any credit or debit card transactions. Payment card networks will provide at least 90 days notice to acquirers for rate and/or fee changes and at least 180 days notice for structural changes.**
>
> 3. **Payment card network rules will ensure that following notification of a fee increase or the introduction of a new fee, Merchants will be allowed to cancel their contracts without penalty.**
>
> Witness Statement of Weiner, Exhibit "R"

The Merchants have a lot of "transparency", to the extent that they want it. The Government turned its mind to transparency and provided a regime.

114. The other point, which came out in cross examination of the Merchants, is that they are absolutely at liberty to tell their customers – the consumers – exactly what they pay for credit card acceptance. They are also at liberty to tell them that they would prefer

another payment mechanism. Nobody has any rule against that. Nobody has any prohibition. The Merchants do not tell their consumers these things, by and large. Nor do they tell them what they pay for gas or electricity or sewers or other input costs. They are free to, but they do not.

Transcript of Questions from the Panel to de Armas, pages 334 and 335 (public)

115. It is not transparency that the Merchants want – it is a nice sounding word – but that is not what they want. They want a club. They want "leverage". They want the power to injure the MasterCard system or the Visa system.

116. [redacted]

[redacted]

K. BALANCING THE DEMAND

The Commissioner tries to suggest that the balancing exercise, between issuer and acquirer, is not to be taken seriously because the Respondents failed to show complex economic analysis supporting the system. Her counsel referred, in submissions, to this, rather flippantly, as a "magical box". That misunderstands the nature of the exercise.

117. A few years ago at the American Bar Association Antitrust Law Section Spring Meeting there was a paper that was presented by an economist, explaining why her dog was a rocket scientist.

118. This was because of the dog's remarkably sophisticated ability to calculate accurately intersecting trajectories of two objects traversing parabolas through the air. That is, when the owner tossed a dog treat through the air, the dog would launch itself into the air, intersect with the arc of the dog treat, and catch it in its mouth. She explained the complicated mathematics involved in doing that correctly. It's a remarkably sophisticated problem – sort of like missile interceptors – the dog had mastered the problem, not with a difficult mathematical analysis, but through trial and error.

119. That is how MasterCard, and Visa, get the balance right – through trial and error. You heard that even though it is complicated, they get at it and do their best. You heard from a number of the card company witnesses – that they had gotten it wrong from time to time. They had to make corrections both ways. They were too low; they were too high, they work at it to get the balance right. Getting the most consumers to carry and use the card, and getting the most Merchants to accept the card results in maximizing transactions. And they want the balance right because they make their money on the maximum number of transactions.

Transcript of Examination-in-Chief of Stanton, pages 2453-2455 (public)

120. When they calibrate just right – then the most people want to use the card and the most Merchants accept the card.

121. The flip side of that is getting the balance wrong. When, because interchange is too low, or because the rewards are not attractive enough, or maybe because you are surcharged too much or your card isn't accepted everywhere where the MasterCard logo appears, then fewer people will be using their card. What happens then is that fewer Merchants accept it. Then fewer people carry the card. And then fewer Merchants accept. And so on.

122. We understand the theory of what can happen – but we actually have evidence of it.

123. Mr. Broughton of C'est What? used to accept EnRoute and Diners Cards. He said he use to accept them, but maybe one or two people a month were coming in with them, so being set up as a Merchant on EnRoute and Diners, and doing the monthly accounting was not worth it, and he stopped accepting them: "We have experience in the past of choosing to stop accepting credit cards, specifically EnRoute and Diners Club. We chose to stop accepting them because no one was using them."

Cross-Examination of Broughton, pages 365-366 (public)

124. The Commissioner pointed out to you an Australian submission from 10 years ago which mentioned the possibility that a credit card system could go into a "death spiral". The Commissioner suggested that these predictions of problems should be discounted. It was florid language – but EnRoute and Diners – Diners – the card that started the general purpose cards – went into a death spiral. That is what Mr. Broughton's evidence illustrated.

125. That is <u>exactly</u> what happens when the balance goes wrong. That's exactly why MasterCard and Visa are determined to keep the balance right. They don't want to become EnRoute. They didn't want to become Diners. Not enough consumers want them, and therefore Merchants don't want to take them either. These are the "Feedback Effects" which the Commissioner downplays. They are real. Ask EnRoute.

L. <u>ALLEGEDLY "NORMAL" MARKETS</u>

The Commissioner has submitted that in a "normal" market people could do things that they cannot do because of the No Surcharge, Non-Discrimination and Honour All Cards rule.

126. This may be the situation in some theoretical market with atomistic competition; however, in the marketplace we actually experience, people enter into contracts all the time, to do all sorts of things. Contracts, by definition, restrict what people can do, because they agree to be bound by contract. And of course that is what the Merchants did here.

127. Mr. Thomson in argument, talked about example of "normal" pricing and pricing signals. In the example, a Merchant gets a price increase—Mr. Thompson's bicycle shop is the example he used in his opening argument—and as a result the Merchant raises the price of the bicycles she sells, and everything works perfectly.

128. Even for the moment accepting the economics of that – and we do not accept them – that is not the <u>only</u> "normal". There are many arrangements in the economy where the supplier says, if you sell my product, you can't charge more than $X. If your cost goes up, so what. If you want to sell my product, sell below $X.

129. If you don't want to agree, that's fine, but if you want to sell my bikes, that is the rule. Those sorts of arrangement are perfectly common, and perfectly <u>proper</u>. They are not contrary to the *Competition Act*, or injurious to competition.

130. Those maximum price agreements may not send the perfect price signal Dr. Frankel wants us all to send all the time, but it is perfectly common and proper in the real economy.

131. Indeed, we are fortunate enough to have the example of Shoppers Drug Mart franchise agreements, specifically providing for maximum prices. "Including without limitation the nature, type and quality of goods and services offered for sale by the Franchised Business and the maximum sale prices established for such goods and services […]"

Transcript of Cross-Examination of Daigle, pages 449-451 (public)
Exhibit RV-25

132. [redacted]

[redacted]

133. We have the exact same thing in *Fairview Donut*. Tim Horton's sets a maximum price for donuts – and is perfectly entitled to do so.

Fairview Donut Inc. v. TDL Group, 2012 ONSC 1252

134. The Commissioner's economists attributed all sorts of evil economic motives to the MasterCard and Visa rules. We need look no further than Mr. Daigle of Shoppers Drug Mart or Tim Horton's, to find a much simpler explanation.

M. 81% PROFIT SUGGESTION

The Commissioner tries to allege that MasterCard and Visa have market power because of high profitability. They do so by referring to a document that showed an 81% contribution margin.

135. [redacted]

[redacted]

136. [redacted]

[redacted]

137. [redacted]

138. There is no doubt that MasterCard and Visa have raised interchange – something – that is not a price. That does not mean they have problematic market power.

139. [redacted]

140. [redacted]

[redacted]

[redacted]

N. CONVENIENCE FEES

The Commissioner has tried to suggest that the fact that MasterCard allows, in certain instances, convenience fees to be charged – and Visa does so in the U.S. – somehow undermines their position with respect to surcharging.

141. Insofar as MasterCard allows convenience fees to be charged in certain limited instances, that does not undermine the fact that it does not see value for its business – or an efficient balance for the system – in allowing surcharging in the vast majority of situations. There is simply nothing inconsistent between those positions. It is a matter of deciding what makes sense in the particular situation.

142. MasterCard's goal still remains, in each case, the same – maximizing transactions on the system. Most of the time it thinks an extra charge will injure volume. In certain limited circumstances, it makes the assessment that an extra charge may expand transactions. The principle is the same in both cases – to expand transactions. The mechanism may be different. That is not inconsistent – that is a consistent goal achieved through various methods.

Transcript of Examination-in-Chief of DeVita, page 2487 (public)

O. EUROPEAN COMMISSION DECISION OF DECEMBER 19, 2007

143. This decision[4] was the focus of some considerable discussion by the Commissioner, although it is not entirely clear why.

144. It is not a price maintenance case. It was not a case involving challenge to the No – Surcharge Rule or the Honour All Cards Rule. It did touch on the Honour All Cards Rule – but in that respect noted**,** that the Commission had announced a <u>favourable</u> position with respect to the Honour All Cards Rule.

> *MasterCard and Others v. the Commission*, para. 18

145. The case was, in fact, a challenge to the setting of the Multilateral Interchange Fees ("MIF") by MasterCard, and, furthermore, a challenge to the setting of Interchange by what the Commission described an "association of undertakings" – because it arose primarily before the Initial Public Offering, and because, in Europe, unlike Canada, or elsewhere in the world, the European banks maintained control over rules which, in Canada, they never controlled.

146. So, it was a case challenging Interchange as itself anti-competitive. This is not only different than our case, it is expressly contrary to the Commissioner's position. The Commissioner expert, Dr. Winter, stated:

> "Both respondents, especially MasterCard, have made two arguments. The first is that the interchange fee will be set to balance the two sides of the market in a way that maximizes the volume of output, maximize transactions. That is an argument I agree with"
>
> Transcript of the Examination-in-Chief of Winter, page 1929 (public)

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[4] COMP/34.579 MasterCard; COMP/36.518 Euro Commerce and COMP/38.580 Commercial Cards. [*MasterCard and Others v. the Commission*]

147. Mr. Fanaki, in submissions of June 19, 2012, confirms that the Canadian Commission, in our case, has no issue with Interchange.

148. But, unlike the European Commission, the Commissioner and her expert, Dr. Winter, have no problem with Interchange. They do not like the no surcharge rule, but unlike the European Commission in the case that the Commissioner is citing, the theory on this side of the Atlantic has nothing to do with challenging Interchange. That is a very significant difference.

149. By way of other differences, with respect to the No – Surcharge Rule, while it was not subject to challenge in the European case, unlike in the case which the Commissioner has just argued before this Tribunal, in Europe the EC conclusion was that such surcharges were not likely to provide Merchants with the power to pressure MasterCard into lowering the MIF. In other words, the European Commission did not think that was likely to work – much as we have suggested in the present case.

MasterCard and Others v. the Commission, paras. 510-521

150. Another factual distinction to note is that the case involved Interchange fees as between different countries in Europe. Of course, a fundamentally important goal of European competition law, but not North American, not Canadian competition law, is integration of the various European national economies. That is simply a consideration we do not have here.

MasterCard and Others v. the Commission, paras. 38-39

151. The decision in the European Commission case was that there should be "no" interchange – but what that really means it should be set at a level of Zero. Of course, Zero is a number also, it is just a low number.

152. We know that there are lots of differences between European and North American competition law, but they make the usefulness of this case questionable.

153. The conclusion reached in the European Commission case was specifically predicated upon Interchange is “collectively set” –that is also a significant difference from the case here in Canada.

MasterCard and Others v. the Commission, para. 40-57

154. What the European Commission did was say, here you have got a collectively set fee. If you collectively set fees under European law that is violation of Article 81(1) (as it then was) and you have then justify the collective action under Article 81(3) of the Treaty. In European law you have to justify it rate on empirical evidence. Of course we have a fundamentally different view of the world here in Canada.

155. Article 81(3) says that, if agreements between undertakings are caught by Article 81(1), they can, nevertheless, benefit from an exemption if they satisfy four aspects of Article 81(3). The four requirements are that the agreement (a) contributes to improving the production or distribution of goods, and, to promoting technical or economic progress; (b) allows consumers of fair share the resulting benefits; (c) does not impose the restrictions not indispensable to the obtainment of the objectives; and (d) do not eliminate competition.

MasterCard and Others v. the Commission, para. 666

156. So, there are a significant number of theoretical and factual differences between that case and the present case.

157. The specific issue the Commissioner raised with respect to this case was the product market question, and she raised it in two ways. One was the product market issue which we are familiar with here – that is, is it limited to credit cards, is it, or broader? There, in that case the European Commission decided that the focus should not include cash and cheques. It did include acquiring for <u>all</u> payment cards, including debit cards, in the market. That of course being the equivalent of including Interac here in the market.

158. That was the first aspect of the product market question explored in the case. It left it open as to whether the market might be narrower still, but the decision included all payment cards.

MasterCard and Others v. the Commission, para. 307

159. This case was put to Dr. Church in cross-examination. In fact, Dr. Church was asked to look at the fact that MasterCard had sought to define a broad payments market in that case, and also sought to bring the importance of, the two sided market to the attention of the European Commission, just as it is done here, and the Commission rejected that approach.

160. The first thing to note is that MasterCard there, and here, was entirely consistent in its view of the marketplace.

161. If the Commissioner was that case to suggest that previously MasterCard argued "x" and now it's arguing "y" that would be one thing. But, MasterCard has been consistent.

162. The fact that the European Commission, in a case challenging Interchange, did not accept MasterCard's argument is not an occasion of shame for MasterCard. MasterCard believes the Commission was wrong then, and that ultimately in the European Court of Justice it will prevail, but leaving that aside, the point is that MasterCard has been consistent in its approach.

163. The other point the Commissioner sought to make with the case is that the European Commission allegedly "rejected" two sided market analyses. It did not combine the issuing and acquiring sides – as MasterCard said it should.

164. We do not seek to belabour the point, but since the Commissioner took us there, it bears review. Right at the outset of the case, paragraph 6, the European Commission notes the following:

> "The Commission does not dispute in general that payment systems are characterized by indirect network externalities and that in theory a revenue transfer between issuing and acquiring banks may help to optimize utility the

> network to its users. However, whether a collectively fixed interchange fee should flow from the Acquirers to Issuers or vice-versa, and at which level it should be set cannot be determined in a general manner by economic theory alone, as theories always run on assumptions and may not sufficiently reflect market reality. Rather, any claim that an MIF [Multilateral Interchange Fees] creates efficiencies within the first condition of Article 81(3) of the Treaty must be founded on a detailed robust and compile analysis with realities in its assumptions deductions on empirical data out facts".

MasterCard and Others v. the Commission, para. 6

165. In reviewing that paragraph, it is clear that the European Commission did not reject the basic theory that the market is two-sided. It said to get the exemption – which of course is a concept not related to the present case – you need facts. But it did not reject the concept.

166. Another point to make about the European case is that in not accepting MasterCard's submission on the two sided aspect of the market the European Commission indicated its "long standing case practice in defining product markets in industries with two sided demand".

MasterCard and Others v. the Commission, para. 266

167. If the EU is going to decide cases which draw on new economic thinking by referring to <u>longstanding precedent</u>, this new economic thinking won't get much of a look-in.

168. Economists developed all the issues that we now take for granted long before courts accepted them. In the 1960's cases like *U.S. v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967) were decided by the U.S. Supreme Court, which ran entirely contrary to the developing economics, and now the accepted law. Professor Elzinga spoke of the Supreme Court recognizing that new economic thinking in the breakthrough case of *Matsutshita Electric Industrial Co. v. Zenith Radio*, 475 U.S. 574 (1986) in which he was involved. He also went to the U.S. Supreme Court in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007) which accepted new economic in thinking about price maintenance. Well after the economic thinking developed – the court applied it. But, it takes courts a while.

169. Turning back to the European Commission case, the decision expressly states that recognizing the effects on both sides of a two-sided market was at odds with its precedents (para. 266). That is always true, until it changes. It has not yet changed in the EU. It has, and is, changing elsewhere.

P. ENTRY

170. Another key issue for the question of market power is whether there can be entry. If entry is easy, even a 100% market share in a properly define market does not imply market power, as discussed in the main document.

171. One of the places where antitrust agencies and courts get things wrong, very frequently, is the question of entry.

172. The Competition Bureau found, when it did an ex post survey of mergers which it had reviewed, that one of the consistent errors was underestimating the likelihood and significance of entry into the marketplace.

> Industry Canada, *Competition Bureau Merger Remedies Study* (2011), page 8

173. This is, in fact, because we are human beings. Things are the way they are, and therefore will always be the way they are. Things will never change – until they do. And then, of course, the change was inevitable.

174. We have evidence before the Tribunal that right now Discover is preparing to enter Canada – not only in acquiring transactions but in issuing. We know that PayPal has already entered, both online and point of sale. We also have evidence of the accelerated pace of competition from new technologies, mainly mobile payments. Who knows what is next, but the report of the Payments Task Force is focused on the rapidly changing landscape. Dr. Elzinga remarked as to what a fast paced environment this is.

> Elzinga Report, paras. 177-181
> Witness Statement of Stanton, paras. 50-51

175. The Tribunal has heard Dr. Elzinga's evidence on the threat that PayPal poses to the systems, and their assessment of that.

[redacted]

176. [redacted]

[redacted]

177. Entry is likely to transform the payments market, and it will likely include Discovery, PayPal, Amex moving in part to a 4 party model, but it will also involve innovation we cannot see today. It will be something we cannot guess at now. A mobile payment device; something else. We do not know where it is or what it is – we cannot see it – but we know there is a lot of innovation happening right now in the payments business. Do not underestimate the likelihood of entry. It is a systemic error to do so.

Q. WHO WILL BE BLAMED

178. [redacted]

[redacted]

179. [redacted]

[redacted]

> "The fact that very few consumers (no more than a third) recognize that retailers are responsible for setting surcharges, rather than banks for example, exacerbates a risk that consumers presume that surcharges are the same across all firms, undermining consumers' incentives to search or switch to better offers,"
>
> Dunn Report, Exhibit "H" at page 13

180. Professor Mulvey, the marketing expert, testified that MasterCard's and Visa's most valuable assets are their good names. He testified that consumers don't like surcharging – and that it will damage those brands. That is the only expert evidence on this point.

Mulvey Report, paras. 54-55

APPENDIX "B"

CANADIAN PRICE MAINTENANCE CASES

1957	1	*R v Moffats Ltd.* (1957) 28 CPR 57 (Ont CA)	Moffats introduced a cooperative advertising plan whereby it undertook to pay fifty percent of the cost of advertisements published respecting Moffats supplied refrigerators, subject to the proviso that the price designated in the advertisement would not be less than the price specified by Moffats. The evidence was that there was a correspondence between the price at which the goods are advertised and which they are sold. There was as well evidence that Moffats' intention was to encourage price maintenance by its co-op policy. There was a conviction for attempted resale price maintenance.
1964	2	*R v Campbell* [1964] 2 OR 487	The accused was the agent of a manufacturer of surgical blades. The manufacturer supplied a form of contract for use by the retailer, in which the agreement was subject to the manufacturer's approval. A 5% rebate was provided to the retailer if he used the form contract including its stipulated prices for the blades. The Court found the accused guilty of aiding and abetting the manufacturer in unlawfully attempting to prevent competition and to induce the retailers to sell at set minimum prices, contrary to s. 34 of the *Combines Investigation Act* (read in conjunction with s.21 of the Criminal Code and s. 28 of the *Interpretation Act*).
1966	3	*R v William E Coutts Co. Ltd.* (1966) 52 CPR 21, 67 DLR (2d) at p. 88, [1968] 1 O.R. at p. 550 (HCJ), affd 54 CPR 60, DLR loc. Cit. p. 87, [1968] 2 CCC 221 (CA)	A wholesaler of greeting cards refused to supply retailers with its cards because they had held one-cent card sales on consecutive weeks. Accused convicted. A "practice" did not need to be of indefinite duration.
1968	4	*R v Philips Appliances Ltd* [1969] 1 OR 386 (Ont CA)	At trial, Philips Appliances Ltd. was convicted of two counts under s.34(2)(a) of the *Combines Investigation Act*. The Court of Appeal upheld one conviction and dismissed the other. It upheld the conviction for attempting to induce Simpson-Sears Limited to resell Philips Electric Shavers at prices specified by Philips. Other conviction overturned as evidence inconclusive
1969	5	*R v Thomas Products Corp. Ltd.* (unreported, Aug 27, 1969, Ont Prov Ct)	Retailer was advised by the supplier of Revlon products (Thomas) that retailer was not to give out trading stamps. At issue was whether a trading stamp amounted to a discount and whether by its insistence that retailer not grant trading stamps with its sale of Revlon products, Thomas sought to increase yields from sales by maintaining all the prices in other retail outlets throughout Canada by fixing prices at a minimum. The accused corporation pleaded guilty to price maintenance contrary to s. 34(2)(b) of the *Combines Investigation Act* and was fined $750, and the Court issued an Order prohibiting the continuation or repetition of the offence by the accused.

	6	*Sunbeam Corp. (Canada) Ltd. v The Queen* [1969] SCR 221, 56 CPR 242, 1 DLR (3d) 161	The accused manufacturer sent to all dealers in its products a circular setting out the "minimum profitable resale price" of each article and stating its intention to withhold supplies from dealers who made a practice of "loss-leading." It was charged with four counts of attempting to induce retail dealers to sell at prices not less than those specified, contrary to s. 34(2)(b). The accused was convicted of two counts, where there was direct evidence, as it was held that the real intention had been price maintenance. On the last two counts, the accused was acquitted because the evidence was not sufficiently certain.
1972	7	*R v Corning Glass Works of Canada Ltd.* (1972) 9 CPR (2d) 69 (Ont Co Ct)	Corning Glass Works of Canada Ltd., was charged with eight counts of attempting to induce various distributors of its products to resell articles or commodities at a discount not greater than a maximum discount, or at prices they specified. The accused pleaded guilty to 3 counts of price maintenance contrary to s. 34. The accused was fined $3,250.
	8	*R v Magnasonic Can. Ltd.* (unreported, Mar 2, 1972, BC Prov Ct)	Magnasonic Canada Ltd. attempted to induce some of its distributors, in British Columbia, to resell certain types of stereophonic equipment at prices specified by it. These allegations all related to resale price maintenance activities, contrary to s. 38 of the Act. Conviction.
1974	9	*R v Browning Arms Co. of Canada Ltd.* (1974) 15 CPR (2d) 97 (Ont CA)	The accused, Browning Arms Co. sold guns and other sporting goods to retailers. Browning's salesmen would "bring price cutting retailers in line" when informed by other retailers. The trial judge fined Browning $15,000 for each on four counts of breaching s. 38(2) for a total of $60,000; the Ontario Court of Appeal upheld the verdict.
	10	*R. v. Petrofina Canada Ltd.* (1974) 20 CPR (2d) 83, 21 CCC (2d) 315 (Ont Dist Ct)	The accused, a gasoline distributor, pleaded guilty to unlawfully attempting to influence the price of a retailer. A fine of $15,000 was levied and a prohibition order was made.
1976	11	*R v Kito Canada Ltd.* (1976) 25 CPR (2d) 145, 30 CCC (2d) 531, [1976] 4 WWR 189 (Man CA)	The accused required companies to resell its carpet sweeper for a price not less than a minimum price, which it specified. The accused was convicted on 4 counts of resale price maintenance contrary to s. 38 and fined.
1977	12	*R v Onward Manufacturing Co.* (unreported, May 4, 1977, Ont. Prov Ct)	Complaints were received from retailers who alleged that Onward Manufacturing Company Limited, a manufacturer of radio, television and stereo components, and some of its distributors were enforcing a policy of resale price maintenance. Five counts of contravention of s. 38 of the *Combines Investigation Act* were laid against Onward. On reviewing the evidence, the court found that statements made and the refusal to sell products on the part of the accused contravened the provisions of the Act. The accused was found guilty on all five counts and was fined $5000 per count, for a total of $25,000.

	13	*R v Ben Sanders Co* 43 CPR (2d) 68 (Ont Co Ct)	A complaint was received that Ben Sanders Company Limited of Toronto and its supplier, Standard Packaging Corporation of the United States, attempted to require Aldo Ippolito & Company Limited, a second customer of Standard Packaging, to maintain wholesale prices on playing cards and other items at the titled price. The Accused was charged with one count under s.38(2) of the *Combines Investigation Act*, and one count under s.423(1)(d) of the Criminal Code, alleging a conspiracy between Ben Sanders and Standard Packaging to breach s.38(2) of the Act. The first count was discharged at a preliminary hearing, and the accused was acquitted of the second count at trial, because the Crown did not satisfy its onus beyond a reasonable doubt that the accused conspired with anyone to attempt to require Aldo Ippolito to re-sell playing cards at not less than a minimum price.
	14	*R v Ravel Enterprises Ltd* (unreported, Dec 22, 1977 and Jan. 24, 1978, Ont Co Ct)	The court concluded that the accused refused to sell or supply its products to the retailer because that company had resold one of the accused's products at a discount greater than the discount specified by an agreement and therefore they are guilty under s. 38(3)(b)(iii).
	15	*R v Silverwood Industries Ltd* (unreported, July 18, 1977, Ont Dist Ct)	The retailer purchased milk from the accused at a discount of 20% off suggested wholesale prices and resold it. Following complaints from a major distributor, Mr. McGrail (of Silverwood) made efforts to persuade the retailer to increase the price at which he resold milk from his store. The defendant advised the retailer that if he did not raise his prices to fair levels, the defendant would stop supplying him. The retailer raised his prices slightly, but then noticed a decrease in is sales. The retailer then decided to change suppliers. The court concluded that before the retailer changed suppliers, the accused was attempting, by threat of refusing to supply milk and by inducement in the way of offering assistance in promotion schemes plus offering the $200 for two months rebate, to induce the retailer to sell his milk above a particular price. However, there was no specification by the accused as to what price to sell the milk, therefore the court concluded that the accused was not guilty.
1978	16	*R v John Frederick Grange Karod Manufacturing Ltd and Lind Manufacturing Ltd* (unreported, BC Cty Ct)	The defendants were charged under s. 38 (1) (b) with refusing to supply "Chiropractic", "Chiropractic Elegance" and "Chiropractic Prestige" mattresses to Stacey's Furniture by reason of the low pricing policy of Stacey's Furniture. The court concluded that there was a refusal and it was due to the low pricing policies of Stacey's Furniture, therefore the accused was guilty under s. 38(1)(b).
	17	*R v Warner Bros Distributing (Canada) Ltd.* (unreported, August 1978, Ont Prov Ct)	Accused charged under s. 38(1) of the *Combines Investigation Act*, after entering into an agreement with Famous Players Theatres to disallow the use of discount cards during the showing of a particular film. The agreement was entered into prior to the coming into force of the Act and was not the subject-matter of any further agreements, threats, promise of any like means subsequent to the enactment of s. 38. Charge dismissed.
	18	*R v Kroehler Manufacturing Co. Ltd.* (1979) 45 CPR (2d) 227 (Ont Co Ct)	The accused was a large furniture manufacturer convicted of three counts of resale price maintenance contrary to s. 38 of the *Combines Investigation Act*. The Court held that there were many attempts on the part of Kroehler to have some retailers bring their prices up to a suggested level or, in the alternative, increase their mark-up for the purpose of achieving the same result. It held that the deterrent effect should be borne in mind and assessed the maximum fine suggested of $15,000 on each of three counts.

	19	*R v Levi Strauss of Canada Ltd.* (2009) 70 CPC (6th) 27 (Ont SCJ (Div Ct) affd 100 OR (3d) 721 (CA) leave to appeal to SCC, refused 325 DLR (4th) iv	After a guilty plea to eight counts of resale price maintenance , the Court assessed a fine of $18,750 on each count.
	20	*R v Superior Electronics Inc.* (1979) 45 CPR (2d) 234 (BCCA)	Superior Electronics had made agreements requiring retailers of audio equipment "to refrain from conducting business in a manner that could be detrimental to the image of the line (i.e. poor taste in advertising, loss-leader specials, *heavy price-cutting*)". The words "heavy price-cutting" did not constitute an offence prior to January 1976 when the agreements were made. After being advised that the clause did offend the law, Superior Electronics ceased to use it.
1979	21	*R v Campbell* *(1979) 51 CPR (2d) 284 (BC Co. Ct.)*	The accused was engaged in the business of renting out sub-compact vehicles. In 1976 and 1977, the car rental industry in Kelowna was undergoing a price war between the various businesses, causing losses to all parties. In an attempt to stop the price war and stabilize the market, the accused threatened to use Sears Car Rental Company "as a club" against his competitors by entering the market with greatly reduced rates, unless his competitors stopped the price war. The Court held that the accused was guilty of contravening s. 38(1)(a) of the Combines Investigation Act.
1980	22	*R v A & M Records of Canada Ltd.* (1980) 51 CPR (2d) 225 (Ont Co. Ct.)	The accused was in the business of producing, manufacturing, and distributing records and pre-recorded tapes. It had a policy of allowing their dealers up to 2.5% of their net purchases as an advertising allowance, of which A & M would pay 100% of such advertising cost. However, they would not pay advertising in cases where advertised price was below dealer "every-day cost". Following an investigation under the *Combines Investigation Act*, charges were laid under s. 38(1). After a guilty plea, a fine of $35,000 was imposed.
	23	*R v Church & Co. (Canada) Ltd.* (1980) 52 CPR (2d) 21 (Ont. Prov. Ct.)	The accused corporation manufactured and marketed high priced men's dress shoes. It had established a suggested retail price list together with a co-operative advertising program to ensure that retailers did not sell or advertise at prices below the suggested retail price. On occasion, it delayed shipping orders to retailers who were selling below suggested prices or simply refused to supply the product until the retailer stepped into line. It pleaded guilty to all 28 counts of price maintenance under s. 38 of the *Combines Investigation Act*, and the Court imposed total fines of $64,000.
	24	*R v H.D. Lee of Canada Ltd.* (1980) 57 CPR (2d) 186 and 62 CPR (2d) 77, [1981] CSP 1003 (Que Sess Peace)	The accused was charged with 4 counts of resale price maintenance contrary to s. 38 relating to the refusal to sell jeans to Army and Navy Department Stores because of its low pricing policy and its failure to adhere to minimum prices specified by the accused. The accused was also charged with attempting to induce other retailers to resell jeans at a specified price. The court concluded that the resale price maintenance was a central part of the accused's marketing plan. The court concluded that there was no doubt that the accused refused to supply Army and Navy because they had resold or offered to resell articles below the price specified by the accused. In addition, the court concluded that the accused failed to establish any defense. The court found the accused guilty of all 4 counts and was fined $65,000.

	25	*R v Matsushita Electric Co. of Canada Ltd.* (unreported, Sept 30, 1980, BC Co. Ct)	The accused was charged with refusal to supply Panasonic microwave ovens contrary to s. 38(1)(b). The court concluded that the Crown had not proven, beyond a reasonable doubt, that the refusal to supply was because of the low pricing policy of the customer, and therefore the accused was acquitted.
	26	*R v Philips Electronics Ltd.* (1980) 53 CPR (2d) 74, 116 DLR (3d) 298, 55 CCC (2d) 312, (Ont CA), affd [1981] 2 SCR 264, 59 CPR (2d) 212n, 126 DLR (3d) 767n	In this case, Philips Electronics published an advertisement itself, listing certain of its manufactured goods, stores where the goods could be purchased, and prices of the goods. The Court of Appeal found that such an advertisement was not a threat, promise, agreement or “any like means”. Consequently, there was no violation of the section, as the attempt to influence prices was not made by agreement, threat, promise or any like means.
	27	*R v Rolex Watch Co. of Canada Ltd.* (1980) 50 CPR (2d) 222, 53 CCC (2d) 445 (Ont CA)	Representatives of the defendant Rolex Watch Company of Canada Limited pressured retailers into stopping sale prices on watches. Rolex was charged with 4 counts of resale price maintenance contrary to s. 38(2)(a), for requiring or inducing or attempting to require or induce, by agreement, threat, promise or other means, Potter’s Jewellers Limited of Vancouver, Miller’s Credit Jewellers Limited of Vancouver (on two occasions, in 1969 and 1971), and J. Alex Mackenzie Limited of Alberta to resell watches at a price specified by Rolex. The accused was charged with price maintenance under s. 38(1) for two of the counts and fined $30,000; it was acquitted of the other two counts because the documentary evidence did not establish guilt beyond a reasonable doubt.
1981	28	*R v Agricultural Chemicals Ltd.* (1981) 60 CPR (2d) 204 (Ont Co Ct)	The accused, Agricultural Chemicals Limited (Agrico), was a marketer and supplier of agricultural chemicals. It had begun business relations with a dealer named Alpine Plant Foods Limited, but then refused to supply goods to Alpine soon after approving Alpine’s application to be a dealer. Alpine alleged that Agrico contravened s. 38(1)(b) of the *Combines Investigation Act* because the reason Agrico cut off supply was that Alpine was selling the products at prices lower than its competitors. The Court held that the accused was not guilty, because the evidence of the communications between the parties showed that the real reason behind Agrico’s refusal to supply goods was Alpine’s failure to provide profit and loss statements necessary to establish a line of credit.
	29	*R v Matsushita Electric Co. of Canada Ltd.* (unreported, Jan. 30, 1981 and Feb. 13, 1981, Ont Cty Ct)	The accused was charged with two counts of price maintenance in relation to the supply and sale of Techniques stereo equipment, contrary to s. 38(1)(a) of the *Combines Investigation Act*, and with refusal to supply contrary to s. 38(1)(b). It refused supply because of the price at which a retailer advertised a product. The Court found that the gradual tightening of credit facilities extended to the retailer, the refusal to supply and disallowance from participating in a co-operative advertising program were evidence of conduct in contravention of s. 38(1)(a).

1982	30	*R v Cluett Peabody Canada Inc.* (1982) 64 CPR (2d) 30 (Ont. Co.Ct) affd 71 CPR (2d) 280n (CA)	The accused was charged with three counts of resale price maintenance under s. 38(1)(a). On the first count, it had supplied shirts to a customer-retailer who, instead of retailing the shirts, sold them to another retailer who then resold the shirts to the public at a discounted price. The accused requested its original customer stop supplying the second retailer, but no prices were discussed and no threats or promises were made. The Court acquitted the accused, as the Crown had not proved beyond a reasonable doubt that it attempted to influence the price upwards. On the second count, the accused was found guilty for discouraging price reduction by having an agreement with a retailer not to place off-price advertisements for the shirts. On the third count, the accused and a retailer who sold the shirts at a discount had a "gentleman's agreement" not to use the accused's name in advertisements offering off-price merchandising. The Court acquitted the accused as the evidence fell short of proof beyond a reasonable doubt that any arrangement entered into constituted an attempt to affect prices. The accused was also convicted of one count of refusal to supply a product under s. 31(8).
	31	*R v André Brouillette* *(unreported, Dec. 3, 1982, Que Dist Ct)*	One count of price maintenance was laid at Montreal against Acme Signalisation and André Brouillette, following the receipt of a complaint alleging an attempt to influence upward a competitor's bid for the supply of outdoor signs in the Montréal area. Both of the accused pleaded guilty; Brouillette was fined $10,000 and Acme was fined $30,000. The court in sentencing the accused commented that the conduct had all the marks of fraud and indicated that the accused were aware that they were operating in an unlawful fashion.
	32	*R v Great West Imports Ltd.* (unreported, Sept 28, 1984, Man QB)	The accused was charged with refusal to supply musical instruments because of a low pricing policy contrary to s. 38(1)(b) of the *Combines Investigation Act.* In finding the accused guilty, the court held that it is not necessary for a customer to continue to request supply after being cut off in order for the conduct to constitute a refusal to supply.
	33	*R v TransCanada Glass Ltd, Arthur Allen Skidmore and Gary Hubbel* (unreported, Sept. 13, 1982, BC Cty Ct)	Complaints were received alleging that a branch of Trans Canada Glass Ltd. in British Columbia had refused supply of auto glass to installers because of their low pricing policy, and attempted to exert upward influence on their retail prices. Charges were laid against Trans Canada Glass and two senior employees, Arthur Allan Skidmore and Gary Hubbel, alleging contravention of s. 38(1)(a) of the *Combines Investigation Act*. The corporation pleaded guilty to one count, was fined $4000 and received a prohibition order, while all remaining charges were withdrawn.
1983	34	*R v Andico Manufacturing Ltd.* (1983) 4 CPR (3d) 476 (Man QB)	The accused, Andico Manufacturing Ltd., was engaged in the business of supplying waterbed mattresses. It cut off supply to one of its dealers, Burron Lumber Ltd., which was able to sell the waterbeds at lower prices than competitors because Burron's carpenter could craft the wooden frame and sell the whole bed all ready for assembly and use. The Court examined the evidence, including a taped conversation between the Andico and Burron representatives, and held that Andico was guilty of contravening s. 38 of the *Combines Investigation Act* because the price at which Burron sold the waterbeds was the controlling factor and real issue behind Andico's decision to cut off supply to Burron.

	35	*R v Brown Shoe Co of Canada Ltd.* (1983) 6 CCC (3d) 427 (Ont. HCJ)	The accused, Brown Shoe Co. of Canada Ltd., was charged with 10 counts of infringing the resale price maintenance proscription in the *Combines Investigation Act* by means of a co-operative advertising program contrary to s. 38(1)(a), one count of refusing to supply goods to a customer because of that customer's low pricing policy contrary to s. 38(1)(b), and two counts of influencing the resale price of goods by other methods. The provincial court judge discharged the accused on all 13 counts at a preliminary inquiry. The Crown applied for a judge's consent to prefer an indictment, but this proceeding was stayed at the Ontario High Court of Justice.
	36	*R v International Waterbed Distribution Ltd* (unreported, Dec 2, 1983, Man QB)	The accused was a distributor or waterbeds, who was charged with contravention of ss. 38(1)(a) and 38(1)(b). On December 14th, 1981, the defendants sent Burron Lumber Limited a letter that said they were no longer able to supply them with their products because they are not bona fide waterbed retailers. The court concluded that the defendants refused to sell their product to the retailer, Burron Lumber Limited because of the retailers low pricing policy. The sentence was a fine of $7,000.
	37	*R v RCA Inc* (unreported, September 22, 1983, Alta QB)	A complaint was received from an Edmonton retailer alleging that R.C.A. had refused to renew his authorized dealership contract and hence had refused further supply of R.C.A. televisions and video cassette records because of his low pricing policy. Four counts under s.38(1)(a) and two counts under s.38(1)(b) were laid against R.C.A. R.C.A. pleaded guilty to one count of price maintenance contrary to s.38(1)(a), and the remaining charges were withdrawn.
	38	*R v Savroche Enterprises Inc.* (unreported, Sept 23, 1983, Que CA)	Information was received indicating that Savroche Enterprises Inc., the Canadian distributor for Jordache jeans, had attempted to discourage the reduction of a retailer's prices and had subsequently refused further supplies to the retailer because of the latter's low pricing policy. Three counts of contravening s.38(1)(a) and eight counts of contravening s.38(1)(b) were laid at Montreal against Savroche. One of the s.38(1)(b) counts was withdrawn due to the unavailability of a witness, and the accused pleaded guilty to the remaining counts.
1984	39	*R v. Cody-Food Equipment Ltd.* (1984) 12 WCB 396 (Ont Co Ct)	The accused company is a restaurant equipment dealer and installer in the Atlantic provinces, which pleaded guilty to an offence under s. 38(8) of the *Combines Investigation Act* and was fined $9000 and received a prohibition order. An individual for whom the company takes responsibility telephoned the proprietor of Durable Equipment Limited to tell that company that if it sold directly to Cameron Restaurant Equipment Limited, Durable would lose the business of accused. Cameron had bid about $3250 to supply a Durable refrigerator to the C.N. Durable told Cameron it would not supply the refrigerator, and Cameron lost the C.N. contract and possibly other contracts calling for Durable equipment. The accused sold the equipment to C.N. for about $95 more than Cameron's price.
	40	*R v Dave Downie Sales Agency Inc.* (1984) 14 WCB 33 (BC Co Ct)	The corporate accused was an agency supplying retailers with sporting goods. It was convicted of attempting, by threat, to influence upward, and discourage the reduction of, the price at which retailers sold certain skis, contrary to s. 38(1)(a) of the *Combines Investigation Act.*

	41	*R v E.S. Gould Marketing Co.* (unreported, Apr 11, 1984, Ont Prov Ct)	The accused company was engaged in the business of supplying stereo equipment. It was convicted of, by agreement, threat, promise or any like means attempting to discourage the reduction of the price at which Sherway Appliances Limited supplied the product, contrary to s. 38(1)(a) of the *Combines Investigation Act.* It was also convicted of refusing to supply the product to Sherway because of its low pricing policy, contrary to s. 38(1)(b).
	42	*R v Great West Imports Ltd.* (unreported, Sept 28, 1984, Man QB)	The accused was a distributor of musical instruments. At the urging of a retailer, Great West Imports "cut off" one of their other customers from one of their products because of a low price advertisement. The Court found Great West guilty finding their argument, that the retailer never attempted to order after being told they were cut off, to be unpersuasive.
	43	*R v Imperial Oil* (unreported, Apr 4, 1984, Ont Co Ct)	The accused supplied gasoline to various gas bars. In this case, the accused was convicted of refusal to supply gasoline to an operator of a small gas bar because of a low pricing policy contrary to s. 38(12)(b).
	44	*R v Salomon Canada Sports Ltd.* (unreported, Mar. 19, 1984, Que Dist Ct)	Accused appealed a conviction on three counts of price maintenance for failure of trial judge to properly apply s. 38(9). Whether or not the retailer is guilty of using loss-leaders or bait and switch selling is of no consequence. The accused satisfied the court that he and anyone upon whose report he depended had reasonable cause to believe and did believe that the retailer was acting in such a manner. The defence of reasonable belief is not available to a charge of price maintenance under s. 38(1)(a), however the accused satisfied that court that he had not used any of the prohibited means in an attempt to have the retailer change its prices. The issue is not whether the retailer was selling at a loss but whether the supplier had reason to believe that he was engaging in loss-leadering.
	45	*R v Schelew* *(1984) 78 CPR (2d) 102, 52 NBR (2d) 142 (CA)*	The accused members of a landlord association were charged with price maintenance in relation to the supply of rental accommodation contrary to s. 38(1)(a) of the Combines Investigation Act. The accused were acquitted at trial, and an appeal to the Court of Appeal was dismissed. The Court held that an attempt to move upwards the price of rental accommodation is not sufficient to warrant a conviction under s. 38(1) which requires that it be done by agreement, threat, promise or any like means. The conduct complained of amounted to no more than the author's views of the consequences he believed are foreseeable if the co-accused did not act. It also held that there was reasonable doubt about the existence of any agreement, let alone a threat or promise.
1985	46	*R v Camrost Group Ltd.* (1985), 14 WCB 421 (Ont. Dist. Ct.)	Camrost sold condominiums to various parties. Part of the sale agreement included a clause which prohibited purchasers from reselling without the approval of Camrost. When a purchaser later tried to resell, Camrost attempted to restrict sales that occurred at a price that was lower than what Camrost was listing other units at. The Court held that Camrost had violated s. 38(3) of the *Combines Investigation Act* because when a suggestion of price is made, unless it is clear that the person to whom the suggestion is made is under no obligation to accept the suggestion, the offence has been made out.
1985	47	*R v Henry Galler Inc.* [1985] CSP 1058 (Que)	Complaints were received from two retailers alleging that Henry Galler Inc. had a policy of discouraging the advertising and sale of Hitachi products at low prices. One count of contravening s.38(1)(a) and two counts of contravening s.38(1)(b) were laid at Montreal against Henry Galler. The accused pleaded guilty to the two s.38(1)(b) counts, and the Crown withdrew the s.38(1)(a) count.

	48	*R v Les Tapis Artisans Inc.* (unreported, June 18, 1985, Que Sess Peace.)	In acquitting the accused on a charge of refusal to supply carpets because of a low pricing policy contrary to s. 38(1)(b) of the *Combine Investigation Act*, the court held that the offensive practice must constitute more than a "one shot" effort. The court held that the evidence did not disclose that the supply was refused on the basis of a low pricing policy.
	49	*R v Lois Canada Inc.* (unreported, May 17, 1985, Ont Dist Ct.	The accused was charged with two counts of price maintenance, contrary to s. 38(1)(a) and two counts of refusal to supply, contrary to s. 38(1)(b) of the *Combines Investigation Act* with the respect to the sale and supply of jeans. The court found that the supply had been refused on one count because of the low pricing policy.
	50	*R v Northwest Stoves Ltd.* (unreported, Jan. 18, 1985, BC Cty Ct)	The defendant corporation, a wholesale distributor of woodburning stoves, pleaded guilty to one count of resale price maintenance contrary to s.38(1)(a) of the *Combines Investigation Act*. The defendant, a BC company, is one of two franchise wholesalers in the province to sell Fisher brand woodburning stoves. In 1981, due to complaints from other retailers that one of the defendant's customer outlets, Franken Enterprises Ltd., was undercutting the suggested retail price by 10% below the 30% retail markup, the president of the defendant company persuaded Franken to bring its price into line by requiring a minimum store front display inventory of six stoves or else Franken's purchase costs of Fisher stoves would increase by 10%.
	51	*R v Rainbow Jean Co Ltd* (unreported, Oct. 8, 1985, PEI Prov Ct)	The accused was a medium-sized clothing manufacturing and distribution business whose principal products were jeans. It was convicted of one count of price maintenance under s. 38(1)(a) and fined $2500. The offence was committed through a sales agent who threatened to discontinue supplying jeans to a Charlottetown merchant unless the merchant stopped selling the company's jeans at a discount to the price of the company's jeans in other local stores.
	52	*Fouillard Implement Exchange Ltd. v Kello-Bilt Industries Ltd.* [1986] 2 WWR 93, 37 Man R (2d) 111 (CA), affg [1985] 6 WWR 548, 36 Man R (2d) 133 (QB)	The plaintiff, a farm implement dealer, sold equipment manufactured by the defendant. The plaintiff was told that if it did not comply with the suggested retail price list the defendant would terminate the plaintiff's dealership. The plaintiff did not comply and the dealership was terminated. The court gave no opinion as to whether the plaintiff had a remedy under the *Combines Investigation Act.*
1986	53	*R v Compagnie Manufacturière Lori-Ann Inc.* (1974) 20 CPR (2d) 83, 21 CCC (2d) 315 (Ont Dist Ct)	The accused were found guilty of refusal to supply contrary to s. 38(1)(b) of the *Combines Investigation Act* following their refusal to honour orders placed by a retailer against whom complaints had been made regarding retail prices. The accused failed to give any plausible evidence to explain the failure to supply other than for the complainant's low pricing policy.
	54	*R v Drospo* (unreported, Mar. 4, 1986, Que Dist Ct.)	The defendant company was a supplier of leather motorcycle jackets. They refused to supply one retailer because the retailer was selling the jackets at a low price in order to attract customers. The defendant was found guilty of 38(1)(a) for failure to supply goods.

55	*R v Euroclean Canada Inc.* (1986) 15 WCB 493 and 17 WCB 417 (supplementary)(Ont Dist Ct)	The accused, Euroclean Canada Inc supplied Husqvarna Sewing Machines to many companies, including The Fabric Factory Ltd. The crown alleged that the accused contravened ss. 38(1)(a) and 38(1)(b). The owners of The Fabric Factory Ltd. were given a "Dealer Price List" showing "Suggested Retail" prices, which included a notation that said there is no obligation to accept these suggested prices and no one will suffer if they fail to do so. In October, 1978, Fabric Factory advertised a sale of Husqvarna machines for $200 off list price. When the accused found out they told Fabric Factory that they could no longer purchase machines from the accused because they were cutting prices and that they should remove the advertisement and raise the price back to the list price. In December, 1978, Fabric Factory received a letter stating that "Sewing Machines of the World" had been appointed as Master Dealer for their area, and that in the future they should purchase new machines through that outlet. This was done because Husqvarna had not been doing well. The court found that the Master Dealer Program set up by the accused could not be said to contain a threat or promise to inhibit list price reduction by sub-dealers. In addition, the court concluded that while the accused did refuse to supply Fabric Factory with machines after January 1979, there were good business reasons for doing this and there was nothing to suggest it was done because of a low pricing policy. Therefore the court concluded there had been no violation of ss. 38(1)(a) and 38(1)(b).
56	*R v George Lanthier & Fils Ltée* (1986) 12 CPR (3d) 282 (Ont Dist Ct) affd 24 CPR (3d) 288n (Ont CA)	The accused was convicted of retail price maintenance as a result of a threat to limit the volume of bread supplied to a particular store in response to that store's expressed wish to advertise the supplier's products at a price below cost. The judge commented that if a charge of refusal to supply had been prosecuted, he would have accepted the accused's loss-leader defence.
57	*R v Griffith Saddlery & Leather Ltd.* (1986) 14 CPR (3d) 389 (Ont Prov Ct)	The accused was a supplier of equestrian products. The accused was charged with two counts of refusal to supply contrary to s. 38(1)(b). One of the counts involved the accused's supply to Windever Stables Limited, where they had a credit arrangement, which allowed Windever to purchase stock from the accused for her tack shop. The accused had a selling policy that said they would not sell direct to the consumer nor to riding schools, stables or blacksmiths but only to legitimate retail outlets who carry sufficient inventory to service customers in their area. After visiting her tack shop, the accused discontinued sales. During that visit there was no discussion about pricing policy and no evidence about pricing policy on any previous occasions. The second account involved a similar alleged course of conduct with Equerry Equestrian Company. The court concluded that while supply had been refused, it was not satisfied that the low pricing policy of the retailer was the reason for the refusal of supply and therefore the charges were dismissed.
58	*R v Laird* *(unreported, Dec. 16, 1986, Sask QB)*	A complaint was received concerning a gasoline price war among service station operators. It was alleged that the price war was designed to discipline an independent operator because of his low pricing policy. Charges of violations of s.38(1)(a) of the Combines Investigation Act were laid against Kenneth Laird, Sundance Service Ltd., Brad Stevenot, Triple "A" Enterprises Ltd., Patrick Lutz and P&F Holdings Ltd. Charges of violations of s.38(6) were also laid against Kenneth Laird, Sundance Service Ltd., James Kerr, and the Meadow Lake Consumers Co-operative Association. The defendants had to wait seventeen and a half months from the time they were charged and the trial date. Also, the transcript from a preliminary hearing was incoherent. The Court held that the defendant's constitutional right to be tried within a reasonable time, under s.11(b) of the Charter, was violated and charges were dismissed.

	59	*R v Salomon Canada Sports Ltee* (1986) 28 CCC (3d) 240 (Que CA)	Salomon was charged with resale price maintenance in respect of a retailer which, over a period of several months, advertised that it would give away a pair of Salomon ski bindings with the purchase of a pair of skis. The retailer also advertised Salomon products at below the market price, but at a price which was above the cost charged by Salomon to the retailer when it purchased the equipment. The Quebec Court of Appeal allowed the accused's appeal from its convictions and entered acquittals on the basis that Salomon had reasonable cause to believe that the retailer had engaged in loss-leading and bait-and-switch selling, that the giving of free bindings with purchases of skis over a period of several months in four different stores constituted a practice and that "profit" as used in the context of what is now subsection 61(10) should be defined taking into account the "net cost price" to the retailer not simply the cost of the goods. One of the judges commented that the relevant consideration is "net profit", that is with appropriate additions for overhead.
	60	*R. v. Sunoco Inc.* (1986) 12 CPR (3d) 79 (Ont Dist Ct) revd 28 CPR (3d) 287 (Ont CA)	Accused was a gasoline distributor and was found guilty of price maintenance for applying a system that froze an "allowance" given to retailers if a low price was charged.
	61	*R. v. Sunoco Inc.* (1986) 11 CPR (3d) 557 (Ont Dist Ct), affd (unreported, May 25, 1988, Ont CA)	The accused was a gasoline supplier charged with price maintenance and refusal to supply under the *Combines Investigation Act.* The accused entered into a contract with a gasoline retailer that promised price support but restricted with whom the retailer could price match and prohibited the initiation of downward pricing. The Court held that the agreement violated s. 38(1)(a). The defendant was found not guilty for refusing to supply because it was unclear that they refused to supply until the business relationship with the supplier broke down.
1987	62	*R v Dairy Supplies Ltd.* (1987) 16 CPR (3d) 350, 39 DLR (4th) 54, 33 CCC (3d) 253 (Man CA), affd [1988] 1 SCR 665, 49 DLR (4th) 479, 40 CCC (3d) 382	The accused was charged with refusal to supply contrary to s. 38(1)(b) of the *Combines Investigation Act* in relation to the supply of refrigeration and dispensing equipment, parts and components. The trial judge ruled as inadmissible documents seized through a search of the accused's premises, pursuant to s.10 of the *Combines Investigation Act*, because it violated s. 24(2) of the Charter. The Court of Appeal overruled the finding on admissibility of the evidence and ordered a new trial.
	63	*R v Epson (Canada) Ltd.* (1987) 19 CPR (3d) 195 (Ont Dist Ct), (1990) 32 CPR (3d) 78 (Ont CA)	The accused sold printers and was a leader in the industry, accounting for a third of all printers sold in Canada. It was about to introduce a computer and decided to market the machine through their dealers, and wished to ensure that the dealers made sufficient profit to be able to afford giving the public pre-sale advice and assistance and post-sale follow-up. It included a clause in dealership agreements under which dealers agree not to advertise the computer for sale at a lower price than the supplier's suggested retail price. Agents of Epson threatened dealers with cancellation of dealer status and non-delivery of products. The Court convicted Epson of 10 offences under s. 38(1)(a) of the *Combines Investigation Act.*

64	*R v North Sailing Products Ltd.* (1987) 18 CPR (3d) 497 (Ont Dist Ct)	The accused was convicted of price maintenance under s. 38(1)(a) of the *Competition Act* in relation to the sale of sailboat fittings and supplies. The Court found that an employee of the accused stated that the complainant's discount had been reduced by the accused because it was discounting at retail contrary to the accused's anti-discounting policy. Although management of the accused had in fact reduced the discount after considering the complainant's volume of purchases was lower than expected, the Court held that the employee was speaking on behalf of the accused when he made the unauthorized representation to the complainant, and thus the accused was liable.
65	*R v Pacific Energy Woodstoves Ltd., and Paul Erickson* (unreported, Apr. 24, 1987, BC Prov Ct.)	Paul Erickson was charged, along with the defendant company, of price maintenance and refusal to supply under s.38(1)(a) and s.38(1)(b). The charges were laid following an inquiry into complaints alleging that the accused had attempted to influence upward the price at which one of its customers sold stoves and related accessories. Erickson was charged by virtue of being "an agent" of the company. The Court held that s. 38 of the *Combines Investigation Act* deals strictly with a "person" and does not include employees, servants and agents. Thus employees, servants and agents cannot be charged under that section by virtue only of their connection to an accused company. Both Pacific Energy and Erickson were acquitted.
66	*R v Sony of Canada Ltd* (1987) 16 CPR (3d) 50 (Ont Dist Ct)	Audiotel (St. Hubert) bought goods from Sony, sold them to Audiotel franchises at cost+10%, which in turn sold the products to consumers at an average discount of 25%. Sony created separate audio and television franchises, both of which were offered to Audiotel. The video franchise was received late, allegedly because of Audiotel's discount sales practices. Audiotel opened two new discount retail outlets which competed with existing Sony franchises, which brought them into conflict with Sony of Canada. At issue was whether Sony could dictate the number and location of Audiotel franchises. Sony discontinued to supply to Audiotel, stating it was in breach of its franchise agreement. The court found Audiotel's allegations to be unsubstantiated suspicions since Sony had accepted discount sales for many years.
67	*R v Raymond Lanctot Ltee* (unreported, Sept 14, 1988, Que Ct Sess)	The accused were charged with refusal to supply sunglasses contrary to s. 61(1)(b) of the *Competition Act*. In dismissing the accused, the Court held that for there to be refusal there must be a demand and in a case of a refusal to sell there must be a demand to purchase. The request to purchase can be made orally to a salesman or someone authorized to accept the order, or made in writing to persons authorized to accept and make such sales. The Court held that the Crown failed to put evidence that the request to purchase had been directed to the accused or someone duly authorized on their behalf.

	68	*R v Must de Cartier Canada Inc.* (1989) 27 CPR (3d) 37 (Ont Dist Ct)	Oliver Jewellers decided to run a sale, and put advertisements in the Globe & Mail which stated "50% off" its entire stock, and made express reference to Cartier products. The day after the advertisement appeared, a memorandum was circulated within the Cartier organization stating that effective immediately no orders should be shipped to Oliver Jewellers. By way of explaining that memorandum, the Cartier manager said that he was concerned about Oliver's financial stability and outstanding arrears. He further testified that he understood from the advertisement of the sale that Oliver was in financial difficulty. At the first meeting between Oliver and Cartier, Oliver agreed that they were running the sale because they were experiencing cash flow problems. Later Cartier asked Oliver to agree in writing to submit all future proofs of advertisements containing the Cartier trademark "to make sure that Oliver would advertise the Cartier way, according to the Cartier image". The court stated that Cartier was free to persuade Mr. Oliver to advertise in a particular way so long as it did not engage in means prohibited by the legislation. It also indicated that it was "not satisfied that the purpose of the agreement … was an attempt … to discourage the advertising of Cartier watches at reduced or discount prices."
1989	69	*R v Shell Canada Products Ltd.* (1989) 24 CPR (3d) 501 (Man QB), 25 CPR (4d) 101 (Man CA)	The accused was charged with price maintenance in relation to the supply of gasoline in Winnipeg contrary to s. 38(1)(a). While the complainants were free to set the pump price for the gasoline they purchased from Shell, the company's supply arrangement included a guaranteed margin in the event of price wars. The court found that telephone calls between the complainants and the marketing representatives of the accused, who used words such as "acting irresponsibly" and "to get the price back up", constituted an attempt to influence upwards and discourage the reduction of the retail gasoline price, as it created a fear of alienating the supplier or of prejudicing a relationship. It was assessed a fine of $100,000, which was increased to $200,000 on appeal.
	70	*R. v Wenger Ltd.* (unreported, June 15, 1989, Que ct.)	A complaint was received from a retailer of watches and jewellery in Chicoutimi, Quebec alleging that Wenger Ltd. of Montreal had refused to supply products to him because of his low pricing policy. On February 20, 1990, Wenger was convicted of one count of refusing supply of Cardinal watches to Bijouterie Marcel Gilbert Importateur of Chicoutimi, contrary to s.38(1)(b), by the Quebec Provincial Court, Criminal Division.
1993	71	*R v Royal LePage Real Estate Services Ltd., Ted Zaharko and John Roche* *(1993) 50 CPR (3d) 161, 105 DLR (4th) 556, [1994] 1 WWR 228 (Alta. QB)*	Royal LePage and Zaharko were charged jointly as real estate brokers, that they unlawfully by agreement, threat, promise or like means attempted to influence upward or discourage the reduction of the price at which Elite Real Estate supplied or offered to supply real estate services contrary to s.61(1)(a) of the Competition Act. The accused were also charged jointly that they, as real estate brokers, unlawfully discriminated against Elite Real Estate and Realm Realty Inc. because of Elite and Realm's low pricing policies, contrary to s.61(1)(b). In other related proceedings, 41813 Alberta Ltd. and Gerlad Roberts were charged with refusing to supply to Elite Real Estate, real estate that 41813 Alberta had listed for sale and did otherwise unlawfully discriminate against Elite, contrary to s. 61(1)(b).

1994	72	*Polaroid Canada Inc. v. Continent-Wide Enterprises Ltd.* (1994) 59 CPR (3d) 257 (Ont Ct (Gen Div)	Continent-Wide Enterprises Ltd. purchased Polaroid products for export, sale and distribution. It was involved in trans-shipping and international discounting. Polaroid decided to institute policies to control or prevent trans-shipping because they created stock shortages and back order situations in Canada, which led to customer dissatisfaction and losses of sales in Canada. Trans-national shipping also had the tendency to bring the Canadian price up to the U.S. level. Therefore Polaroid instituted an export price policy, which required that products purchased at the usual price not be exported from Canada for resale. This policy contained no actual export price list. The policy also required that if Polaroid subsequently found that a purchaser was exporting product, they could impose a surcharge equal to the difference between the domestic and export price. The actual export prices were prohibitive. The policy stated that it applied to authorized dealers. Continent-Wide had never completed any dealer documentation with Polaroid and it continued to purchase large volumes of Polaroid products for export without paying the export price. Polaroid eventually terminated Continent-Wide as a dealer and brought a claim for the difference between the domestic price and the export price. The court decided that although Continent-Wide did not file an application for authorized dealer status, it sought to be treated by them as a dealer, which is generally what Polaroid did, and therefore was an authorized dealer. Polaroid was permitted to impose the export price policy unilaterally. Therefore, Continent-Wide became contractually bound by the export price policy when it received proper notice of the policy, which was October 7th when they received a letter which included the export price list. However, the basis for the policy was not the low pricing policy of Continent-Wide but rather its intended place of resale. Also, there was no refusal to deal, even though the export price levels had a prohibitive effect. In addition it applied to all dealers who proposed to export goods, therefore there was no illegality on the basis of s.61(1)(b).
	73	*R v 41813 Alberta Ltd.* *(unreported, Jan 1994, Alta. QB, Mason, J.; see R v Royal LePage Real Estate Services Ltd., Ted Zaharko and John Roche, (1993) 50 CPR (3d) 161 for related proceedings)*	The accused was charged with refusal to supply and price discrimination against Elite Real Estate contrary to s.61(1)(b). The accused discriminated against Elite because of the low, residential commission rate Elite was charging as a discount realty company and, in particular, within the context of co-brokering agreements between the accused and Elite. Roberts refused to permit Elite to show properties Roberts had listed or to deal with them in a co-broker relationship. In addition, the accused discriminated against Elite by offering to pay a lesser commission than would be payable to a board member by the terms of MLS listings. The court found that the fiduciary relationship between the listing agent and the vendor imposes an obligation to cooperate and co-broker with any legitimate selling broker. The Competition Act makes it unlawful to discriminate against someone because of that person's low pricing policy. The accused's policy of paying the complainant less commission than is normally paid to brokers is discriminatory. S.61 must be able to address a relationship that never developed because it was never allowed to. The element of proving that the accused's actions were based on the low pricing policy was established. The court concluded that the accused was guilty.
1995	74	*R v La Boutique L'Ensemblier Inc.* (unreported, Oct 16, 1995, Que SC, Pidgeon, J.)	The accused pleaded guilty to charges under s. 61(6) in relation to pressure which the accused retailers put on a number of suppliers relating to sales to a competing retailer with a low pricing policy. The incidents involved the setting of a condition of doing business whereby the suppliers in question were prohibited from supplying the discounter. The court concluded that the accused were unaware of the law, had cooperated with the Crown and had consented to the issuance of a prohibition order. Therefore each accused was fined $20,000 and a prohibition order was issued.

2001	75	*Wong v Sony of Canada Ltd.* (2001) 105 ACWS (3d) 24 (Ont SCJ)	Wong brought a class action against Sony alleging that Sony breached s. 52 (false and misleading advertising) and s.61 (price maintenance) of the *Competition Act* by publishing a "Suggested Price List" and an "Actual Price List" to be distributed to resellers of Sony products. Wong alleged that the "Suggested Price List" was false and misleading advertising, and that the prices imposed upon retailers in the "Actual Price List" were higher than would be the case in a competitive market. Sony moved to strike out parts of plaintiff's statement of claim. The Court refused to strike out the entire statement of claim, holding that there was a reasonable cause of action as the plaintiff alleged that Sony threatened to diminish rebates, delay or refuse shipments, and open competing Sony Stores to induce retailers to abide by Sony's pricing requirements. It also held that customers from the Sony Store retail store, an affiliate of Sony, arguably suffered losses from Sony's anti-competitive retail price maintenance, and therefore refused to strike out this group from the class definition.
1996	76	*R v Mr. Gas Ltd.* (unreported, Aug 11, 1995, Ont Ct, Prov Division, Dempsey, J.) (unreported, Jan 26, 1996, Ont Ct, Prov Division, Dempsey, J.)	Mr. Gas was a retailer of gasoline that set gas prices for 71 independently operated service stations in Ontario and Quebec. Mr. Gas aimed to price its gasoline at four-tenths of a cent below the major service station chains. Every day, Mr. Gas prepared retail price surveys and exchanged current pricing information by telephone between the various independents. It also advised its competitors on its planned price changes, particularly increases, to see if they would follow suit. The Court found that Mr. Gas did attempt to influence the upward price, but did not do so by agreement, or promise, or any like means. The words `any like means' in 61(1)(a) must be interpreted restrictively. In one count, there was an express communication of a future threatened course of conduct by Mr. Gas, and on that count there was a conviction.
1996	77	*R. c. Perreault* [1996] RJQ 2565 (Que Sup CT)	The accused operated four driving schools. In 1987, when smaller competitors arrived on the market and offered lower prices to carve a niche for themselves, the accused immediately contacted them to enter into an agreement to set prices at a same higher level. He claimed to be speaking on behalf of the other more established schools as well. Faced with recalcitrant competitors, the accused uttered threats on several occasions. Ultimately, he reacted by waging a price war. As a result, four out of eight competing businesses shut down their operations. Consumers paid much higher prices thereafter. A jury convicted the accused of conspiracy to reduce competition, maintaining an eviction price policy, and threatening competitors in an attempt to raise prices. The accused was sentenced to a one-year prison term.

2004	78	*351694 Ontario Ltd. v Paccar of Canada Ltd.* (2004) 35 CPR (4th) 257, 2004 FC 1565	The defendant was a manufacturer and distributor of Kenworth trucks and parts. The plaintiff was a Kenworth truck, sales, parts, and service dealer. After a dispute between the parties about sales allowance requests, the parties severed their business relations. The plaintiff sued the defendant for price maintenance. The dealer agreements between the defendant and its dealers left the dealers legally free to sell outside their designated territory, but it was thought the defendant discouraged this. There was also evidence of threats to discourage a reduction of price. The plaintiff's allegations based on s.61(1)(a) were barred by the limitation set out in s. 36(4)(a)(i). With respect to s.61(1)(b), the evidence indicated no instance regarding the supply of trucks from which the inference could be drawn that the defendants refused to supply or otherwise discriminated against the plaintiff. With respect to the supply of parts, the situation was different. Usually parts were shipped directly to the dealer's customer, however, where the dealer was supplying a customer outside its usual trading area at a deep discount, the defendant would ship them to the dealer who then had to ship them to its customer, which added to the cost. This rule was instituted in response to the plaintiff's discounting and was an ongoing one, therefore falling within the limitation period. This amounted to an act of discrimination in the supply of goods. Therefore the allegation under s.61(1)(b) was not barred by s. 36(4)(a)(i).
2005	79	*R v Labatt* (2005, Que Ct)	Sales representatives influenced convenience stores to raise the price of discount beer, through cash incentives and free cases of beer. In one case, Labatt offered a retailer $2000 to increase the price of one of their products. Labatt pleaded guilty, was fined $250,000, and received a prohibition order requiring them to educate their staff and retailers.
2006	80	*Skybridge Investments Ltd. v Metro Motors Ltd.* 2006 385 WAC 140, 61 BCLR (4th) 241, 2006 BCCA 500	Ford had a dealer agreement which prohibited Metro and other Ford dealers from selling vehicles to any entity intending to export the vehicles from Canada. Skybridge had contracted with Metro to sell 31 Ford vehicles to a USA customer. Ford alerted Metro of the suspected sale for export and Metro refused to sell the vehicles to Skybridge. Skybridge alleged that Metro breached s. 61(6) of the *Competition Act*, arguing that the export prohibition was because of the low pricing policy of exporters. The Court held that there was no evidence that Skybridge was a low pricer, and that the basis for the policy of restraint was not the dealer's low pricing policy but rather the dealer's intended place of resale. It also held that s.61(6) did not extend to entities outside Canada to include Skybridge's USA customer.

2007	81	*Axiom Plastics Inc. v E.I. Dupont Canada Co.* (2007) 87 O.R. (3d) 352, 46 CPC (6th) 234, 160 ACWS (3d) 221 (SCJ), leave to appeal to Div Ct refused 90 O.R. (3d) 782, 55 CPC (6th) 118, 167 ACWS (3d) 45; 2011	The plaintiff sought certification of a proposed class action against the defendant. The plaintiff alleged vertical price fixing where the defendant used a form of price support by which it gave an extra discount to distributors who, in turn, provided a discount to purchasers, but the price support rebate was only provided once the distributor provided proof of sale. The plaintiffs allege that the effect of this system was that the distributor was compelled to sell at not less than the price list, unless the defendant agreed otherwise. Dupont also entered into agreements with Tier 1 manufacturers specifying the prices at which moulders who supply Tier 1 manufacturers would be charged for Dupont resins. In consideration of Tier 1 manufacturers requiring suppliers to use Dupont resins, Dupont rebated to the Tier 1 manufacturer a portion of the purchase price paid to Dupont. Axiom pleads that at various time, DuPont entered into agreements with its Authorized Canadian Distributors to require them to supply and offer to supply DuPont engineering resins to the Tier 2 manufacturers at Conspiracy Prices, and to discourage the Authorized Canadian Distributors from reducing the prices thereof. The court concluded that it was not plain and obvious that the vertical arrangements could not breach s.45 or 61(1)(a) and found that Axiom's claim was not fundamentally or solely one of exclusive dealing. If the class is restricted to persons required by a customer to buy DuPont resins, the importance of the common issues in relation to the claims as a whole weighs in favor of certification.
2009	82	*2038724 Ontario Ltd. v Quiznos Canada Restaurant Corp.* (2009) 70 CPC (6th) 27 (Ont SCJ (Div Ct) affd 100 OR (3d) 721 (CA) leave to appeal to SCC, refused 325 DLR (4th) iv	The plaintiffs were franchisees of the franchisor. Under the franchise agreement, franchisees were required to purchase from sources designated by the franchisor. The plaintiffs alleged that the defendants conspired to overcharge them for supplies, which constituted a breach of sections 45 and 61. The issue in this case was whether a breach of s.61 could form a common issue for class action purposes. Majority found that to establish breach of s.61 the losses need not be quantified and there does not need to be proof of loss or damage. Establishing a breach of s.61 can be proven on a class-wide basis.
2012	83	*Fairview Donut Inc v The TDL Group Corp* *2012 ONSC 1252*	Franchisees alleged that franchise donut production costs increased with the introduction of the "par baking" method, which ate into their profit margins. They also alleged that they were required to sell lunch menu items at a loss or break-even prices. The resale price maintenance claim was dismissed because wholesale prices were set through a joint venture, and they did not "impair the ability of downstream purchasers to sell at any price they choose".

APPENDIX "C"

THE RESALE PRICE MAINTENANCE PROVISION OVER TIME

1951 version

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

(2) No dealer shall directly or indirectly by agreement, threat, promise or any 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 or discount specified by the dealer or established by agreement, 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.

(3) No dealer shall refuse to sell or supply an article or commodity to any other person for the reason that such other person

(a) has refused to resell or to offer for resale the article or commodity

(i) at a price specified by the dealer or established by agreement;

(ii) at a price not less than a minimum price specified by the dealer or established by agreement,

(iii) at a markup or discount specified by the dealer or established by agreement,

(iv) at a markup not less than a minimum markup specified by the dealer or established by agreement, or

(v) at a discount not greater than a maximum discount specified by the dealer or established by agreement, or

(b) has resold or offered to resell the article or commodity

(i) at a price less than a price or minimum price specified by the dealer or established by agreement,

(ii) at a markup less than a markup or minimum markup specified by the dealer or established by agreement, or

(iii) at a discount greater than a discount or maximum discount specified by the dealer or established by agreement.

(4) Every person who violates subsection two or three is guilty of an indictable offence and is liable on conviction to a penalty not exceeding ten thousand dollars or to two years' imprisonment, or if a corporation to a penalty not exceeding twenty-five thousand dollars.

(5) The Commissioner has authority to institute and conduct an inquiry into all such matters as he considers necessary to inquire into with a view of determining whether this section has been or is being violated and to make a report thereon in writing to the Minister, and for such purposes the Commissioner has all the powers, authority, jurisdiction and duties that are conferred upon him by this Act, including sections sixteen and seventeen, with respect to an inquiry as to whether a combine exists or is being formed.

(6) A report of an inquiry under this section shall be dealt with in the same manner as a report of an inquiry or investigation under this Act as to whether a combine exists or is being formed.

<u>1952 version</u>:

The amendment renumbered the provision as section 34 and repealed and substituted subsections 4, 5 and 6 with a new subsection 4

34. (1) In this section “dealer” means a person engaged in the business of manufacturing or supplying or selling any article or commodity.

(2) No dealer shall directly or indirectly by agreement, threat, promise or any 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 or discount specified by the dealer or established by agreement, 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.

(3) No dealer shall refuse to sell or supply an article or commodity to any other person for the reason that such other person

(a) has refused to resell or to offer for resale the article or commodity

(i) at a price specified by the dealer or established by agreement;

(ii) at a price not less than a minimum price specified by the dealer or established by agreement,

(iii) at a markup or discount specified by the dealer or established by agreement,

(iv) at a markup not less than a minimum markup specified by the dealer or established by agreement, or

(v) at a discount not greater than a maximum discount specified by the dealer or established by agreement, or

(b) has resold or offered to resell the article or commodity

(i) at a price less than a price or minimum price specified by the dealer or established by agreement,

(ii) at a markup less than a markup or minimum markup specified by the dealer or established by agreement, or

(iii) at a discount greater than a discount or maximum discount specified by the dealer or established by agreement.

(4) Every person who violates subsection two or three is guilty of an indictable offence and is liable on conviction to a fine in the discretion of the court or to imprisonment for a term not exceeding two years or to both.

<u>1960 version</u>:

The section was renumbered as section 38 as part of the 1970 revision of the Statutes of Canada. Subsection 5 was added

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

(2) No dealer shall directly or indirectly by agreement, threat, promise or any 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 or discount specified by the dealer or established by agreement, 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.

(3) No dealer shall refuse to sell or supply an article or commodity to any other person for the reason that such other person

(a) has refused to resell or to offer for resale the article or commodity

(i) at a price specified by the dealer or established by agreement;

(ii) at a price not less than a minimum price specified by the dealer or established by agreement,

(iii) at a markup or discount specified by the dealer or established by agreement,

(iv) at a markup not less than a minimum markup specified by the dealer or established by agreement, or

(v) at a discount not greater than a maximum discount specified by the dealer or established by agreement, or

(b) has resold or offered to resell the article or commodity

(i) at a price less than a price or minimum price specified by the dealer or established by agreement,

(ii) at a markup less than a markup or minimum markup specified by the dealer or established by agreement, or

(iii) at a discount greater than a discount or maximum discount specified by the dealer or established by agreement.

(4) Every person who violates subsection two or three is guilty of an indictable offence and is liable on conviction to a fine in the discretion of the court or to imprisonment for a term not exceeding two years or to both.

(5) Where, in a prosecution under this section, it is proved that the person charged refused or counseled the refusal to sell or supply an article to any other person, no inference unfavourable to the person charged shall be drawn from such evidence if he satisfies the court that he and any one upon whose report he depended had reasonable cause to believe and did believe

(a) that the other person was making a practice of using articles supplied by the person charged as loss-leasers, that is to say, not for the purpose of making a profit thereon but for the purposes of advertising;

(b) that the other person was making a practice of using articles supplied by the person charged not for the purpose of selling such articles at a profit but for the purpose of attracting customers to his store in the hope of selling them other articles; that the other person was making a practice of engaging in misleading advertising in respect of articles supplied by the person charged; or

(c) that the other person made a practice of not providing the level of servicing that purchasers of such articles might reasonable expect from such other person; or

(d) that the other person made a practice of not providing the level of servicing that purchasers of such articles might reasonably expect from such other person.

1976 version:

The entire section was repealed and replaced

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 a product within Canada; or

(b) refuse to supply a product to or otherwise discriminate against any other person engaged in business in Canada because of the low pricing policy of that other person.

(2) Subsection (1) does not apply where the person attempting to influence the conduct of another person and that other person are affiliated companies or directors, agents, officers or employees of

(a) the same company, partnership or sole proprietorship, or

(b) companies, partnerships or sole proprietorships that are affiliated,

or where the person attempting to influence the conduct of another person and that other person are principal and agent.

(3) For the purposes of this section, a suggestion by a producer or supplier of a product of a resale price or minimum resale price in respect thereof, however arrived at, is, in the absence of proof that the person making the suggestion was made that he was under no obligation to accept the suggestion and would in no way suffer in his business relations with the person making the suggestion or with any other person if he failed to accept the suggestion, proof of an attempt to influence the person to whom the suggestion is made in accordance with the suggestion.

(4) For the purpose of this section, the publication by a supplier of a product other than a retailer, of an advertisement that mentions a resale price for the product is an attempt to influence upward the selling price of any person into whose hands the product comes for resale unless the price is so expressed as to make it clear to any person to whose attention the advertisement comes that the product may be sold at a lower price.

(5) Subsections (3) and (4) do not apply to a price that is affixed or applied to a product or its package or container.

(6) No person shall, by threat, promise or any like means, attempt to induce a supplier, whether within or without Canada, as a condition of his doing business with the supplier, to refuse to supply a product to a particular person or class of persons because of the low pricing policy of that person or class of persons.

(7) For the purposes of subsection (2),

(a) a company is affiliated with another company if

(i) one is a subsidiary of the other

(ii) both are subsidiaries of the same company

(iii) both are controlled by the same person, or

(iv) each is affiliated with the same company; and

(b) a partnership or sole proprietorship is affiliated with another partnership, sole proprietorship or a company if both are controlled by the same person.

(7.1) For the purposes of this section, a company is deemed to be controlled by a person if shares of the company carrying voting rights sufficient to elect a majority of the directors of the company are held, other than by way of security only, by or on behalf of that person.

(8) Every person who violates subsection (1) or (6) is guilty of an indictable offence and is liable on conviction to a fine in the discretion of the court or to imprisonment for five years or to both.

(9) Where, in a prosecution under paragraphs (1)(b), it is proved that the person charged refused or counseled the refusal to supply a product to any other person, no inference unfavourable to the person charged shall be drawn from such evidence if he satisfies the court that he and any one upon whose report he depended had reasonable cause to believe and did believe

(a) that the other person was making a practice of using products supplied by the person charged as loss-leaders, that is to say, not for the purpose of making a profit thereon but for purposes of advertising;

(b) that the other person was making a practice of using products supplied by the person charged not for the purpose of selling such products at profit but for the purpose of attracting customers to his store in the hope of selling them other products;

(c) that the other person was making a practice of engaging in misleading advertising in respect of products supplied by the person charged; or

(d) that the other person made a practice of not providing the level of servicing that purchasers of such products might reasonably expect from such other person.

<u>1986 version</u>:

Subsections 38(7) and (7.1) were repealed. Subsection 2 was amended to contain a more expansive definition of affiliated companies.

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 a product within Canada; or

(b) refuse to supply a product to or otherwise discriminate against any other person engaged in business in Canada because of the low pricing policy of that other person.

(2) Subsection (1) does not apply where the person attempting to influence the conduct of another person and that other person are affiliated companies or directors, agents, officers or employees of

(a) the same company, partnership or sole proprietorship, or

(b) companies, partnerships or sole proprietorships that are affiliated,

or where the person attempting to influence the conduct of another person and that other person are principal and agent.

(3) For the purposes of this section, a suggestion by a producer or supplier of a product of a resale price or minimum resale price in respect thereof, however arrived at, is, in the absence of proof that the person making the suggestion was made that he was under no obligation to accept the suggestion and would in no way suffer in his business relations with the person making the suggestion or with any other person if he failed to accept the suggestion, proof of an attempt to influence the person to whom the suggestion is made in accordance with the suggestion.

(4) For the purpose of this section, the publication by a supplier of a product other than a retailer, of an advertisement that mentions a resale price for the product is an attempt to influence upward the selling price of any person into whose hands the product comes for resale unless the price is so expressed as to make it clear to any person to whose attention the advertisement comes that the product may be sold at a lower price.

(5) Subsections (3) and (4) do not apply to a price that is affixed or applied to a product or its package or container.

(6) No person shall, by threat, promise or any like means, attempt to induce a supplier, whether within or without Canada, as a condition of his doing business with the supplier, to refuse to supply a product to a particular person or class of persons because of the low pricing policy of that person or class of persons.

(7) Repealed

(7.1) Repealed

(8) Every person who violates subsection (1) or (6) is guilty of an indictable offence and is liable on conviction to a fine in the discretion of the court or to imprisonment for five years or to both.

(9) Where, in a prosecution under paragraphs (1)(b), it is proved that the person charged refused or counseled the refusal to supply a product to any other person, no inference unfavourable to the person charged shall be drawn from such evidence if he satisfies the court that he and any one upon whose report he depended had reasonable cause to believe and did believe

(a) that the other person was making a practice of using products supplied by the person charged as loss-leaders, that is to say, not for the purpose of making a profit thereon but for purposes of advertising;

(b) that the other person was making a practice of using products supplied by the person charged not for the purpose of selling such products at profit but for the purpose of attracting customers to his store in the hope of selling them other products;

(c) that the other person was making a practice of engaging in misleading advertising in respect of products supplied by the person charged; or

(d) that the other person made a practice of not providing the level of servicing that purchasers of such products might reasonably expect from such other person.

2. For the purposes of this Act,

(a) one corporation is affiliated with another corporation if one of them is the subsidiary of the other or both are subsidiaries of the same corporation or each of them is controlled by the same person;

(b) if two corporations are affiliated with the same corporation at the same time, they are deemed to be affiliated with each other; and

(c) a partnership or sole proprietorship is affiliated with another partnership, sole proprietorship or a company if both are controlled by the same person.

<u>1988 version</u>*:*

Repealed subsection 8. Section 38 renumbered as section 61

61 (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 a product within Canada; or

(b) refuse to supply a product to or otherwise discriminate against any other person engaged in business in Canada because of the low pricing policy of that other person.

(2) Subsection (1) does not apply where the person attempting to influence the conduct of another person and that other person are affiliated companies or directors, agents, officers or employees of

(a) the same company, partnership or sole proprietorship, or

(b) companies, partnerships or sole proprietorships that are affiliated,

or where the person attempting to influence the conduct of another person and that other person are principal and agent.

(3) For the purposes of this section, a suggestion by a producer or supplier of a product of a resale price or minimum resale price in respect thereof, however arrived at, is, in the absence of proof that the person making the suggestion was made that he was under no obligation to accept the suggestion and would in no way suffer in his business relations with the person making the suggestion or with any other person if he failed to accept the suggestion, proof of an attempt to influence the person to whom the suggestion is made in accordance with the suggestion.

(4) For the purpose of this section, the publication by a supplier of a product other than a retailer, of an advertisement that mentions a resale price for the product is an attempt to influence upward the selling price of any person into whose hands the product comes for resale unless the price is so expressed as to make it clear to any person to whose attention the advertisement comes that the product may be sold at a lower price.

(5) Subsections (3) and (4) do not apply to a price that is affixed or applied to a product or its package or container.

(6) No person shall, by threat, promise or any like means, attempt to induce a supplier, whether within or without Canada, as a condition of his doing business with the supplier, to refuse to supply a product to a particular person or class of persons because of the low pricing policy of that person or class of persons.

(7) Repealed

(8) Repealed

(9) Where, in a prosecution under paragraphs (1)(b), it is proved that the person charged refused or counseled the refusal to supply a product to any other person, no inference unfavourable to the person charged shall be drawn from such evidence if he satisfies the court that he and any one upon whose report he depended had reasonable cause to believe and did believe

(a) that the other person was making a practice of using products supplied by the person charged as loss-leaders, that is to say, not for the purpose of making a profit thereon but for purposes of advertising;

(b) that the other person was making a practice of using products supplied by the person charged not for the purpose of selling such products at profit but for the purpose of attracting customers to his store in the hope of selling them other products;

(c) that the other person was making a practice of engaging in misleading advertising in respect of products supplied by the person charged; or

(d) that the other person made a practice of not providing the level of servicing that purchasers of such products might reasonably expect from such other person.

<u>2009 version</u>*:*

Section 61 was repealed in its entirety. The amendment introduced a new reviewable matter.

76. (1) On application by the Commissioner or a person granted leave under section 103.1, the Tribunal may make an order under subsection (2) if the Tribunal finds that

(*a*) a person referred to in subsection (3) directly or indirectly

(i) by agreement, threat, promise or any like means, has influenced upward, or has discouraged the reduction of, the price at which the person's customer or any other person to whom the product comes for resale supplies or offers to supply or advertises a product within Canada, or

(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) 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) 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, trade-mark, copyright, registered industrial design or registered integrated circuit topography.

(4) No order may be made under subsection (2) if the person referred to in subsection (3) and the customer or other person referred to in subparagraph (1)(*a*)(i) or (ii) are principal and agent or mandator and mandatary, or are affiliated corporations or directors, agents, mandataries, officers or employees of

(*a*) the same corporation, partnership or sole proprietorship; or

(*b*) corporations, partnerships or sole proprietorships that are affiliated.

(5) For the purposes of this section, a suggestion by a producer or supplier of a product of a resale price or minimum resale price for the product, however arrived at, is proof that the person to whom the suggestion is made is influenced in accordance with the suggestion, in the absence of proof that the producer or supplier, in so doing, also made it clear to the person that they were under no obligation to accept the suggestion and would in no way suffer in their business relations with the producer or supplier or with any other person if they failed to accept the suggestion.

(6) For the purposes of this section, the publication by a producer or supplier of a product, other than a retailer, of an advertisement that mentions a resale price for the product is proof that the producer or supplier is influencing upward the selling price of any person to whom the product comes for resale, unless the price is expressed in a way that makes it clear to any person whose attention the advertisement comes to that the product may be sold at a lower price.

(7) Subsections (5) and (6) do not apply to a price that is affixed or applied to a product or its package or container.

(8) If, on application by the Commissioner or a person granted leave under section 103.1, the Tribunal finds that any person, by agreement, threat, promise or any like means, has induced a supplier, whether within or outside Canada, as a condition of doing business with the supplier, to refuse to supply a product to a particular person or class of persons because of the low pricing policy of that person or class of persons, and that the conduct of inducement has had, is having or is likely to have an adverse effect on competition in a market, the Tribunal may make an order prohibiting the person from continuing to engage in the conduct or requiring the person to do business with the supplier on usual trade terms.

(9) No order may be made under subsection (2) in respect of conduct referred to in subparagraph (1)(*a*)(ii) if the Tribunal is satisfied that the person or class of persons referred to in that subparagraph, in respect of products supplied by the person referred to in subsection (3),

(*a*) was making a practice of using the products as loss leaders, that is to say, not for the purpose of making a profit on those products but for purposes of advertising;

(*b*) was making a practice of using the products not for the purpose of selling them at a profit but for the purpose of attracting customers in the hope of selling them other products;

(*c*) was making a practice of engaging in misleading advertising; or

(*d*) made a practice of not providing the level of servicing that purchasers of the products might reasonably expect.

(10) In considering an application by a person granted leave under section 103.1, the Tribunal may not draw any inference from the fact that the Commissioner has or has not taken any action in respect of the matter raised by the application.

(11) No application may be made under this section against a person on the basis of facts that are the same or substantially the same as the facts on the basis of which

(*a*) proceedings have been commenced against that person under section 45 or 49; or

(*b*) an order against that person is sought under section 79 or 90.1.

(12) For the purposes of this section, “trade terms” means terms in respect of payment, units of purchase and reasonable technical and servicing requirements.

[redacted]

Australian Fact Sheet

Evidence Relied Upon By MasterCard	Evidence Relied Upon by The Commissioner of Competition
Interchange rates are capped at 50 basis points[1]	The RBA believes that allowing surcharging has or will lower retail prices
Surcharging has been allowed for a decade, as a result of regulation[2]	The RBA believes that surcharging allows merchants to send appropriate price signals
Despite surcharging being allowed, default interchange rates are not below the 50 basis point cap for MasterCard and Visa credit cards[3]	The RBA believes that the reforms were appropriate and should be continued, subject to the issue of whether surcharges should be capped
Approximately 30% of merchants surcharge and 5% of transactions are surcharged[4]	MasterCard and Visa have continued to grow, albeit not as rapidly as American Express
Surcharging has occurred, on average, at a rate of twice or more of the merchant discount rate applicable to Visa and MasterCard credit cards[5]	
Increased evidence of adverse surcharging practices has led the RBA to consider imposing caps on surcharges[6]	
The largest merchants are the most likely to surcharge[7]	
Online merchants are more likely to surcharge than bricks-and-mortar merchants[8]	
Surcharging tends to occur without differential surcharging by card type[9]	
[redacted]	
Consumer card fees have increased since the regulation came into force[11]	
Consumer card rewards have decreased since the regulation came into force[12]	
No one has been able to show that retail prices are lower than they would have been absent the regulation	

[1] Examination in chief of McCormack, page 594 (public).

[2] Cross examination of Buse, page 2141 (public).

[3] Cross examination of Carlton, page 1367 (public); cross examination of Frankel, page 1179 (public); cross examination of Stanton, page 1008 (in camera).

[4] Cross examination of Frankel, pages 1181 1182 (public).

[5] Cross examination of Leggett, pages 2646 2647 (public); Review of Card Surcharging: A Consultation Document, June 2011, Exhibit RM 69.

[6] Cross examination of Leggett, pages 2650 2651 (public); Review of Card Surcharging: A Consultation Document, June 2011, Exhibit RM 69; cross examination of Buse, pages 625 626 (public).

[7] Examination in chief of Buse, page 2114 (public); Witness Statement of Elizabeth Buse, Exhibit RV 409, para. 18.

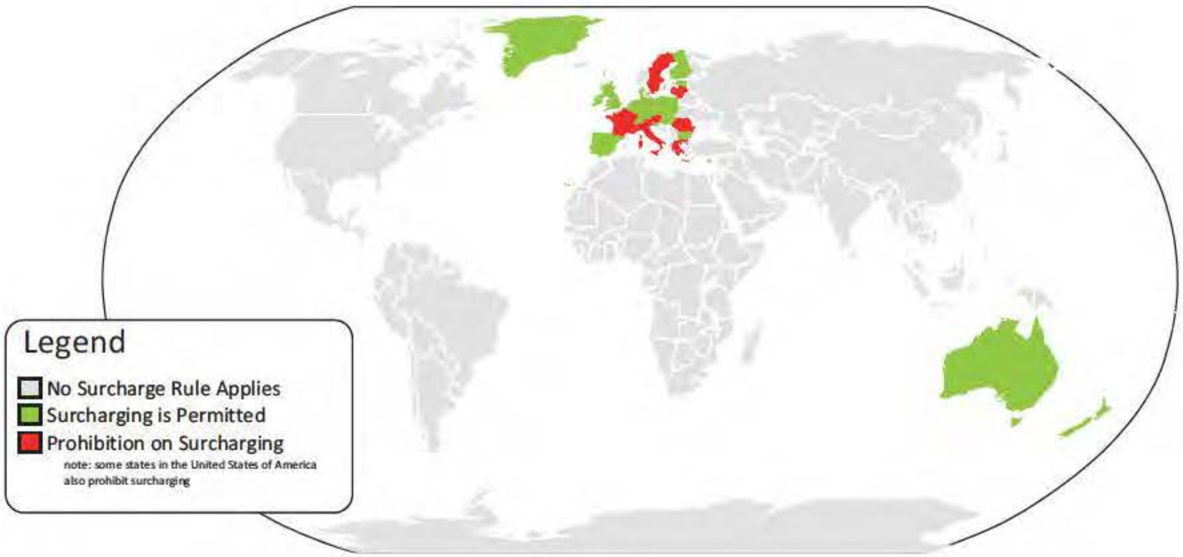
[8] Witness Statement of Elizabeth Buse, Exhibit RV 409, para. 19; examination in chief of Leggett, page 2602 (public).

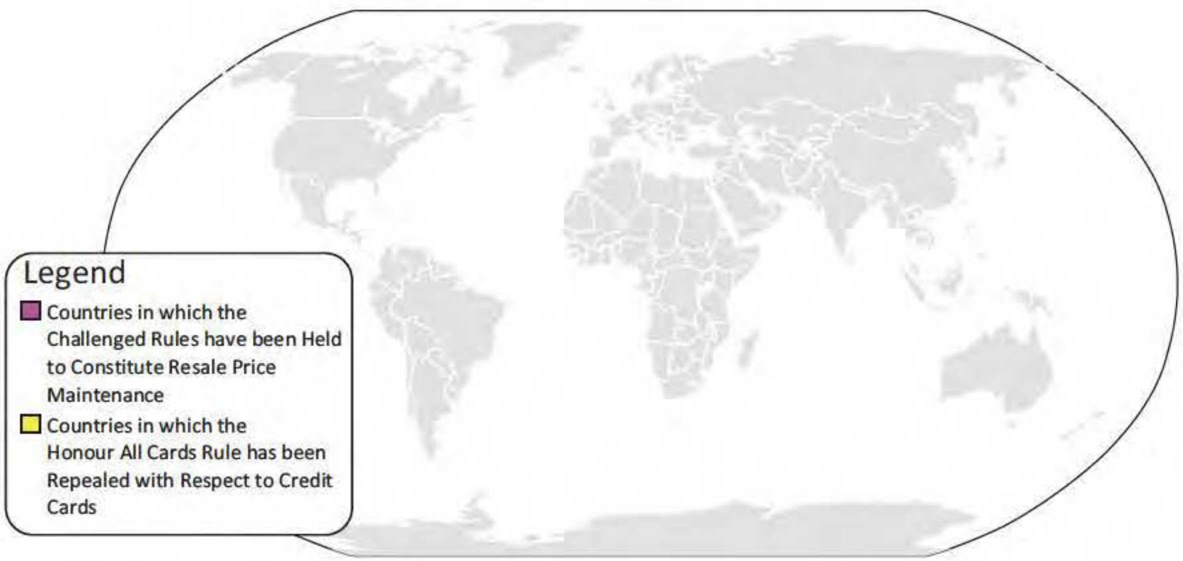
[9] Cross examination of Leggett, page 2651 (public); examination in chief of Buse, page 2115 (public).

[redacted]

[11] Examination in chief of Dunn, pages 3461 3462 (public); Summary Evidence of Peter T. Dunn, Exhibit RM 522; cross examination of Carlton, pages 1339 1340 (public); examination in chief of Leggett, pages 2597 2605 (public).

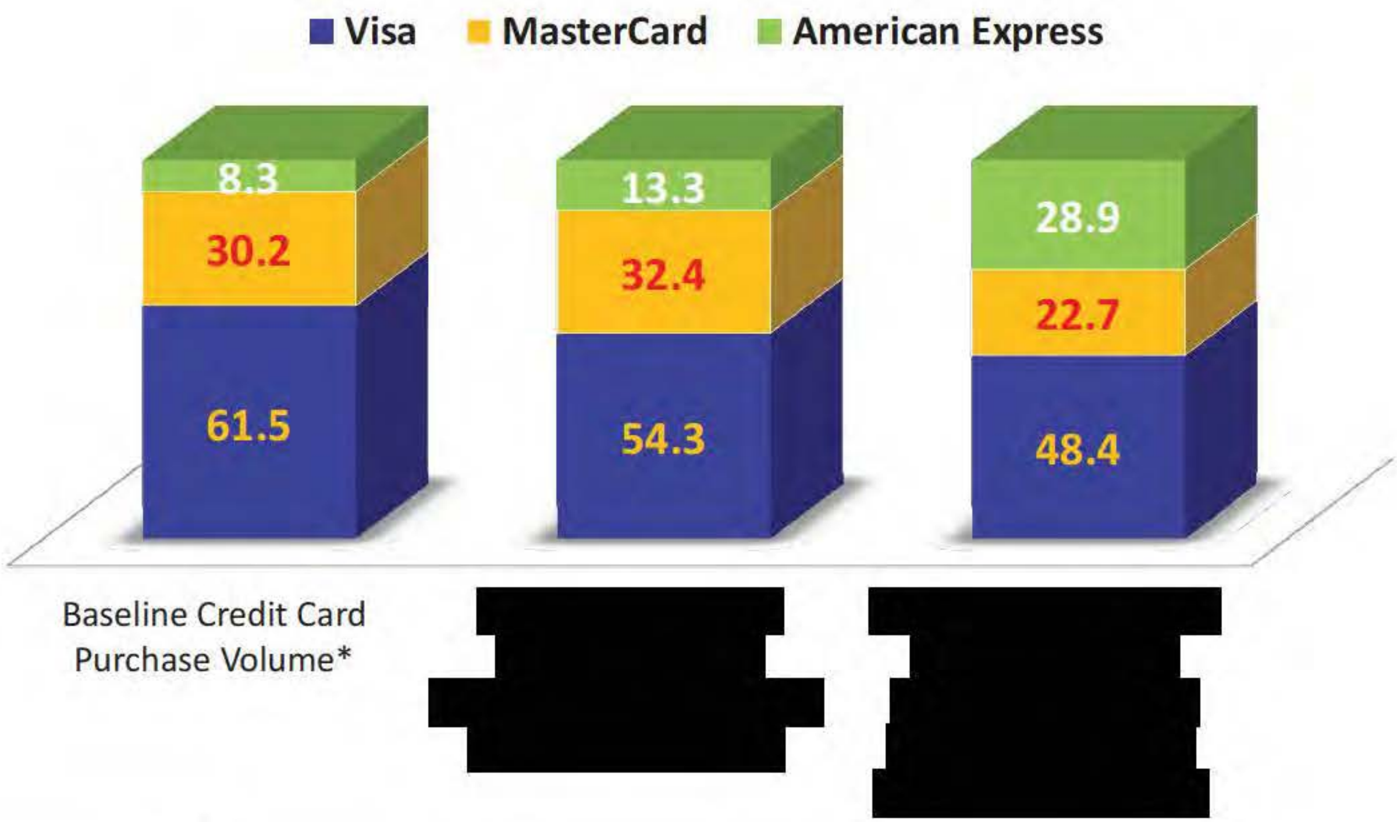
[12] Examination in chief of Dunn, pages 3461 3462 (public), Summary Evidence of Peter T. Dunn, Exhibit RM 522; examination in chief of Buse, pages 2112 2113 (public).


Legend
No Surcharge Rule Applies
Surcharging is Permitted
Prohibition on Surcharging
note: some states in the United States of America also prohibit surcharging


Legend
Countries in which the Challenged Rules have been Held to Constitute Resale Price Maintenance
Countries in which the Honour All Cards Rule has been Repealed with Respect to Credit Cards

[redacted]

2010 Credit Card Percentage Dollar Purchase Volumes in Canada as Between Visa, MasterCard and American Express



[redacted]

[redacted] Acceptance And Surcharging Chart for Domestically Issued MasterCard Credit Cards[123]

BMO CashBack MasterCard Surcharged - 1.0%	BMO MasterCard On Personal Line of Credit Surcharged - 1.0%	BMO US Dollar MasterCard Surcharged - 1.0%	BMO Preferred Rate MasterCard Surcharged - 1.0%	BMO Student Price Card MasterCard Surcharged - 1.0%	BMO MasterCard On Personal Line of Credit Surcharged - 1.0%	No Fee BMO IGA Air Miles MasterCard Not Accepted	No Fee BMO Sobeys Air Miles MasterCard Not Accepted
BMO No Fee Club Sobeys MasterCard Not Accepted	BMO PrePaid Travel MasterCard Surcharged - 1.0%	CIBC Dividend One MasterCard Surcharged - 1.0%	CIBC Petro Points MasterCard Surcharged - 1.0%	CIBC Platinum MasterCard Surcharged - 1.0%	Aventura MasterCard Surcharged - 1.0%	BMO Air Miles MasterCard Surcharged - 2.0%	BMO Premium CashBack MasterCard Surcharged - 2.0%
BMO Gold Air Miles MasterCard Surcharged - 2.0%	Shell Air Miles MasterCard Surcharged - 1.0%	Shell Cash Back MasterCard Surcharged - 1.0%	BMO Gold AIR MILES MasterCard for Business Surcharged - 2.0%	BMO AIR MILES MasterCard for Business Surcharged - 2.0%	BMO Premium CashBack MasterCard for Business Surcharged - 2.0%	BMO CashBack MasterCard for Business Surcharged - 2.0%	BMO Preferred Rate MasterCard for Business Surcharged - 2.0%
BMO U.S. Dollar MasterCard for Business Surcharged - 2.0%	BMO World Elite MasterCard Surcharged - 2.0%	Divdend Unlimited World MasterCard Surcharged - 2.0%	Aventura World MasterCard Surcharged - 2.0%	WestJet RBC MasterCard Surcharged - 2.0%	WestJet RBC World MasterCard Surcharged - 2.0%	People's Trust Non Reloadable MasterCard Surcharged - 1.0%	World Points MasterCard Surcharged - 2.0%
Smart Cash Platinum Plus MasterCard Surcharged - 1.0%	Travel Rewards MasterCard Surcharged - 1.0%	Travel Rewards Elite MasterCard Surcharged - 1.0%	Premier Rewards MasterCard Surcharged - 1.0%	All Affinity MasterCard Credit Cards* Surcharged - 2.0%	Shoppers Drug Mart/ Pharmaprix MasterCard Not Accepted	People's Trust Secured MasterCard Surcharged - 1.0%	People's Trust Reloadable PrePaid MasterCard Surcharged - 1.0%
Allure MasterCard Surcharged - 1.0%	Edition MasterCard Surcharged - 1.0%	MC1 MasterCard Surcharged - 1.0%	Syncro MasterCard Surcharged - 1.0%	Ovation Gold MasterCard Surcharged - 2.0%	Platinum MasterCard Surcharged - 2.0%	Platinum Business MasterCard Surcharged - 2.0%	MasterCard Business Card Surcharged - 2.0%
MasterCard Business Line Surcharged - 2.0%	MasterCard Corporate Card Surcharged - 2.0%	Ultramar Business Card Surcharged - 2.0%	Cash Back Gold MasterCard Surcharged - 2.0%	SmartLine Platinum MasterCard Surcharged - 1.0%	Aspire Gold MasterCard Surcharged - 1.0%	Gold MasterCard with a 9.9% Interest Rate Surcharged - 1.0%	Delta SkyMiles Gold MasterCard Surcharged - 1.0%
Gold MasterCard with a 11.9% Interest Rate Surcharged - 1.0%	Gold MasterCard with a 14.9% Interest Rate Surcharged - 1.0%	Low Rate Guaranteed MasterCard Surcharged - 1.0%	Guaranteed MasterCard Surcharged - 1.0%	Guaranteed Secured MasterCard Surcharged - 1.0%	Low Rate Guaranteed Secured MasterCard Surcharged - 1.0%	Guaranteed MasterCard for Newcomers Surcharged - 1.0%	Capital One Miles Plus MasterCard Surcharged - 2.0%
Cash Back Plus Platinum MasterCard Surcharged - 2.0%	Aspire World MasterCard Surcharged - 2.0%	Delta SkyMiles World MasterCard Surcharged - 2.0%	ATB Platinum MasterCard Surcharged - 2.0%	Alberta Gold Rewards Business MasterCard Surcharged - 2.0%	Alberta Business MasterCard Surcharged - 2.0%	Alberta Gold Ag Rewards Business MasterCard Surcharged - 2.0%	Alberta Agri Industry Business MasterCard Surcharged - 2.0%
ATB Alberta MasterCard Surcharged - 1.0%	My Husky Rewards MasterCard Surcharged - 1.0%	ATB Alberta Rewards MasterCard Surcharged - 1.0%	Student First MasterCard Surcharged - 1.0%	ATB Gold MyRewards MasterCard Surcharged - 1.0%	ATB Gold Cash Back MasterCard Surcharged - 1.0%	ATB Preferred Variable Rate MasterCard Surcharged - 1.0%	ATB Preferred Fixed Rate MasterCard Surcharged - 1.0%
Options MasterCard Not Accepted	Gold Options MasterCard Not Accepted	Premier MasterCard Surcharged - 2.0%	Gold MasterCard Surcharged - 2.0%	Advance MasterCard Surcharged - 2.0%	President's Choice Financia MasterCard Not Accepted	Low Rate Gold MasterCard Surcharged - 1.0%	Citi Gold MasterCard Surcharged - 1.0%
Citi Enrich MasterCard Surcharged - 1.0%	Citi MasterCard Surcharged - 1.0%	Staples easyRewards MasterCard Not Accepted	Citi Platinum MasterCard Surcharged - 1.0%	Driver's Edge Plantinum MasterCard Surcharged - 1.0%	Petro Points MasterCard Surcharged - 1.0%	HSBC Standard MasterCard Surcharged - 1.0%	All Credit Union MasterCards** Surcharged - 1.0%
Sears MasterCard Not Accepted	Sears Voyage MasterCard Not Accepted	Walmart Rewards MasterCard Accepted	Ultramar MasterCard Surcharged - 1.0%	Cash Advantage MasterCard Not Accepted	Canadian Tire Gas Advantage MasterCard Not Accepted		

[1] All detailed surcharge rates and card acceptance statements are subject to change. New MasterCard credit card products may be issued before this chart is updated, in which case, acceptance and surcharging level of such card will be in [redacted] sole discretion.

[2] This chart only covers MasterCard credit cards. [redacted]

[3] This chart only covers domestically issued MasterCard credit cards. [redacted]

* The acceptance and surcharging level of any affinity card will be in [redacted] sole discretion.

** The acceptance and surcharging level of any unlisted credit union MasterCard credit card will be in [redacted] sole discretion.