

**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**

COMPETITION TRIBUNAL TRIBUNAL DE LA CONCURRENCE	
<b>FILED / PRODUIT</b>	
February 14, 2011 CT-2010-010	
Jos LaRose for / pour REGISTRAR / REGISTRAIRE	
OTTAWA, ONT	# 25

Applicant

- and -

**VISA CANADA CORPORATION AND  
MASTERCARD INTERNATIONAL INCORPORATED**

Respondents

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**REPLY OF THE COMMISSIONER OF COMPETITION**

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## I. OVERVIEW

1. The Commissioner of Competition (the "Commissioner") denies each of the allegations in the Response of MasterCard<sup>1</sup> (the "MasterCard Response") and in the Response of Visa (the "Visa Response", and together with the MasterCard Response, the "Responses"), except as expressly admitted herein.

2. In seeking to justify the obvious anti-competitive effects of their conduct, the Respondents attempt to cloak themselves in the interests of consumers by repeatedly claiming that the Merchant Restraints were implemented "to protect consumers". This self-serving assertion is neither fair nor accurate. The real purpose and effect of the Merchant Restraints is to preserve the now approximately \$5 billion in Card Acceptance Fees paid each year by merchants in Canada, by preventing those merchants from taking steps to effectively foster competition in respect of, and thereby constrain, these significant Card Acceptance Fees. Those Card Acceptance Fees are largely passed on to consumers in the form of higher retail prices.

3. The Responses contain multiple unsupportable assertions and rely on numerous legal, economic and factual fallacies. The Respondents' attacks on the Application are wholly without merit, and should be rejected. As discussed more fully below, the Commissioner replies to the following eight issues arising from the Responses:

- (a) **Relevant Product Market:** The Respondents' position that the relevant product market includes all methods of payment, including cash, wire transfers and text

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<sup>1</sup> Unless otherwise indicated, defined terms in this Reply have the meaning ascribed to them in the Commissioner's Notice of Application and Statement of Grounds and Material Facts (together, the "Application").

messaging, rests on unsupportable assertions that are inconsistent with economic theory and reality. Moreover, their position is flatly contradicted by the predominant methodology for defining relevant markets – the hypothetical monopolist test – which neither Respondent even mentions, let alone applies. Although other methods of payment exist, none of them is an effective substitute for merchants for Credit Card Network Services;

- (b) **Two-Sided Nature of the Market:** The Commissioner denies the Respondents' allegation that the Application somehow misconceives the nature of or has ignored any part of the relevant market in issue, and further denies that the "two-sided" market is "the key economic fact" in this case. Nowhere in their Responses do Visa and MasterCard explain or establish that the two-sided nature of the market bears upon, let alone undermines, the Commissioner's position that the Merchant Restraints influence upward or discourage the reduction of Card Acceptance Fees paid by merchants in Canada;
- (c) **Alleged Balancing of the Market:** A significant portion of the Responses is devoted to attempting to justify the Merchant Restraints on the basis that they allegedly contribute to "appropriately balancing" the market or to achieving an "important and delicate balance" between cardholder demand and merchant acceptance. This claim by the Respondents, in their roles as self-appointed regulators of the Credit Card Network Services market, is untenable and fails to address adequately, or at all, the blatant anti-competitive effects of the Merchant Restraints, not the least of which is to eliminate a significant source of

competitive discipline on Card Acceptance Fees. Contrary to what the Respondents repeatedly claim, even if the Merchant Restraints maximize output *on the Respondents' respective networks*, this does not make them pro-competitive. It is not uncommon for anti-competitive practices to result in higher output *for the firms engaging in those practices*;

(d) **Application of Section 76 of the *Competition Act*:** Visa and MasterCard attempt to avoid responsibility for the adverse effects on competition resulting from the Merchant Restraints by, in effect, alleging that they have no role in the supply of Credit Card Network Services to merchants, and instead merely act as "the moderator" between Acquirers and Issuers. This assertion is incorrect. Not only do Visa and MasterCard supply Credit Card Network Services indirectly to merchants through Acquirers, they include explicit contractual provisions in their agreements with Acquirers that dictate the terms upon which Credit Card Network Services may be supplied by Acquirers to merchants, including the Merchant Restraints. Visa and MasterCard are clearly more than mere "moderators". They exert control over the provision of Credit Card Network Services in Canada in their capacity as operators of their respective credit card networks;

(e) **Payment of Card Acceptance Fees does Not Mean Those Fees are Competitive:** The Respondents claim that the fact that merchants have continued to accept their credit cards despite high and increasing Card Acceptance Fees is evidence that the benefits of accepting their credit cards outweigh the costs. This

does not mean, however, that such Card Acceptance Fees have been set at competitive levels. Nor does this mean that Card Acceptance Fees have not been improperly influenced upward by the Merchant Restraints. Rather than supporting the Respondents' claim that Card Acceptance Fees are competitive, the fact that merchants have continued to accept the Respondents' credit cards and to pay the significant Card Acceptance Fees associated with those cards is clear and compelling evidence of the Respondents' market power and the lack of competitive alternatives available to merchants;

(f) **Adverse Effects on Competition Resulting from the Merchant Restraints:**

The Respondents' claim that the Merchant Restraints do not affect competition adversely because merchants have "significant tools" at their disposal to steer customers to lower cost payment methods is also without merit. Discounting and the other mechanisms identified by the Respondents are not effective in encouraging customers to use lower-cost methods of payment. Indeed, Visa and MasterCard prohibit surcharging precisely because they recognize the effectiveness of surcharging in encouraging consumers to use lower-cost payment methods;

(g) **No Inconsistency Between the Theory of Harm and Relevant Market:**

The Respondents assert that, based on the Commissioner's definition of the relevant product market, allowing merchants to effectively encourage consumers to use lower-cost forms of payment, such as by surcharging on higher-cost credit cards, "cannot constrain pricing for Credit Card Network Services" as these lower-cost

forms of payment are outside of the relevant product market defined by the Commissioner. There is no inconsistency. From a *merchant's* perspective, other payment methods are not effective substitutes for Credit Card Network Services. The fact that *consumers* may elect to use another method of payment in the event that credit cards are subject to a surcharge, does not alter the fact that, even in the face of a significant increase in Card Acceptance Fees, *merchants* are unable to elect to accept only other forms of payment while declining to accept Visa and MasterCard credit cards. As explained below, the loss of revenue merchants would suffer by ceasing to accept Visa and MasterCard credit cards would be greater than the cost to merchants of paying a significant increase in the level of Card Acceptance Fees;

- (h) **Merchant Restraints are Not Pro-Consumer:** The Merchant Restraints are intended to protect the economic interests of Visa and MasterCard, not the interests of consumers. In particular, Visa and MasterCard seek to continue to collect without interruption or diminishment the billions of dollars in Card Acceptance Fees that are paid annually by Canadian merchants through the Respondents' networks. Contrary to what the Respondents suggest, the significant Card Acceptance Fees paid by merchants are largely passed on to consumers in the form of higher prices, including higher prices for those consumers that pay with cash, Interac debit and other lower-cost methods of payment. There is likewise no merit to the Respondents' claim that the Merchant Restraints are necessary to protect consumers from "bait and switch behaviour" or opportunistic or excessive surcharging. That claim rests on pure speculation and

ignores, among other things, the significant competitive and regulatory incentives that merchants have to refrain from engaging in such conduct.

## **II. RELEVANT PRODUCT MARKET**

4. Visa and MasterCard contend that the relevant product market for assessing the adverse competitive effects of the Merchant Restraints should be expanded beyond the relevant market of Credit Card Network Services proposed by the Commissioner to include all available forms of payment, including (but not limited to) cash, cheques, wire transfers and payments through text messaging.

5. As discussed below, the Respondents' position is untenable, and is fundamentally at odds with the predominant methodology for defining relevant product markets. The position of the Respondents is also inconsistent with prior decisions determining relevant markets specifically in respect of credit card networks.

6. The Commissioner states that the relevant product market for the consideration of the competitive effects of the Merchant Restraints is the supply of Credit Card Network Services, defined as the operation of a network that provides infrastructure and services enabling merchants to obtain authorization, clearance and settlement of transactions for merchants' customers that pay using the Respondents' own brands of credit cards.

7. The assertions of the Respondents concerning the relevant market fail to discuss, let alone apply, the well known and established hypothetical monopolist test for defining relevant markets. Instead, the Respondents ground their position with respect to the relevant market on the

unsupportable and self-serving claim that they compete against all other forms of payment and that these payment methods should therefore *all* be included in the relevant market.

8. Under the hypothetical monopolist test of a proposed relevant market, the question is whether a hypothetical monopolist in the market could profitably raise its price by a small but significant amount (usually taken to be 5%), for a non-transitory period of time. If customers would substitute other products in sufficient amounts to render such a price increase unprofitable, then the proposed relevant product market should be expanded to include such substitutes.

9. Different products are in the same market if they are sufficiently close substitutes for each other from the perspective of the relevant customers. In the present Application, the relevant customers are *merchants* that accept Visa and/or MasterCard credit cards and pay associated Card Acceptance Fees. The Application alleges that the Merchant Restraints influence upward or discourage the reduction of Card Acceptance Fees paid by *merchants*.

10. A merchant that wishes to accept the hypothetical monopolist's credit card cannot process that transaction using another method of payment, such as a wire transfer or text message. Rather, to process the payment, the merchant must purchase Credit Card Network Services from an Acquirer who has access to the relevant credit card network and who is authorized to supply Credit Card Network Services to the merchant.

11. Facing a price increase from a hypothetical monopolist of Credit Card Network Services, merchants confront the Hobson's choice of paying the price increase or not receiving Credit Card Network Services. Without Credit Card Network Services, merchants would be unable to accept



credit cards as a method of payment by their customers. In the current market, most merchants cannot refuse to accept credit cards as a means of payment, despite having to pay high Card Acceptance Fees, as they would suffer economically, including by losing significant sales to retail rivals that continue to accept credit cards. Merchants would not decline to accept credit cards in response to a 5% price increase by the hypothetical monopolist above the level that would prevail in the absence of the Merchant Restraints.

12. The loss of revenue suffered by merchants from ceasing to accept credit cards would be greater than the cost to merchants of paying a small, but significant non-transitory increase in the level of Card Acceptance Fees. Indeed, despite substantial increases over time in the cost to merchants of accepting Visa and MasterCard credit cards, there has been no reduction in the number of outlets that accept Visa or MasterCard credit cards.

13. Competition from other payment methods would not be sufficient to prevent a hypothetical monopolist of Credit Card Network Services from profitably maintaining supracompetitive prices for Credit Card Network Services provided to merchants.

14. Although other methods of payment exist, from the perspective of merchants none of them is an effective substitute for Credit Card Network Services. If all payment types were effective substitutes, which is expressly denied, merchants would not be expected to accept the Respondents' credit cards, which are a higher-cost method of payment, and increases in fees for Credit Card Network Services would be deterred (or at least constrained) by the likelihood that merchants would significantly reduce their purchase of Credit Card Network Services. However, the Respondents have not been deterred from raising or maintaining Card Acceptance Fees significantly above the competitive level.

15. Notably, American courts and the European Commission have rejected repeated attempts by the Respondents to broaden the relevant market to include all other methods of payment, such as cash, cheques and debit cards.

16. In light of the foregoing, the Respondents' position with respect to the relevant product market is untenable.

### **III. CREDIT CARD NETWORK AS A TWO-SIDED MARKET**

#### **(a) Relevance of Two-Sided Market Framework**

17. Visa and MasterCard assert (see, for example, Visa Response at paragraphs 2 and 26 and Visa Concise Statement of Economic Theory at paragraphs 4 to 6 and 16; MasterCard Response at paragraphs 5 to 6, 52 to 57, 84 and 100(a) and MasterCard Concise Statement of Economic Theory at paragraphs 4 and 6) that the Commissioner "misconceives the nature of the market in issue". They claim that Credit Card Network Services are supplied in a "two-sided" market consisting of consumers, on one side, and merchants, on the other. The Respondents also claim that the alleged misconception of the Commissioner in respect of this issue, and more particularly the Commissioner's alleged exclusive focus on the interests of merchants, is somehow fatal to her Application.

18. The Commissioner denies that the Application misconceives the nature of or has ignored any relevant part of the market in issue and, as it relates to this Application, expressly rejects the Respondents' claim that a two-sided market is "fundamentally different, from an economic perspective, than a one-sided market" (see Visa Concise Statement of Economic Theory at paragraph 4). The Commissioner also denies the assertion of the Respondents that the two-sided

nature of the Credit Card Network Services market is "the key economic fact in this case" (see MasterCard Concise Statement of Economic Theory at paragraph 4).

19. Nowhere in their Responses do Visa and MasterCard explain or establish how the two-sided nature of the market bears upon the Commissioner's allegation that the Merchant Restraints influence upward or discourage the reduction of the significant Card Acceptance Fees paid by merchants in Canada. Nor do they explain or establish how this feature of the market somehow affects or alters the conclusions that the relevant market consists of Credit Card Network Services in Canada and that the Merchant Restraints have had and are having an adverse effect on competition in that market.

20. A number of markets are commonly considered to be two-sided, such as newspapers and communications networks, yet those markets are routinely examined using the same legal and economic approaches applicable to "one-sided" markets. For example, the fact that a market is two-sided does not preclude one side (or the other) from constituting a relevant market, nor does it preclude or undermine the suitability of the application of the hypothetical monopolist test or the adverse competitive effects analysis to (only) one side of the market.

21. In this matter, the fact that Visa and MasterCard also supply Credit Card Network Services to Issuers and, through them, to cardholders does not alter the fact that the Merchant Restraints influence upward or discourage the reduction of the prices paid by merchants for Credit Card Network Services on the Visa and MasterCard networks. Nor does this fact somehow preclude the Tribunal from prohibiting Visa and MasterCard from continuing to enforce the Merchant Restraints in their agreements with Acquirers.

**(b) Setting of Default Interchange Fees and Alleged Balancing of the Market**

22. A significant portion of the Responses is devoted to attempting to justify the practice by which Visa and MasterCard set so-called "default" Interchange Fees. As noted in paragraph 44 of the Application, by far the most significant component of a Card Acceptance Fee is the Interchange Fee, which typically represents at least 80% of the total Card Acceptance Fee. The Respondents each establish schedules that set default Interchange Fees. Those default Interchange Fees are then adopted, almost or entirely without variation, by Issuers.

23. MasterCard correctly recognizes in paragraph 37 of its Response that the "Competition Bureau has not challenged" the Respondents' practice of setting default Interchange Fees, but nevertheless claims that the setting of default Interchange Fees is "central to the matters in issue in this Application". Although MasterCard does not say so explicitly, it appears that this contention rests on the Respondents' related assertion that the Merchant Restraints are somehow justified because, without them, Visa and MasterCard could not set and maintain the "appropriate" level of Interchange Fees.

24. In this regard, throughout their Responses Visa and MasterCard attempt to justify the Merchant Restraints on the basis that they somehow contribute to "appropriately balancing" the market or to achieving an "important and delicate balance" between cardholder demand and merchant acceptance. For example, MasterCard asserts at paragraph 8 of its Concise Statement of Economic Theory that the Merchant Restraints are "another mechanism by which consumer and merchant demand is balanced".

25. For the reasons set out below, the Respondents' purported justification of the Merchant Restraints is entirely without merit. Notably, this justification is also at odds with the Respondents' claim in their Responses that the Merchant Restraints have no effect on the level of Interchange Fees, on Card Acceptance Fees or on merchants.

26. Rather than allowing the market to operate freely and permitting market forces to establish competitive Interchange Fees, Visa and MasterCard have, through the imposition of the Merchant Restraints, eliminated a significant source of competitive discipline on Interchange Fees, thereby permitting the Respondents to maintain artificially high Interchange Fees and, by necessary implication, supracompetitive Card Acceptance Fees. The "equilibrium" fixed by Visa and MasterCard, in their roles as self-appointed regulators of the Credit Card Network Services market, is not the true equilibrium that would be achieved in a competitive market absent the Merchant Restraints.

27. Visa claims at paragraph 5 of its Concise Statement of Economic Theory and throughout its Response that "balancing the market" is "the key to increasing the overall output through the Visa Network". Similarly, MasterCard contends in its Response that the goal of the Merchant Restraints is to "maximize output" on the MasterCard network and that "[a] competition law challenge to conduct designed to maximize output is, to say the least, very peculiar" (see, *e.g.*, MasterCard Concise Statement of Economic Theory at paragraphs 2, 3 and 8 and MasterCard Response at paragraph 41).

28. In fact, and to the contrary, it is not uncommon for anti-competitive conduct to result in higher output *for the firms engaged in the anti-competitive practices in issue*. For example, that is precisely the situation where a dominant firm has improperly eliminated or disadvantaged its

rivals, thereby increasing *its own* output relative to a competitive market. There is nothing "peculiar" about seeking to eliminate anti-competitive practices, even where doing so may result in lower output *for the firms engaged in such practices*.

29. Even if the Merchant Restraints resulted in Card Acceptance Fees that were set at a level of maximizing output *on the credit card networks* of MasterCard and Visa (and even if this was relevant to the within Application), this could not reasonably be considered an economically efficient outcome. Maximizing or increasing the use of the Respondents' significantly more costly payment networks at the expense of consumers who use lower-cost payment methods, such as cash and Interac debit, is not economically efficient.

30. Further, lower Card Acceptance Fees and removal of the Merchant Restraints will likely result in increased merchant acceptance of credit cards. Certain merchants or suppliers, including municipalities and universities, are reluctant to accept credit cards as a form of payment given the high Card Acceptance Fees and the inability to recover such costs in the form of a surcharge. In the absence of the Merchant Restraints, these suppliers would be more likely to accept credit cards, leading to more widespread acceptance of credit cards.

#### **IV. APPLICATION OF SECTION 76 OF THE *COMPETITION ACT***

31. Visa and MasterCard contend that the price maintenance provisions found in section 76 of the Act are inapplicable to them, primarily on the basis that the Respondents do not supply Credit Card Network Services directly or indirectly to merchants. For example, Visa asserts in paragraph 41 of its Response that it "does not supply its services indirectly (or directly) to merchants through Acquirers". In paragraph 31 of its Response, MasterCard describes its role in

the supply of Credit Card Network Services as merely "the moderator" between Issuers and Acquirers.

32. Visa and MasterCard attempt to avoid responsibility for the adverse effects on competition resulting from the Merchant Restraints by, in effect, alleging that they have no role in the supply of Credit Card Network Services to merchants. This argument is entirely without merit. Not only do Visa and MasterCard supply Credit Card Network Services indirectly to merchants through Acquirers, they include explicit contractual provisions in their agreements with Acquirers that dictate the terms upon which Credit Card Network Services may be supplied by Acquirers to merchants. As Visa admits at paragraph 32 of its Response: "Visa's Operating Regulations require Acquirers to obtain merchants' agreement to abide by the [Merchant Restraints] (among others) in their contracts".

33. Visa and MasterCard are clearly not mere "moderators". They are the operators of their respective credit card networks, and establish unilaterally the mandatory terms and conditions on which access and other Credit Card Network Services may be supplied by Acquirers to merchants.

34. In paragraph 41 of its Response, Visa states that it "does not provide the products (services) identified by the Commissioner as Credit Card Network Services to its customers". However, in paragraphs 16 and 32 of its Response, and elsewhere therein, Visa admits that Acquirers are its customers and that "[a]uthorization, clearing and settlement are services provided by Visa Canada to Issuers and Acquirers". The Commissioner states that, contrary to the assertions of Visa, it is obvious that Visa supplies Credit Card Network Services to its Acquirer customers.

35. Visa contends in paragraphs 16 and 41 of its Response that section 76 of the Act is not applicable because the services supplied by Visa to Acquirers are not "resold". In this regard, Visa alleges that the services provided by Acquirers to merchants are different from the services supplied by Visa to Acquirers. For example, Visa asserts that the services provided by Acquirers include additional services, such as point-of-sale equipment and transaction reports, and that these ancillary services are not supplied by Visa to Acquirers.

36. Visa's arguments are without merit. Section 76 of the Act does not require that a product be "resold". Rather, section 76 applies to an agreement or other prescribed 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. As noted above, it is evident that Visa and MasterCard supply Credit Card Network Services to their Acquirer customers and that the Merchant Restraints implemented by the Respondents influence upward or discourage the reduction of the price at which Acquirers supply a product within Canada.

37. Alternatively, and in any event, Visa and MasterCard do, in fact, supply Credit Card Network Services to be "resold" by Acquirers to merchants. At a fundamental level, Visa and MasterCard have created credit card networks to which they provide direct access to Acquirers on certain mandatory terms, including an agreement by the Acquirers to apply the Merchant Restraints. Acquirers, in turn, provide access to the Visa and MasterCard networks to merchants for the purpose of processing transactions and receiving payment, again on terms dictated by Visa and MasterCard, including the mandatory Merchant Restraints.

38. Visa further argues that for its conduct to be subject to section 76 of the Act, Acquirers must be reselling to merchants precisely the same set of services – no more and no less – that are



supplied by Visa to Acquirers. This too is incorrect. Section 76 explicitly refers to conduct that influences upward or discourages the reduction of the price that "a product" is supplied by a customer, as opposed to "the product" or "the same product".

39. Section 76 of the Act explicitly contemplates that firms engaged in the supply of Credit Card Network Services may be subject to a remedy for price maintenance. Among the few types of firms expressly identified in section 76 are firms that are "engaged in a business that relates to credit cards".

40. Further, Visa contends in paragraph 46 of its Response that section 76 of the Act does not apply to the Merchant Restraints on the basis that they "say nothing about what Acquirers may charge merchants". Similarly, MasterCard states in paragraph 82 of its Response that it has no agreement with "Acquirers as to what they charge merchants for acquiring services".

41. However, section 76 of the Act is not confined to agreements that specify a particular price or set minimum prices. Rather, in pertinent part, section 76 applies to conduct that "directly or indirectly" by agreement or other prescribed means has "influenced upward, or has discouraged the reduction of" the price at which a supplier's customer supplies or offers to supply a product within Canada. As described in paragraphs 69 to 75 of the Commissioner's Application, the Merchant Restraints have the effect of influencing upward or discouraging the reduction of the significant Card Acceptance Fees charged by Acquirers for supplying Credit Card Network Services to merchants.

42. MasterCard argues in paragraph 86 of its Response that, based on the Commissioner's theory of the case, "increasing the price of an input product constitutes price maintenance,

because it will likely increase the cost of an output product". Similarly, Visa states in paragraph 44 of its Response that Card Acceptance Fees "are costs that are akin to all other costs that merchants incur and which presumably merchants have to cover in the prices they charge if they hope to make a profit".

43. As a result of the Merchant Restraints, however, the significant Card Acceptance Fees are not, in fact, "akin" to other costs faced by merchants.

44. Obviously, merchants have various operating costs and often provide services to customers that may be optional, such as parking, home delivery and assembly of products. Merchants compete on the provision of such services. In some cases, the cost of supplying such services is incorporated into the price paid by customers and offered with no additional charge. In other cases, however, the purchase price does not include these additional services, and merchants charge customers who wish to utilize such services a fee to recoup (in whole or in part) the cost of providing those services. This permits merchants to offer lower prices to those customers who assemble their own products, deliver their own products or otherwise do not utilize the additional services.

45. By contrast, the Merchant Restraints require merchants to treat Card Acceptance Fees differently from other costs merchants incur. Specifically, the Merchant Restraints prevent merchants from declining to accept higher-cost Visa and MasterCard credit cards – that is, from declining to offer these costly, additional services – and also prevent merchants from applying a surcharge to credit cards with higher Card Acceptance Fees – that is, from charging a fee to recover all or part of the expense associated with those costly, additional services.

46. In the absence of the Merchant Restraints, the significant Card Acceptance Fees paid by merchants would be similar to such other costs, in the sense that merchants would be able to elect whether to accept higher-cost credit cards or whether to apply a surcharge for those customers who choose to use higher-cost credit cards. As with the treatment of other input costs, this would permit merchants to charge lower prices to those customers who elect not to use higher-cost credit cards.

47. MasterCard contends in paragraphs 3 and 89 of its Response that the Application is not in furtherance of a "proper goal of competition law". Similarly, Visa asserts in paragraph 63 of its Response that no other antitrust authority has challenged the Merchant Restraints as constituting price maintenance.

48. Although foreign competition authorities have applied different statutory frameworks in analyzing, challenging and seeking relief in respect of the Merchant Restraints, many of these authorities have identified significant concerns regarding the anti-competitive effects of the Merchant Restraints similar to those alleged by the Commissioner. Further, despite differences in the applicable legal frameworks, a number of competition authorities have required Visa and MasterCard or their respective affiliates to amend the Merchant Restraints to address competition issues similar to those identified in this Application.

49. For example, the New Zealand Commerce Commission recently secured a remedy against Visa International Service Association, Visa Worldwide Pte Limited and MasterCard requiring, among other things, the removal of the rule prohibiting merchants from surcharging Visa and MasterCard credit cards. Among the concerns identified by the New Zealand Commerce Commission were that the Merchant Restraints, and the No Surcharge Rule in

particular, "have the purpose, effect or likely effect of controlling or maintaining, or providing for the controlling or maintaining of, the [Card Acceptance Fees] charged by acquirers" and that the Merchant Restraints "prevent competitive pressure from eroding [Interchange Fees] and [Card Acceptance Fees]".

50. In the proceedings brought against Visa Inc. and MasterCard by the U.S. Department of Justice ("DOJ"), relied upon by Visa at paragraph 64 of its Response, the DOJ recognized explicitly in its Complaint that, among other things, the "Merchant Restraints impose a competitive straightjacket on merchants", that the respondents' "set of vertically imposed restrictions independently restrains competition among networks" and that each of the respondent's "vertical Merchant Restraints are directly aimed at restraining horizontal interbrand competition".

51. Further, contrary to the assertions of MasterCard, the Commissioner's Application is entirely consistent with the "proper goal of competition law" of prohibiting price maintenance that has an adverse effect on competition, including prohibiting agreements and other conduct between suppliers and downstream firms that influence upward or discourage the reduction of the price at which such downstream firms supply or offer to supply products to customers. As described in greater detail in the Commissioner's Application at paragraphs 67 to 94, the Commissioner seeks a remedy with respect to restrictions imposed by suppliers (Visa and MasterCard) that by agreement or like means (the Merchant Restraints) restrict the terms upon which downstream firms (Acquirers) may supply products (Credit Card Network Services) to customers (merchants), thereby influencing upward or discouraging the reduction of the price at

which Acquirers supply products to merchants and adversely affecting competition in the relevant market.

**V. PAYMENT OF CARD ACCEPTANCE FEES DOES NOT MEAN THOSE FEES ARE COMPETITIVE**

52. In paragraph 22 of its Response, Visa asserts that the "fact that many ... merchants accept credit cards (including Visa Cards) speaks to the fact that, for those merchants, the benefits of doing so outweigh the costs". Similarly, MasterCard states at paragraph 88 of its Response that "merchants who accept credit cards have determined that they are more profitable doing so than not".

53. The fact that merchants accept credit cards and pay high Card Acceptance Fees does not somehow support the assertion that those Card Acceptance Fees have been set at competitive levels or have not been influenced upward by the Merchant Restraints.

54. To take an example from a different context, the fact that customers continue to buy a product sold at a supracompetitive price by suppliers who are conspiring to fix prices (presumably because even at the supracompetitive price the benefits of purchasing the product outweigh the costs) does not mean that the conspirators' conduct is not anti-competitive, that the prices paid by customers are competitive, or that participants in the cartel are not deserving of condemnation. Even a pure monopolist sets prices at levels where consumers will continue to purchase its products.

55. Indeed, the fact that merchants continue to pay Card Acceptance Fees despite the fact that such fees are set at a supracompetitive level confirms the market power held by the Respondents

and the lack of competitive alternatives available to merchants, rather than that Card Acceptance Fees are competitive.

56. Contrary to paragraph 95 of the MasterCard Response, the Commissioner is not attempting to substitute her judgment concerning the optimal level of Interchange Fees. Rather, the Commissioner is seeking to have the level of those fees determined by competitive market forces, unobstructed by the Merchant Restraints imposed by Visa and MasterCard.

## **VI. ADVERSE EFFECTS**

57. In subparagraph 62(d) of its Response and paragraph 14 of its Concise Statement of Economic Theory, Visa alleges that the removal of the Merchant Restraints would not enhance competition between Issuers with respect to the level of Card Acceptance Fees as "Issuers do not compete in this regard". To the extent that Issuers do not compete in this regard, this is so in whole or in part because the Merchant Restraints eliminate any incentive for them to do so.

58. As discussed above and in the Application, the most significant component of Card Acceptance Fees are the Interchange Fees retained by Issuers and which are essentially set by the Respondents through their default Interchange Fees. As a result of the Merchant Restraints, the Respondents currently establish default Interchange Fees for Visa and MasterCard credit cards without regard to whether merchants may react by applying a surcharge or declining to accept any of the Respondents' credit cards. The Merchant Restraints also eliminate (or significantly reduce) the need or incentive for Issuers to deviate from the default Interchange Fees set by the Respondents.

59. In the absence of the Merchant Restraints, the Respondents would have an incentive to set default Interchange Fees at a competitive level that would not result in Card Acceptance Fees that cause merchants to surcharge, prefer other credit cards or decline to accept such cards. Even if the Respondents would not lower default Interchange Fees in response to the removal of the Merchants Restraints, which the Commissioner expressly denies, *Issuers* would have an incentive to agree to lower Interchange Fees in exchange for commitments from merchants not to surcharge or refuse their cards. Consequently, the prospect and fact of merchants surcharging, disfavouring or refusing to accept certain credit cards would lead to increased competition between the Respondents, as well as among Issuers, with respect to Interchange Fees.

60. Visa contends in paragraph 13 of its Concise Statement of Economic Theory that the Commissioner fails to distinguish between "demand for a product for resale and derived demand". Visa suggests that because it does not supply merchants directly with Credit Card Network Services, it does not compete with respect to Card Acceptance Fees. There is no merit to this assertion. In fact, it is Visa that fails to fairly acknowledge that, although suppliers may not *directly* participate in downstream markets, suppliers in competitive markets do so *indirectly* and will wish to ensure that prices are set at levels that are competitive in downstream markets. For example, suppliers of products to a grocery store set wholesale prices at levels that allow those products to be offered by the grocer at retail prices that are competitive. Although the suppliers do not participate directly in the retail market, they must still have regard to competition at the retail level.

61. For the reasons explained above and in the Application, as a result of the Merchant Restraints the Respondents and Issuers have no, or a significantly reduced, incentive to ensure

that Interchange Fees and Network Fees are set at levels that will result in competitive Card Acceptance Fees.

62. Visa also contends in paragraph 13 of its Concise Statement of Economic Theory that the Merchant Restraints do not result in an adverse effect on competition because merchants have "significant tools at their disposal", such as discounting, to encourage customers to use lower-cost forms of payment. This contention is without merit. The Commissioner need only establish that making surcharging available as an option to merchants would allow merchants to more effectively encourage consumers to use lower-cost methods of payment, not that all other mechanisms identified by the Respondents are ineffective. Nevertheless, the Commissioner reiterates that discounting and the other mechanisms identified by Visa in paragraph 58 of its Response are not effective in encouraging customers to use lower-cost methods of payment. More particularly, as outlined in paragraph 66 of the Commissioner's Application, the addition of surcharging as an available option is more effective than discounting in promoting competition in respect of Card Acceptance Fees.

63. Indeed, Visa and MasterCard prohibit surcharging precisely because they recognize the effectiveness of surcharging in encouraging consumers to use lower-cost payment methods. As MasterCard notes in paragraphs 59 and 98(b) of its Response, if merchants surcharge MasterCard credit cards, or refuse to accept MasterCard credit cards this will affect the willingness of cardholders to use MasterCard credit cards. It is telling that MasterCard does not express similar concerns with respect to discounting, and has in fact permitted merchants to grant discounts for use of lower-cost forms of payment.



**VII. NO INCONSISTENCY BETWEEN THE COMMISSIONER'S PROPOSED RELEVANT PRODUCT MARKET AND THEORY OF COMPETITIVE HARM**

64. In paragraphs 57 and 62(f) of the Visa Response, paragraphs 14 and 15 of the Visa Concise Statement of Economic Theory and paragraphs 47 and 48 of the MasterCard Response, the Respondents assert that, based on the Commissioner's definition of the relevant product market, allowing merchants to effectively encourage consumers to use lower-cost forms of payment, such as by surcharging on higher-cost credit cards, "cannot constrain pricing for Credit Card Network Services" as these lower-cost forms of payment are outside of the relevant product market defined by the Commissioner. More particularly, the Respondents argue that the Commissioner's position that consumers would switch to other methods of payment in response to surcharging is inconsistent with her position that these other methods of payment are not within the relevant product market. In paragraph 15 of its Concise Statement of Economic Theory, Visa goes so far as to describe the Commissioner's position on this issue as "nonsensical".

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

66. From a merchant's perspective, other payment methods are not effective substitutes for Credit Card Network Services. The fact that *consumers* may elect to use another method of payment in the event that credit cards are subject to a surcharge does not alter the fact that, even in the face of a significant increase in Card Acceptance Fees, *merchants* are unable to elect to accept only other forms of payment while declining to accept Visa and MasterCard credit cards. As explained above, the loss of revenue merchants would suffer if they ceased accepting Visa and MasterCard credit cards would be greater than the cost to merchants of paying a significant increase in the level of Card Acceptance Fees.

67. In the absence of the Merchant Restraints, merchants could effectively encourage *consumers* to use lower-cost methods of payment, such as by surcharging higher-cost credit cards, without having to refuse to accept the Respondent's credit cards altogether. However, in the presence of the Merchant Restraints, Visa and MasterCard can maintain high Card Acceptance Fees without the risk that they will lose transactions to lower-cost methods of payment because the Merchant Restraints constrain the ability of merchants to effectively encourage *consumers* to switch to lower-cost forms of payment.

68. Further, the fact that other payment methods are outside of the relevant market should not be assumed to mean that there is *no* substitutability between such other payment methods and Credit Card Network Services. Rather, it means that competition from other payment methods would not be sufficient to prevent suppliers of Credit Card Network Services from profitably maintaining supracompetitive prices for merchants over a sustained period of time.

69. Consistent with the above, MasterCard recognizes correctly in paragraph 47 of its Response that the focus of the inquiry in defining a relevant market should be on whether there is "sufficient" competition between Credit Card Network Services and other payment methods, as opposed to *any* competition. Having recognized this principle, MasterCard fails to apply it. Nowhere in its Response does MasterCard assert that *sufficient* competition exists between Credit Card Network Services and other payment methods to establish that these products are within the same relevant product market.

**VIII. MERCHANT RESTRAINTS INCREASE PRICES TO MERCHANTS AND ULTIMATELY HARM CONSUMERS**

70. MasterCard and Visa claim repeatedly in their Responses that the Merchant Restraints were implemented to "protect consumers". This self-serving assertion is simply untrue. Instead, the purpose and effect of the Merchant Restraints is to protect the now approximately \$5 billion per year in Card Acceptance Fees paid by merchants in Canada by preventing merchants from taking steps to effectively foster competition in respect of, and thereby constrain, these significant Card Acceptance Fees.

71. Establishing price maintenance within the meaning of section 76 of the Act does not require the Commissioner to show *both* that the prices paid by merchants for Credit Card Network Services were and are being influenced upward as a result of the Merchant Restraints *and* that retail prices paid by consumers were and are higher owing to the Merchant Restraints.

72. In any event, far from being beneficial to consumers, the billions of dollars in Card Acceptance Fees paid each year by Canadian merchants have largely been passed on to

consumers, including those consumers that pay with cash, Interac debit or other lower-cost methods of payment, in the form of higher retail prices. Absent the ability to effectively constrain against the increase of Card Acceptance Fees above competitive levels (*e.g.*, by refusing to accept higher-cost credit cards or surcharging), the only way merchants can recover the additional costs resulting from artificially high Card Acceptance Fees is to increase prices generally to all consumers.

73. Consumers who pay with cash, Interac debit or other less costly methods of payment are unambiguously harmed by the Merchant Restraints as these restrictions result in artificially high Interchange Fees and correspondingly higher retail prices, while these consumers receive none of the benefits associated with the use of credit cards.

74. In paragraphs 71, 72 and 75 to 80 of the MasterCard Response and paragraph 9 of Visa's Concise Statement of Economic Theory, the Respondents argue that the Merchant Restraints are necessary to protect consumers against attempts by merchants to engage in "bait and switch behaviour with consumers" and from opportunistic or excessive surcharging by merchants.

75. These assertions are self-serving and purely speculative in nature. Merchants have significant legal, economic and reputational incentives not to "bait and switch" or engage in any other form of deceptive marketing or unfair business practice. Merchants that might engage in such practices, such as failing to adequately disclose material conditions of purchase, not only face potential remedies under the *Competition Act* or other statutes, but also a loss of customer goodwill, damage to their reputation and a loss of repeat business.

76. The Respondents' arguments that merchants would engage in opportunistic or excessive surcharging to extract additional revenues from consumers is inconsistent with the manner in which competitive markets operate. Merchants that engage in surcharging or apply excessive surcharges to credit card purchases risk losing sales to those rivals that do not apply surcharges or that apply lower surcharges. In the absence of the Merchant Restraints, competition among merchants would constrain the ability of merchants to apply surcharges, in the same way that competition at the retail level constrains other forms of price increases.

77. In the absence of the Merchant Restraints, those merchants that elected to surcharge on higher-cost credit cards would simply be charging a fee for a costly service (*i.e.*, the right to purchase with a credit card that has a high Card Acceptance Fee). Charging fees to customers who elect to use services that result in costs to the merchant is a standard, competitive business practice, not a "bait and switch" tactic.

78. The Respondents' descriptions of surcharges are completely at odds with the common sense interpretation of these charges as prices set by the merchant for offering a costly service (*i.e.*, a transaction by credit card). For example, at paragraph 80 of its Response, MasterCard claims that its Merchant Restraints prevent "merchants from penalizing consumers who wish to pay with a MasterCard card". Cardholders who use more expensive credit cards may be required to pay the costs associated with using those cards instead of having their credit cards subsidized through higher prices paid by other consumers. Such an arrangement cannot sensibly or fairly be described as a "penalty", any more than a fee charged to customers who elect to use parking (rather than walk or take the bus) can fairly be described as a "penalty".

79. If the Respondents are required to permit merchants to charge cardholders for the cost of using a credit card, this may affect the decision of some cardholders to use credit cards. However, this would simply be the price system at work, guiding consumers to make cost-based decisions.

80. In paragraph 38 of its Response, Visa suggests that the Honour All Cards Rule should be maintained because Visa markets its cards "in large part on the promise that cardholders will be able to use their Visa Card" at merchants that display the Visa logo. The effect of the Honour All Cards Rule is to prohibit merchants from selectively refusing to accept only those Visa and MasterCard credit cards with higher Card Acceptance Fees. As a consequence, faced with Card Acceptance Fees above competitive levels, merchants are confronted with the binary choice of ceasing to accept *all* Visa and MasterCard credit cards, or continuing to accept *all* of the Respondents' credit cards. The fact that Visa has elected to market its products on the basis of universal acceptance is not a legitimate justification for maintaining a restraint that requires merchants to accept all credit cards, including those with supracompetitive Card Acceptance Fees.

81. In any event, the Commissioner is not seeking relief that *requires* merchants to decline higher-cost credit cards. Rather, she is simply seeking relief that will ensure that merchants have that option. In the absence of the Merchant Restraints, participants in the Visa credit card network could take steps to reduce the likelihood that merchants will decline to accept Visa credit cards by ensuring that Card Acceptance Fees are set at competitive levels.

82. Visa alleges in paragraph 63 of its Response that "no antitrust authority in any other jurisdiction has ever challenged the [Honour All Cards Rule]". As Visa must surely be aware,

this is incorrect. Although ultimately resolved through a consensual resolution that did not include removal of the Honour All Cards Rule, the Statement of Claim filed by the New Zealand Commerce Commission in proceedings commenced in 2006 challenged the Honour All Cards Rule claiming that it substantially lessened competition by "preventing merchants from declining to accept [Visa and/or MasterCard cards] issued by particular issuing banks" and by "preventing merchants from declining to accept Visa and/or MasterCard cards of particular types or from offering different terms to customers presenting Visa and/or MasterCard cards of particular types".

83. MasterCard asserts at paragraph 87 and elsewhere in its Response that removal of the Merchant Restraints and, in particular, removal of the Honour All Cards Rule, threatens to "fundamentally undermine, and perhaps destroy the MasterCard system". The Commissioner denies this hyperbolic assertion. Presumably, if MasterCard and its Issuers genuinely believed that the very existence of the credit card network was at risk, they would ensure that Interchange Fees are set at competitive levels so as to reduce the likelihood that merchants will refuse to accept MasterCard credit cards.

84. In other jurisdictions, MasterCard has made similarly dire predictions. In Australia, for example, MasterCard claimed that the removal of certain Merchant Restraints and the lowering of Interchange Fees would "eventually lead to the whole open system unravelling", a process that MasterCard characterized as a "death spiral". In fact, the removal of certain of the Merchant Restraints, including the No Surcharge Rule, did not result in a "death spiral" for MasterCard in Australia. To the contrary, since the removal in that country of the No Surcharge Rule and a

reduction in Interchange Fees, MasterCard has and continues to benefit from *increased* merchant acceptance in Australia.

DATED at Toronto, this 14th day of February, 2011.

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

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

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

**B E T W E E N:**

**THE COMMISSIONER OF COMPETITION**

Applicant

- and -

**VISA CANADA CORPORATION and  
MASTERCARD INTERNATIONAL  
INCORPORATED**

Respondents

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**REPLY**

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