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

NOTICE OF APPLICATION

TAKE NOTICE that the Applicant, the Commissioner of Competition (the "Commissioner"), will make an application to the Competition Tribunal (the "Tribunal") pursuant to section 76 of the *Competition Act* (the "Act") for an order prohibiting the Respondents from implementing, enforcing or continuing agreements or arrangements, or engaging in any like means, that directly or indirectly influence upward or discourage the reduction of the prices paid by merchants for credit card network services within Canada. The particulars of the order sought by the Commissioner are set out in paragraph 95.

AND TAKE NOTICE that the timing and place of hearing of this matter shall be fixed in accordance with the practice of the Tribunal.

AND TAKE NOTICE that the Commissioner has attached hereto as Schedule "A" a concise statement of the economic theory of the case.

AND FURTHER TAKE NOTICE that the Commissioner will rely on the following Statement of Grounds and Material Facts in support of this Application, and such further or other material as counsel may advise and the Tribunal may permit.

STATEMENT OF GROUNDS AND MATERIAL FACTS

I. INTRODUCTION

1. The Respondents, Visa Canada Corporation ("Visa") and MasterCard International Incorporated ("MasterCard"), operate the two largest credit card networks in Canada. In 2009, the Respondents processed more than 90% of all general purpose credit card transactions in Canada, representing approximately $240 billion in purchases.

2. Every time a customer uses one of the Respondents' credit cards to pay a merchant for a good or service, that merchant must pay a fee, commonly referred to as a "Merchant Discount Fee" or "Card Acceptance Fee". In aggregate, Card Acceptance Fees are a significant cost for Canadian merchants. In 2009 alone, merchants in Canada paid approximately $5 billion in Card Acceptance Fees.

3. Visa and MasterCard have each implemented and continue to enforce agreements or arrangements imposing significant restrictions on the terms upon which credit card network services may be supplied to merchants (the "Merchant Restraints"). The Merchant Restraints prevent merchants from effectively encouraging customers to use lower-cost methods of payment and from declining to accept certain Visa and MasterCard credit cards, including those with higher Card Acceptance Fees. The Merchant Restraints impede or constrain competition for credit card network services, including competition with respect to Card Acceptance Fees.

4. Merchants typically pass some or all of the increased costs resulting from high Card Acceptance Fees onto their customers in the form of higher retail prices for goods and services.

These costs are borne by all customers of a merchant, including those that use other methods of payment, such as cash, debit cards or credit cards with lower Card Acceptance Fees.

5. The Commissioner brings this application pursuant to section 76 of the Act for an order prohibiting each of the Respondents from entering into, implementing, enforcing or continuing agreements or arrangements, or engaging in any like means, which influence upward or discourage the reduction of the Card Acceptance Fees paid by merchants and, indirectly, by consumers in Canada.

II. OVERVIEW

6. Each of the Respondents operates a network that provides infrastructure and services enabling merchants to obtain authorization, clearance and settlement of transactions (collectively, "Credit Card Network Services") for merchants' customers that pay using that Respondent's own brand of credit cards.

7. Credit cards offer a number of unique features, such as deferred payment options, that distinguish them from cash, cheques, debit cards and other methods of payment.

8. Canadian merchants pay significant Card Acceptance Fees for Credit Card Network Services. Card Acceptance Fees are generally set as a percentage of the transaction price and are typically withheld from the funds reimbursed to merchants through the credit card network. For example, a Card Acceptance Fee of 2% would result in a merchant being reimbursed $98 for a $100 retail transaction, with the remaining $2 constituting the Card Acceptance Fee.

9. Card Acceptance Fees reflect a number of underlying components. The most significant component of a Card Acceptance Fee, typically representing at least 80% of the total, is the "Interchange Fee" retained by the financial institutions (commonly referred to as "Issuers") that issue Visa and MasterCard credit cards to cardholders.

10. The amount of the Card Acceptance Fees (and the underlying Interchange Fee component) charged to a merchant varies depending on a number of factors, including the type of credit card used by the customer. If a customer uses a so-called "premium" credit card, such as the Visa Infinite or MasterCard World Elite, the merchant typically pays higher fees than if a customer uses a basic credit card, such as a Visa Classic or a basic MasterCard.

11. The use by a merchant's customer of another method of payment, such as cash or debit, usually results in lower costs for the merchant. For example, processing an Interac debit card transaction typically costs a merchant about 12 cents per transaction, regardless of the amount of the transaction. In contrast, if a customer uses a credit card to make a $100 purchase, a merchant will generally pay approximately $2.00 in Card Acceptance Fees, 17 times more than the 12 cents per transaction that would typically be paid by the merchant had the customer used Interac debit to make the same purchase.

12. Visa and MasterCard supply Credit Card Network Services indirectly to merchants through financial institutions commonly referred to as "Acquirers". In their agreements or arrangements with Acquirers, both Visa and MasterCard require Acquirers to impose significant restrictions (previously defined as the "Merchant Restraints") on the terms upon which Acquirers may supply Credit Card Network Services to merchants. Visa and MasterCard require Acquirers to impose and enforce the Merchant Restraints on merchants and require Acquirers to

incorporate these restrictions into agreements or arrangements between Acquirers and merchants relating to the supply of Credit Card Network Services. Merchants must abide by the Merchant Restraints in order to obtain Credit Card Network Services, which are essential in order to accept payments by customers using a Respondent's credit cards.

13. As a result of the Merchant Restraints imposed by Visa and MasterCard, merchants are impeded or constrained in their ability to encourage their customers to use lower-cost methods of payment, such as cash, debit cards and credit cards with lower Card Acceptance Fees. The Merchant Restraints impede or constrain merchants from: (i) discouraging the use of more expensive credit cards by customers in favour of lower-cost methods of payment; (ii) declining to accept certain credit cards, such as those with higher Card Acceptance Fees; and/or (iii) applying a surcharge to transactions where the customer uses more expensive credit cards of the Respondents.

14. The Merchant Restraints impede or constrain the ability of merchants to foster competition on the level of Card Acceptance Fees. Since merchants are unable to effectively encourage customers to utilize credit cards with lower Card Acceptance Fees or other lower cost methods of payment at the point of sale, the Respondents and other participants in each Respondent's credit card network have no meaningful incentive to compete with respect to Card Acceptance Fees, such as through lower Interchange Fees.

15. The Merchant Restraints eliminate a significant source of competitive discipline on Card Acceptance Fees by prohibiting merchants from distinguishing between credit cards, refusing to accept credit cards with higher Card Acceptance Fees or otherwise effectively encouraging customers to use lower-cost payment options. In the absence of the Merchant Restraints,

merchants could choose to refuse or selectively surcharge higher-cost credit cards, thereby encouraging competition with respect to Card Acceptance Fees.

16. 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. In the absence of the Merchant Restraints, the Card Acceptance Fees paid by merchants would be significantly lower.

17. As described below, the Commissioner seeks an Order prohibiting the Respondents from implementing, enforcing or continuing agreements or arrangements, or engaging in any like means, that prevent or constrain merchants from encouraging customers to use lower-cost methods of payment, including, without limitation, rules that prohibit merchants from: (i) discriminating against or discouraging the use of higher-cost credit cards in favour of lower-cost methods of payment; (ii) applying a surcharge or setting prices for customers that reflect the cost to the merchant of the payment method selected; or, (iii) refusing to accept particular credit cards of the Respondents.

III. THE PARTIES

18. The Commissioner is appointed pursuant to section 7 of the Act, and is charged with the administration and enforcement of the Act.

19. Visa is incorporated under the laws of Nova Scotia with its principal place of business in Toronto, Ontario. Visa operates the largest credit card network in Canada and processed approximately 1.6 billion credit card transactions in 2009, representing approximately $162

billion in purchases. Visa is a subsidiary of Visa Inc., a publicly-traded corporation incorporated under the laws of the State of Delaware.

20. MasterCard is incorporated under the laws of the State of Delaware. MasterCard operates the second-largest credit card network in Canada and processed approximately one billion credit card transactions in 2009, representing approximately $79 billion in purchases. MasterCard is a subsidiary of MasterCard Incorporated, a publicly-traded corporation incorporated under the laws of the State of Delaware.

IV. INDUSTRY BACKGROUND

(a) Credit Cards

21. General purpose credit cards ("credit cards"), such as Visa or MasterCard credit cards, are devices that may be used to purchase goods and services from a wide variety of merchants without accessing or reserving the cardholder's funds at the time of purchase, and which allow cardholders to pay charges over time, with interest. Credit cards include cards issued to individuals for personal use and corporate cards that are issued to individuals and firms for business use.

22. In addition to credit cards, some consumers pay using general purpose charge cards, such as certain American Express cards, which may also be used at a wide variety of merchants, but which are different from credit cards in that they require the cardholder to pay all charges within a set period after a monthly bill is rendered.

23. Credit cards do not include cards that access funds on deposit in a chequing or savings account, such as debit cards. Further, for the purpose of this Application, credit cards do not include store, proprietary or private label cards, such as Sears Cards, which are issued by individual merchants and may normally only be used by consumers for purchases from the issuing merchant.

24. Credit cards offer unique features that distinguish them from other methods of payment, such as debit or charge cards, cash or cheques. For example, credit cards offer cardholders an interest-free period between the time of purchase and the date when payment is due, and also provide a convenient form of revolving credit. Specifically, credit cards normally permit the cardholder to pay all charges without interest within a set period after a monthly bill is rendered. Alternatively, the cardholder is permitted to pay only a portion of the applicable charges within that time, and to pay the remainder at a future date, with interest.

25. Customers use credit cards to complete transactions and as a source of credit. In contrast, debit cards do not provide a credit function or an interest-free period following purchases, as charges are deducted directly from the debit cardholder's account at or about the time of the transaction. In addition, debit cards often have lower daily spending limits. Similarly, charge cards require the cardholder to pay all charges within a set period after a monthly bill is rendered. Consequently, for large purchases that a customer wishes to finance over time, credit cards may be preferred by customers over other payment methods that do not allow for deferred payment.

26. Beyond revolving credit, credit cards provide a number of features, including protection against fraudulent transactions and the ability to make purchases remotely (by telephone or through the Internet), which are not generally available with certain other methods of payment.

In addition, Issuers of credit cards commonly offer cardholders reward points and other similar benefits that are not generally offered by other methods of payment.

27. 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 such services over a sustained period of time in Canada or from imposing anti-competitive terms and restrictions on Canadian merchants.

(b) Processing Credit Card Transactions on the Respondents' Networks

28. For the purpose of section 76 of the Act, each of the Respondents is a person that: (i) is engaged in the business of producing or supplying a product; (ii) is engaged in a business that relates to credit cards; and/or (iii) has the exclusive rights and privileges conferred by a patent, trade-mark, copyright or registered industrial design.

29. Specifically, each of the Respondents operates a network for the authorization, clearance and settlement of transactions involving its own brand of credit cards, but not for any other brand of credit card. In addition, the Respondents have developed and implemented marketing programs and have established rules and regulations for processing transactions on their respective credit card networks.

30. Each of the Respondents supplies Credit Card Network Services (directly to Issuers and Acquirers and indirectly to merchants and cardholders) for the purpose of processing credit card transactions, but does not directly issue credit cards, set annual fees on credit cards or determine annual interest rates. Rather, as described below, these steps are performed through other participants in the Respondents' respective networks.

31. In addition to the Respondents, who are the operators of the credit card networks, a credit card transaction on the Visa and MasterCard networks typically involves four participants: cardholders (consumers and businesses that use credit cards to purchase goods and services), merchants (sellers of goods and services that accept credit cards for payment), Issuers (financial institutions that issue credit cards to consumers) and Acquirers (financial institutions that supply Credit Card Network Services to merchants for the purpose of processing credit card transactions). For this reason, the Visa and MasterCard networks are sometimes referred to as "four-party" systems. Each of these other participants and their roles in the Respondents' respective network are described briefly below.

32. Cardholders include a broad range and a significant number of Canadian consumers and businesses. In 2009, there were 44 million MasterCard credit cards and 31 million Visa credit cards in circulation in Canada.

33. Visa and MasterCard credit cards are widely accepted by merchants in Canada, including numerous retail establishments, restaurants and service providers, as well as charities. In 2009, over 670,000 merchant outlets in Canada accepted Visa or MasterCard. The vast majority of these merchants also accept other methods of payment from customers, such as cash or debit cards.

34. Visa and MasterCard credit cards are issued to cardholders by financial institutions, commonly referred to as "Issuers". Issuers enter into contractual relationships with cardholders to allow cardholders to access credit and conduct transactions using credit cards issued by those Issuers.

35. Issuers generally determine how to market and supply credit cards to consumers, including whether to offer a particular card to a particular consumer, the extent of related advertising initiatives, the level of annual fees to be paid by cardholders, and the interest rate and other charges associated with the revolving credit function of a credit card. The nature and level of rewards available through use of a card (such as air miles, concierge services or cash-back rewards) are also generally determined by Issuers, but are often subject to certain minimum benefit levels established by each of the Respondents.

36. In order to accept payments made on a credit card, merchants purchase network services for the applicable credit card network from an Acquirer. Each of the Respondents has entered into various agreements and arrangements with Acquirers for the supply of Credit Card Network Services to merchants. Acquirers are customers of Visa and MasterCard with respect to the supply of Credit Card Network Services.

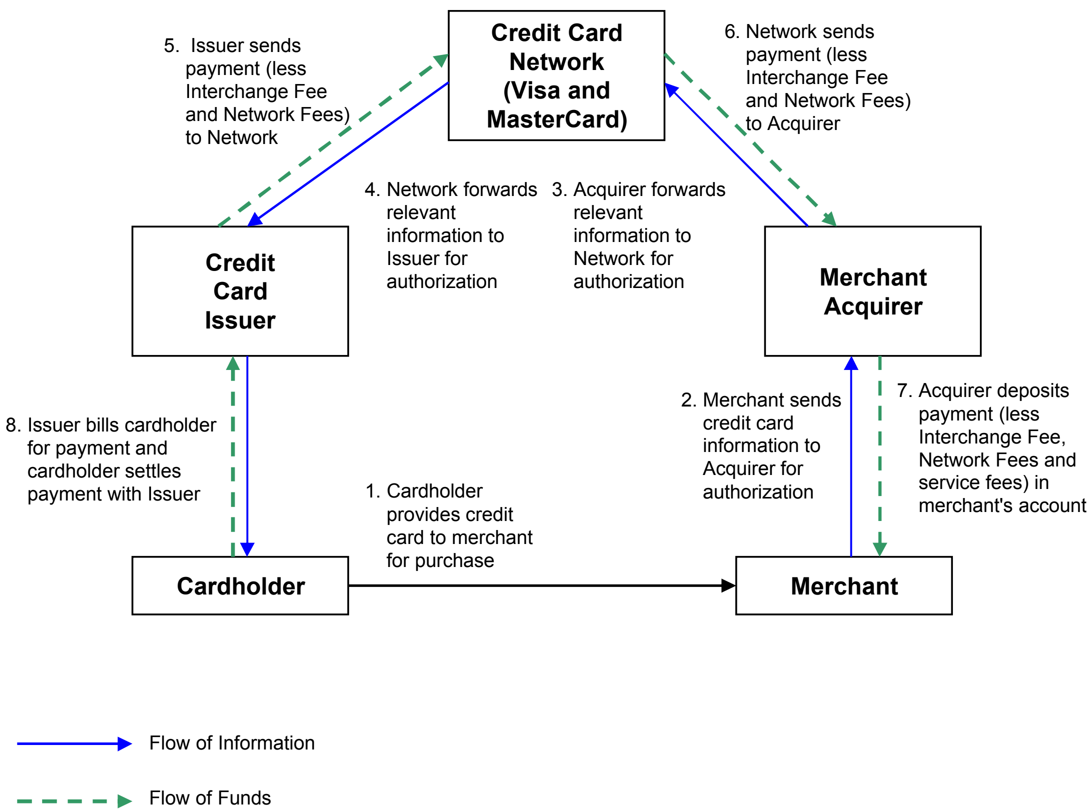
37. A merchant who wishes to accept a Visa or MasterCard branded credit card must process all transactions using such cards through the credit card network associated with that brand. For example, merchants wishing to accept Visa credit cards purchase Credit Card Network Services from an Acquirer who has access to Visa's credit card network and is authorized by Visa to supply Credit Card Network Services. These services include arranging for the authorization and processing of credit card transactions, facilitating the payment of merchants for those transactions and, in some cases, providing equipment (such as electronic point-of-sale terminals) to merchants to facilitate the acceptance of credit cards.

38. Instead of supplying authorization and processing services directly to merchants, certain Acquirers outsource these services to processors, such as Moneris Solutions, that own and

maintain systems to process credit card transactions. These processors contract with merchants on behalf of Acquirers to supply Credit Card Network Services to merchants.

39. A typical example of a system for Credit Card Network Services is illustrated in Figure 1 below:

Figure 1 – Credit Card Network



40. As noted, each of the Respondents has entered into agreements or arrangements with Acquirers that govern the Acquirers' supply of Credit Card Network Services to merchants. Among other things, and as discussed more fully below, these agreements or arrangements require Acquirers to impose and enforce the Merchant Restraints and require Acquirers to incorporate these restrictions into agreements or arrangements between the Acquirers and

merchants governing the acceptance of Visa and MasterCard credit cards. Merchants must abide by the Merchant Restraints in order to be able to accept payments by customers using a Respondent's credit cards.

41. The Merchant Restraints influence upward or discourage the reduction of the prices paid by merchants for Credit Card Network Services. As merchants need to cover payment processing costs, they pass some or all of the increased costs from higher Card Acceptance Fees onto all of their customers in the form of higher retail prices for goods and services.

V. CARD ACCEPTANCE FEES

42. Merchants pay significant fees for each credit card transaction processed on the Visa network or MasterCard network (previously defined as "Card Acceptance Fees") that reflect a number of underlying components and vary according to, among other factors, the type of credit card used by the customer.

43. The components underlying Card Acceptance Fees include: (i) "Network Fees" that are retained by Visa or MasterCard; (ii) Interchange Fees that are retained by Issuers; and (iii) service fees that are retained by Acquirers. In 2009, merchants in Canada paid approximately $5 billion in Card Acceptance Fees on the Visa and MasterCard networks.

44. 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 remainder is comprised of Network Fees and Acquirer service fees. As a result, the level of Card Acceptance Fees is determined predominantly by the level of Interchange Fees. Increases in Interchange Fees have consistently resulted in corresponding increases in Card Acceptance Fees.

45. The Respondents each establish schedules that dictate the default Interchange Fee applicable to a particular transaction on their respective credit card networks. These default Interchange Fees are adopted, almost or entirely without variation, by Issuers.

46. The Interchange Fees and Network Fees establish a floor for Card Acceptance Fees, as no Acquirer could profitably set Card Acceptance Fees below the combined level of Interchange Fees and Network Fees. Acquirers pass on most or all of the Interchange Fees and Network Fees to merchants for payment.

47. Acquirers are unable to constrain increases in the Interchange Fee or Network Fee components of the Card Acceptance Fee. Irrespective of which Acquirer a merchant approaches to supply Credit Card Network Services, that Acquirer faces the same set of Interchange Fees and Network Fees established or imposed by the relevant Respondent, and that Acquirer is required to impose the same restrictions on competition with respect to Card Acceptance Fees as are prescribed by that Respondent.

48. Although bilateral negotiations between Issuers and Acquirers with respect to Interchange Fees are permitted by both Visa and MasterCard, the Merchant Restraints ensure that such negotiations either do not occur, or occur only very rarely. By requiring merchants who wish to accept a Respondent's credit card to accept all of that Respondent's credit cards and to treat all such cards alike, even those with higher Card Acceptance Fees, the Merchant Restraints significantly reduce or eliminate any incentives for Issuers to offer lower Interchange Fees in an attempt to attract business away from any other Issuer.

49. Further, merchants are prevented by the Merchant Restraints from effectively encouraging customers to utilize credit cards with lower Card Acceptance Fees or other lower-cost methods of payment at the point of sale, such as by surcharging credit cards with higher Card Acceptance Fees. Consequently, the Respondents have no meaningful incentive to compete with respect to the level of Interchange Fees or Network Fees that merchants must pay as part of their Card Acceptance Fees.

VI. THE MERCHANT RESTRAINTS

50. Each of the Respondents has instituted its own set of Merchant Restraints that impedes or constrains the ability of merchants who accept that Respondent's credit cards to encourage customers to use lower-cost credit cards or other lower-cost methods of payment.

51. Visa's latest version of the Merchant Restraints is found in Visa's International Operating Regulations (the "Visa Rules") dated October 15, 2010. MasterCard's latest version of the Merchant Restraints is found in a document entitled the "MasterCard Rules" dated October 29, 2010.

52. Visa and MasterCard require Acquirers to incorporate the Merchant Restraints into agreements between Acquirers and merchants, either directly or by reference. The Visa Rules state in Core Principle 6.4 that an Acquirer must "[e]nsure that its Merchant complies with the [Visa Rules] regarding payment acceptance" and "[e]nsure that required acceptance provisions are included in its Merchant Agreement or as a separate addendum". Similarly, MasterCard requires in Rule 5.1 that "[e]ach Member in its capacity as an Acquirer must directly enter into a

written Merchant Agreement with each Merchant from which it acquires Transactions" and that "[e]ach Merchant Agreement must contain the substance of each of the [Merchant Restraints]".

53. The Merchant Restraints imposed by MasterCard prohibit a merchant from engaging in promotions or otherwise effectively encouraging customers to utilize credit cards with lower Card Acceptance Fees. Rule 5.11.1 of the MasterCard Rules provides that a merchant "must not engage in any acceptance practice that discriminates against or discourages the use of a [MasterCard] Card in favour of any other" brand of credit card that is accepted by that merchant.

54. The Merchant Restraints also constrain or impede the ability of merchants to decline to accept those particular credit cards with higher Card Acceptance Fees. Each of the Respondents imposes a rule that requires merchants accepting any of a Respondent's credit cards to accept all forms of that Respondent's credit cards, including cards that result in higher Card Acceptance Fees for merchants. Rule 5.8.1 of the MasterCard Rules explicitly requires merchants to "honor all valid [MasterCard] Cards without discrimination when properly presented for payment". The Visa Rules similarly prescribe in Core Principle 6.2 that merchants "may not refuse to accept a Visa product that is properly presented for payment".

55. Further, the Merchant Restraints prohibit merchants from surcharging or setting prices for customers that reflect the cost to the merchant of the payment method selected by the customer. Rule 5.11.2 of the MasterCard Rules provides that merchants "must not directly or indirectly require any Cardholder to pay a surcharge or any part of any Merchant discount or any contemporaneous finance charge in connection with a Transaction". Similarly, the Visa Rules state as part of the General Prohibitions in Chapter 6 that merchants "must not add any

surcharges to Transactions, unless local law expressly requires that a Merchant be permitted to impose a surcharge".

56. In summary, the Merchant Restraints prohibit merchants who accept Visa or MasterCard credit cards from, among other things:

(a) effectively encouraging the use of lower-cost methods of payment and discouraging the use of credit cards with higher Card Acceptance Fees;

(b) declining to accept certain credit cards, such as those with higher Card Acceptance Fees; and

(c) surcharging the Respondents' credit cards or setting prices for customers that reflect the cost to the merchant of the payment method selected.

57. Owing to the Merchant Restraints, merchants are prevented from engaging in actions or conduct that would result in lower Card Acceptance Fees. The Merchant Restraints constrain or prevent merchants from engaging in actions that foster competition with respect to Card Acceptance Fees or, at least, significant components of Card Acceptance Fees; namely, Interchange Fees and Network Fees.

58. The Merchant Restraints imposed by Visa and MasterCard constrain or prevent merchants from encouraging customers to use lower-cost methods of payment, including credit cards with lower Card Acceptance Fees. Since merchants are unable to effectively encourage customers at the point of sale to use credit cards with lower Card Acceptance Fees or other lower-cost methods of payment, there is a significantly reduced incentive on the part of Issuers

and the Respondents to compete with respect to the Interchange Fees or Network Fees which, as stated above, are significant components of Card Acceptance Fees. Merchants are contractually prohibited through their agreements with Acquirers from taking any effective action that would foster competition with respect to Card Acceptance Fees.

VII. VOLUNTARY CODE OF CONDUCT

59. On April 16, 2010, the Department of Finance Canada issued a voluntary Code of Conduct for the Canadian credit and debit card industries (the "Voluntary Code of Conduct") that was adopted by a number of industry participants, including the Respondents.

60. Among other things, the Voluntary Code of Conduct: (i) provides for increased transparency and disclosure by credit card networks and Acquirers to merchants; (ii) institutes minimum notice periods for increases in Card Acceptance Fees; and (iii) allows merchants that accept credit cards from a particular network to decline to accept debit cards from that network.

61. The Voluntary Code of Conduct also provides that credit card networks must allow merchants to grant discounts for different methods of payment, such as cash, debit cards or credit cards, and to vary discounts between credit card brands (such as Visa and MasterCard). For example, under the Voluntary Code of Conduct, credit card networks must permit a merchant to grant a discount to a customer in connection with a transaction for which a MasterCard credit card was used, and to simultaneously refuse to offer the same (or any) discount to that customer if a Visa credit card was instead used to complete the transaction.

62. The Voluntary Code of Conduct does not require the modifications that would be necessary to address the issues raised under the Act that are the subject of this Application.

63. Among other things, the Voluntary Code of Conduct does not require the Respondents to allow merchants to surcharge transactions when customers use credit cards with higher Card Acceptance Fees. From the perspective of fostering competition with respect to Card Acceptance Fees, the ability to apply a surcharge is the most effective means by which merchants can encourage customers to use credit cards with lower Card Acceptance Fees or other lower-cost methods of payment.

64. The Voluntary Code of Conduct does not require credit card networks to permit merchants to offer discounts based on the *type* of credit card used (as opposed to the *brand* of card). For example, the Voluntary Code of Conduct does not require credit card networks to permit a merchant to offer a discount for the use of a Visa Classic credit card, which has a lower Card Acceptance Fee, but not to offer the same discount for the use of a Visa Infinite credit card, which has a higher Card Acceptance Fee. The Voluntary Code of Conduct does not require Respondents to allow a merchant to refuse to accept only certain credit cards, such as those with higher Card Acceptance Fees.

65. Without the ability to refuse to accept, differentiate or surcharge credit cards with higher Card Acceptance Fees, merchants do not have the means required to effectively promote the use of credit cards with lower Card Acceptance Fees or other lower-cost methods of payment, and in turn, foster competition with respect to Card Acceptance Fees.

66. Relative to discounting, surcharging is a more effective means of promoting competition in respect of Card Acceptance Fees for at least two reasons:

(a) to remain competitive, merchants must be able to advertise the single lowest price they can offer for goods and services, as opposed to a price that may be further discounted at the point of sale; and

(b) customers react more strongly to paying a surcharge (which is viewed as an out-of-pocket expense) than to foregoing a discount (which is viewed as an opportunity cost).

VIII. APPLICATION OF SECTION 76 OF THE ACT

(a) Respondents are Persons Subject to an Order

67. Each of the Respondents is a person that: (i) is engaged in the business of producing or supplying a product; (ii) is engaged in a business that relates to credit cards; and/or (iii) has the exclusive rights and privileges conferred by a patent, trade-mark, copyright or registered industrial design. As such, each of the Respondents may be subject to an order under section 76 of the Act.

(b) Directly or Indirectly by Agreement or Any Like Means

68. As outlined above, each of the Respondents has entered into agreements or arrangements with Acquirers that govern the supply of Credit Card Network Services to merchants. Among other things, these agreements or arrangements require Acquirers to impose and enforce the Merchant Restraints on their merchant customers and to incorporate these restraints into agreements between the Acquirers and merchants.

(c) Influence Upward or Discourage the Reduction of the Price

69. The Merchant Restraints influence upward or discourage the reduction of the Card Acceptance Fees paid by merchants for Credit Card Network Services. In the absence of the Merchant Restraints, the prices paid by merchants for Credit Card Network Services would have been substantially lower than have existed, and than currently exist, in the presence of the Merchant Restraints.

70. The Merchant Restraints eliminate a significant source of competitive discipline on Card Acceptance Fees by prohibiting merchants from distinguishing between credit cards, refusing to accept credit cards with higher Card Acceptance Fees or otherwise effectively encouraging customers to use lower-cost payment options. In the absence of the Merchant Restraints, merchants could elect to refuse or selectively surcharge higher-cost credit cards, or indicate to the Respondents that they are prepared to surcharge or refuse to accept their higher-cost credit cards, thereby encouraging competition with respect to Card Acceptance Fees.

71. The Merchant Restraints prevent or constrain merchants from undertaking actions that would foster competition with respect to Credit Card Network Services, including Interchange Fees (and, ultimately, Card Acceptance Fees). Among other things, in the absence of the Merchant Restraints, a merchant could respond to high or increased Interchange Fees (that result in higher Card Acceptance Fees) for a particular credit card by attempting to encourage customers to use credit cards with lower Interchange Fees or other lower-cost methods of payment, thereby promoting and enhancing competition between Issuers for the supply of credit cards with lower Interchange Fees.

72. The ability to surcharge credit card transactions would allow merchants to recover the additional costs associated with higher-cost credit cards directly from those customers that elect to use such cards, thereby allowing merchants to offer lower retail prices to customers that do not use higher-cost credit cards.

73. In the absence of the Merchant Restraints, the Respondents and Issuers would have an incentive to reduce Card Acceptance Fees to levels that will not cause merchants to surcharge or otherwise prefer or promote certain credit cards. This is because merchants surcharging or refusing to accept a credit card with higher Card Acceptance Fees would likely reduce the volume of transactions using that credit card. As such, the prospect and fact of merchants surcharging or refusing particular credit cards would impose substantial downward pressure on Card Acceptance Fees and would lead to increased competition between Visa and MasterCard, as well as between Issuers, with respect to the Interchange Fee and Network Fee components of Card Acceptance Fees.

74. In addition to promoting competition *between* Visa and MasterCard, the removal of the Merchant Restraints would allow merchants to encourage the use of particular credit cards with lower Card Acceptance Fees, thereby fostering competition *within* each of the Visa and MasterCard networks. For example, the removal of the Merchant Restraints would allow a merchant to surcharge or refuse to accept a Visa Infinite credit card from one Issuer that has higher Interchange Fees, while accepting and not surcharging a Visa Infinite credit card from a different Issuer that has lower Interchange Fees.

75. The mere potential that a particular credit card offered by one of the Respondents would not be accepted or could be subject to surcharging by merchants would create an incentive for

the Respondents to ensure that the Card Acceptance Fees associated with that credit card remain competitive with the Card Acceptance Fees associated with other credit cards. In addition, surcharging by merchants would provide transparency for cardholders with respect to the cost for merchants of credit card acceptance.

(d) The Person's Customer or Any Other Person to Whom the Product Comes for Resale

76. Visa and MasterCard supply Credit Card Network Services indirectly to merchants through Acquirers. Specifically, each of the Respondents supplies Credit Card Network Services to Acquirers who, in turn, supply these services to merchants that accept Visa or MasterCard credit cards. Acquirers are customers of Visa and MasterCard with respect to the supply of Credit Card Network Services.

77. The Merchant Restraints restrict the terms upon which Acquirers supply Credit Card Network Services to merchants, thereby influencing upward or discouraging the reduction of the price at which Acquirers supply Credit Card Network Services to merchants.

78. Further, or in the alternative, the Merchant Restraints also influence upwards or discourage the reduction of the prices charged by merchants for the supply of products to their customers. 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. These costs are borne by all customers, including those who use other, lower-cost methods of payment such as cash, debit cards or credit cards with lower Card Acceptance Fees. Given the volume of Visa and MasterCard transactions and the level of Card Acceptance Fees, the costs to merchants and consumers are significant.

(e) Adverse Effect on Competition

79. As outlined below, the Merchant Restraints implemented and enforced by the Respondents in their agreements or arrangements with Acquirers have had, are having or are likely to have an adverse effect on competition in the market for the supply of Credit Card Network Services.

(i) Relevant Market

80. The Commissioner states that the relevant market for consideration of the competitive effects of the Merchant Restraints is the supply in Canada of Credit Card Network Services.

81. Credit Card Network Services involve the processing of credit card transactions across a network. Each of the Respondent's respective networks provide infrastructure and services enabling merchants to obtain authorization, clearance and settlement of transactions for merchants' customers that pay using the Respondents' respective brands of credit cards. Visa and MasterCard compete as indirect sellers of Credit Card Network Services to merchants in Canada.

82. There are no effective substitutes for Credit Card Network Services available to merchants. Consequently, merchants cannot reasonably replace Credit Card Network Services with other services or reduce usage of these services, even where Credit Card Network Services are substantially more expensive for merchants relative to other methods of payment.

83. 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. Even a large

increase in Card Acceptance Fees above the level that would prevail in the absence of the Merchant Restraints would not provide a meaningful incentive for merchants to cease accepting the Respondents' credit cards. Although other methods of payment exist outside of the relevant market, from the perspective of merchants, none of them is an effective substitute for Credit Card Network Services.

84. Merchants accept credit cards because many customers prefer to use credit cards over other methods of payment. Most merchants cannot refuse to accept Visa or MasterCard credit cards, as they would face serious economic consequences, including losing sales to rivals that accept such credit cards and otherwise losing business. Despite increases over time in merchants' costs of accepting credit cards, there has been no reduction in the number of merchant outlets that accept Visa or MasterCard credit cards.

85. In addition, as discussed above, merchants cannot selectively refuse to accept only those credit cards that have high Card Acceptance Fees, owing to the Merchant Restraint that requires merchants to accept all types of credit cards from the Visa and MasterCard networks.

86. The relevant geographic market for the assessment of the competitive effects of the Merchant Restraints is Canada. Each of the Respondents treats Canada as a separate geographic market. For example, the Respondents set policies and pricing for Canada separately from other countries.

87. Further, merchants in Canada are not permitted by Visa and MasterCard to purchase Credit Card Network Services from Acquirers outside of Canada with respect to transactions conducted in Canada, except in certain limited circumstances (such as some airline travel). As

such, suppliers of Credit Card Network Services outside of Canada are not competitive alternatives.

(ii) <u>Market Power of the Respondents</u>

88. Visa and MasterCard each have market power in the supply of Credit Card Network Services in Canada.

89. Visa and MasterCard each represent a significant proportion of the supply of Credit Card Network Services in Canada. Visa represents at least 60% and MasterCard at least 30% of all purchases made on credit cards in Canada, with American Express accounting for the majority of the remaining credit card purchases. The market for Credit Card Network Services is highly concentrated.

90. Acceptance among merchants of the Respondents' credit cards is widespread in Canada. Because MasterCard and Visa each have a substantial share of credit card transactions and widespread acceptance in Canada, many merchants cannot refuse to accept Visa or MasterCard credit cards, as they would face serious economic consequences, including losing sales to rivals that accept such credit cards.

91. The Respondents' market power is evidenced by the fact that, despite increases in the merchants' costs of accepting the Respondents' credit cards, there has been no reduction in the number of merchant outlets that accept Visa or MasterCard credit cards. Further, Visa and MasterCard are both able to discriminate in the fees charged to different types of merchants, and such differences cannot be explained by different costs of processing merchant transactions.

92. Barriers to entry and expansion for credit card networks are significant and include the substantial costs associated with establishing a physical network for credit card transactions, developing a widely recognized brand and establishing acceptance by merchants and cardholders. In the presence of these significant barriers to entry, there has been no significant entry in this market for at least twenty years.

(iii) <u>Competitive Harm from the Merchant Restraints</u>

93. The Merchant Restraints adversely affect competition in the supply of Credit Card Network Services in Canada in a number of ways, including, without limitation, by:

(a) influencing upward or discouraging the reduction of Card Acceptance Fees. In the absence of the Merchant Restraints, Card Acceptance Fees would be lower than in the presence of the Merchant Restraints;

(b) distorting or harming the competitive process and proper functioning of the price-setting mechanism for Card Acceptance Fees. The Merchant Restraints prevent or constrain merchants from undertaking actions to foster competition in respect of Card Acceptance Fees, such as by refusing to accept credit cards with higher Card Acceptance Fees or applying surcharges to such higher-cost credit cards;

(c) increasing retail prices for customers of merchants. 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. These costs are borne by all customers of the merchant, including those that use other, lower-cost methods of payment, such as cash or debit cards. Given the volume of transactions and the level of Card Acceptance Fees, the costs to merchants and consumers are significant;

(d) preventing competition with respect to Card Acceptance Fees. In the absence of the Merchant Restraints, competition between and within credit card networks would be more significant and effective. In the absence of the Merchant Restraints, merchants and consumers would benefit from competition between credit card networks with respect to the prices paid by merchants for Credit Card Network Services. Moreover, different types of cards (*e.g.* "premium" and "basic") within each network issued by different Issuers would be forced to compete with one another on the basis of, among other things, the price of Credit Card Network Services;

(e) reducing competition between the Respondents, as well as between the Respondents and other rival credit card networks and within each Respondent's network. As a result of the Merchant Restraints, each of the Respondents is effectively insulated from competition from the other Respondent and from any other competitor for the supply of Credit Card Network Services. The Merchant Restraints reduce incentives for the Respondents to offer lower Card Acceptance Fees. Owing to the Merchant Restraints, the Respondents are able to maintain higher Card Acceptance Fees without the risk of losing a material volume of transactions to credit cards with lower Card Acceptance Fees or other less expensive methods of payment;

(f) reducing output of lower-cost payment methods. The Merchant Restraints constrain or prevent merchants from promoting the use of lower-cost methods of payment and, as such, result in reduced use of these less-expensive methods of payment; and

(g) creating or increasing already significant barriers to entry or expansion for lower cost credit card networks. The Merchant Restraints deny the ability of new entrants in the supply of Credit Card Network Services to effectively compete on the basis of lower Card Acceptance Fees. The limitations on the ability of merchants to take active steps to encourage customers to use less-costly credit card networks or types of credit cards with lower Card Acceptance Fees makes it more difficult for such potential competitors to enter the relevant market.

94. Authorities in other jurisdictions have taken enforcement and regulatory action to reduce or eliminate anti-competitive restraints that are similar to the Merchant Restraints. In those jurisdictions, the reduction or elimination of those restraints has allowed merchants to effectively encourage customers to use credit cards with lower Card Acceptance Fees and other less expensive payment methods.

IX. REMEDIES

95. The Commissioner requests that the Tribunal grant the following relief:

(a) an order prohibiting each of the Respondents from entering into, imposing or enforcing, either directly or indirectly, the Merchant Restraints or any other agreements, arrangements, policies, rules or regulations or engaging in any like means, that:

(i) impede or limit the ability of merchants to engage in any practice that discriminates against or discourages the use of particular credit cards in favour of any other credit card, or any other method of payment;

(ii) impede or limit the ability of merchants to apply surcharges on particular credit cards or set prices for customers based on the particular credit card used; and

(iii) impede or limit the ability of merchants to refuse to accept particular credit cards;

(b) an order directing the Respondents to pay the costs of this proceeding;

(c) all other orders or remedies that may be required to give effect to the foregoing prohibitions, or to reflect the intent of the Tribunal and its disposition of this matter; and

(d) an order granting such further and other relief as this Tribunal may consider appropriate.

X. PROCEDURAL MATTERS

96. The Commissioner requests that this application be heard in English.

97. For the purposes of this application, service of all documents on the Commissioner can be effected on:

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With copies to: **William J. Miller**
Department of Justice Canada
Competition Bureau Legal Services
Place du Portage, Phase I
50 Victoria Street, 22nd Floor
Gatineau QC K1A 0C9
Tel: 819.953.3903
Fax: 819.953.9267

Counsel to the Commissioner of Competition

98. The Commissioner requests that this application be heard in the City of Ottawa.

DATED at Gatineau, Quebec, this 14th day of December, 2010.

"Melanie L. Aitken"

Melanie L. Aitken
Commissioner of Competition

TO: **The Registrar of the Competition Tribunal**
Competition Tribunal
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AND TO: **Visa Canada Corporation**
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Counsel for the Respondent, MasterCard International Incorporated

Schedule "A"

CONCISE STATEMENT OF ECONOMIC THEORY

1. The Respondents, Visa Canada Corporation ("Visa") and MasterCard International Incorporated ("MasterCard"), operate the two largest credit card networks in Canada. In 2009, the Respondents processed more than 90% of all general purpose credit card transactions in Canada, representing approximately $240 billion in purchases.

2. Credit cards offer certain unique features, such as deferred payment options, that distinguish credit cards from cash, cheques, debit and charge cards and other forms of payment.

3. Merchants pay significant fees for each credit card transaction processed on the Visa and MasterCard networks ("Card Acceptance Fees"), reflecting a number of different components: (i) network fees that are retained by Visa or MasterCard, (ii) interchange fees that are retained by the financial institutions (referred to as "Issuers") that issue credit cards to cardholders; and (iii) service fees that are retained by the financial institutions (referred to as "Acquirers") that supply "Credit Card Network Services" to merchants. In 2009, merchants in Canada paid approximately $5 billion in Card Acceptance Fees on the Visa and MasterCard networks.

4. Card Acceptance Fees vary depending on a number of factors, including the type of credit card used by the customer. For example, if a customer uses a so-called "premium" credit card, such as Visa Infinite or MasterCard World Elite, the merchant typically pays higher Card Acceptance Fees than if a customer uses a basic credit card, such as a Visa Classic or a basic MasterCard.

5. The use by a merchant's customer of other methods of payment, such as cash or debit, usually results in lower costs for the merchant. For example, processing an Interac debit card transaction typically costs a merchant about 12 cents per transaction, regardless of the amount of the transaction. In contrast, if a customer uses a credit card to make a $100 purchase, a merchant typically pays approximately $2.00 in Card Acceptance Fees, approximately 17 times more than the 12 cents per transaction that would typically be paid by the merchant had the customer used Interac debit to make that same purchase.

6. Visa and MasterCard have each implemented and continue to enforce agreements with Acquirers that influence upward or discourage the reduction of Card Acceptance Fees paid for Credit Card Network Services over the Visa and MasterCard networks. These agreements require Acquirers to impose certain restraints on merchants (the "Merchant Restraints"), including: (i) a rule preventing merchants from surcharging credit card transactions to reflect the increased cost to merchants of the credit card selected for payment; (ii) a rule preventing merchants from discouraging the use of more expensive credit cards by customers in favour of lower-cost methods of payment; and (iii) a rule that requires merchants to accept all types of credit cards from a particular network.

7. By imposing the Merchant Restraints, Visa and MasterCard prevent or substantially limit competition with respect to Card Acceptance Fees. Visa and MasterCard can maintain high Card Acceptance Fees without risk that they will lose transactions to lower-cost credit cards or other lower-cost methods of payment because the Merchant Restraints impede or constrain the ability of merchants to effectively encourage customers to use credit cards that result in lower costs to merchants, or other lower-cost methods of payment. The Merchant Restraints also constrain the

ability of merchants to refuse to accept or surcharge higher cost credit cards, thus impeding competition within each of the Visa and MasterCard networks.

8. For example, allowing merchants to surcharge credit cards with higher Card Acceptance Fees would encourage customers to use credit cards that have lower Card Acceptance Fees. The ability to surcharge or encourage customers to use lower cost methods of payment would act as a competitive discipline on Card Acceptance Fees, including the interchange fees retained by Issuers. These potential sources of competitive discipline on Card Acceptance Fees are eliminated or constrained by the Merchant Restraints, as merchants are not permitted to differentially surcharge credit cards or to effectively encourage consumers to use lower-cost methods of payment.

9. Merchants accept credit cards because many consumers prefer to use credit cards over other forms of payment for many types of transactions. Most merchants cannot refuse to accept Visa or MasterCard credit cards, as they would face serious economic consequences, including losing sales to rivals that accept such credit cards and otherwise suffering a loss of business. In addition, merchants cannot selectively refuse to accept only those credit cards that have high Card Acceptance Fees, owing to the Merchant Restraint that requires merchants accepting any of a Respondent’s credit cards to accept all of that Respondent's credit cards.

10. 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. These costs are borne by all customers of a merchant, including those that use other, lower-cost methods of payment, such as cash or debit cards. Given the

volume of Visa and MasterCard transactions and the level of Card Acceptance Fees, the costs to Canadian merchants and consumers are substantial.

11. Barriers to entry and expansion for credit card networks are significant and include the substantial costs associated with establishing a physical network for credit card transactions, developing a widely recognized brand and establishing acceptance by merchants and cardholders.

12. The Merchant Restraints adversely affect competition in the supply of Credit Card Network Services in a number of ways, including, without limitation, by: (a) influencing upward or discouraging the reduction of Card Acceptance Fees; (b) distorting or harming the competitive process and proper functioning of the price-setting mechanism for Card Acceptance Fees; (c) increasing retail prices for customers of merchants; (d) preventing competition with respect to Card Acceptance Fees; (e) reducing competition between the Respondents, as well as between the Respondents and rival credit card networks, and within each Respondent's network; (f) reducing output of lower-cost payment methods; and (g) creating or increasing already significant barriers to entry or expansion for lower-cost credit card networks by impeding or constraining the ability of merchants to encourage customers to use less-costly credit cards and other methods of payment.

CT-2010-010

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

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

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

NOTICE OF APPLICATION

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