Expert Affidavit of Lawrence P. Schwartz, Ph.D.

July 10, 2006

General Introduction

[1] My name is Lawrence P. Schwartz. I am an economist currently on leave from my position as Director of the economics consulting firm LECG Canada. My curriculum vitae is attached.

[2] I have been asked by counsel to the applicants B-Filer Inc. and NPAY Inc. ("B-Filer") to provide an expert opinion relating to economic issues arising from B-Filer's application under s. 75 of the *Competition Act* (the "Act") for an order that Bank of Nova Scotia ("Scotiabank") supply it with certain banking services, including market definition and the possible adverse effect on competition of Bank of Nova Scotia's refusal to supply the services.

[3] In this regard, I have conducted literature searches on various topics, reviewed pleadings of B-Filer and Scotiabank in connection with this matter, had discussions concerning payment systems and B-Filer's business in the presence of counsel with the main executives of B-Filer, and attended the discovery of Scotiabank on June 12-13, 2006.

An Overview of B-Filer's Business

[4] Since December 2002, B-Filer has, by virtue of receiving biller status at several Canadian banks, provided online payment services to deposit customers of those banks for their purchases of goods and services over the internet at the websites of participating merchants. Those merchants were either unable, or did not seek, to obtain biller status at the banks; with B-Filer's service, they could receive online debit payment from those customers who maintained deposit accounts at banks that had accorded B-Filer biller status.

[5] Those merchants' websites contain a link to the "GPAY Service" (the logo being "UseMyBank") that allows a bank's depositor customer to authorize the GPAY Service to open and complete a bill payment session through that bank's online banking service. The depositor enters his/her bankcard number and password and authorizes the immediate transfer of funds from his/her deposit account to B-Filer's biller account at the bank. Following the transfer, the GPAY Service informs the merchant that payment has been made and returns the depositor to the merchant's website.

[6] This transfer of funds is an immediate debit (i.e. charge) to the depositor's bank account and constitutes final payment for the depositor's purchase, although the bank holds the funds in suspense pending overnight transfer to B-Filer which usually settles with merchants on a weekly basis.

[7] B-Filer processes payment by e-mail money transfer ("EMT") for an online purchaser who is a deposit customer of a bank that has not given B-Filer biller status. In these cases, the purchaser authorizes the GPAY Service to open a session with the purchaser's bank and to send an EMT for the amount of the purchase from the purchaser's bank account to a business account at B-Filer's bank. B-Filer then holds the funds in suspense pending transfer to the merchant.

[8] B-Filer charges participating merchants a fee of **[REDACTED]**. The depositor pays B-Filer nothing for using the GPAY Service, but incurs whatever account-level fees and/or transaction charges may be applicable under the account operating agreement with the bank. For EMTs, the online purchaser's bank imposes a separate fee of $1.50 per such transfer as well as other conditions that may limit the use of EMTs by the purchaser.

[9] From inception to the present, B-Filer has provided online debit payments through the GPAY Service to 57 merchants. These merchants may also accept online payment by other means such as credit cards. In addition to their web-based business, they may also conduct business in physical premises where they accept other means of payment for purchases. However, most of these merchants are web-based and operate only on an online basis.

[10] Many of these merchants offer online gambling; one merchant offers internet dating services. The Princess Margaret Hospital Foundation is also a participating merchant and receives charitable donations online. In its attempt to expand, B-Filer actively markets its services to other commercial merchants such as WestJet, FutureShop and Canadian Tire Corp.

[11] To offer its online debit payment service, B-Filer requires biller status at the financial institutions whose depositors wish to use the GPAY Service. As of December 2002, B-Filer had received biller status at Toronto-Dominion Bank, Canadian Imperial Bank of Commerce, Alberta Treasury Branches, Bank of Montreal, Fédération des caisses Desjardins du Québec, Scotiabank and Royal Bank of Canada. By December 2003, the first three of these financial institutions had withdrawn B-Filer's biller status. As a result, B-Filer processed online debit payments by depositors at Toronto-Dominion Bank and Canadian Imperial Bank of Commerce through EMTs.

[12] In September, 2005, Scotiabank terminated B-Filer's biller status and closed all bank accounts established by B-Filer and its managers. Presently, B-Filer has biller status at Bank of Montreal, Royal Bank of Canada and Fédération des caisses Desjardins du Québec.

[13] Following these various terminations of its biller status, B-Filer started to process online payment transactions by EMTs. Only Royal Bank of Canada and, prior to its termination, Scotiabank, continued to permit B-Filer to open business accounts that could receive deposits by EMT. Such accounts operate differently than personal deposit accounts; these differences include various limits on the number of transactions per account (or group of related accounts referred as a "profile"), daily, monthly and annual limits on EMT deposits. To handle the volume of transactions processed through the GPAY Service, B-Filer has opened a number of such accounts at these banks. As a result, B-Filer's daily business operations have become more complicated and costly compared to the situation where it had received biller status.

[14] Royal Bank of Canada has informed B-Filer that it would not be allowed to increase the number of business accounts or profiles.

[15] As an indication of the impact of the termination, in September, 2005, the month in which Scotiabank terminated its biller status, B-Filer processed transactions with an aggregate value exceeding **[REDACTED].** In October, Scotiabank transaction value dropped to approximately **[REDACTED],** even though transaction value increased at three of the other banks and declined, but by much less in percentage terms, at two others. Since the termination, the monthly aggregate transaction value from Scotiabank has risen but has not surpassed the level in September, 2005 whereas the value of transactions from the other five financial institutions have increased markedly since then.[1]

[1] Data provided by B-Filer.

Scotiabank Account Plans

[16] Scotiabank currently offers several deposit accounts from which depositors may make online debit payments. Six such bank accounts and their fee structures are:[2]

(a) Money Master High Interest Savings Account

1. unlimited free transfers to other Scotiabank accounts through Scotia Online Financial Services, Telephone Banking, Automated Banking Machines and wireless banking services
2. for all other debit transactions (i.e. in-branch withdrawals or transfers, ABM withdrawals; direct payment purchases, bill payments and pre-authorized payments), a $5.00 per-transaction fee will apply
3. interest paid at 3.0% p.a. from the first dollar saved and applied to the full balance

(b) Scotia One Service Account

1. $25 flat monthly fee for unlimited debit transactions whether through a teller or not
2. no apparent minimum balance requirement but interest paid is tiered: on portion of account balance over $10,000 interest paid is Prime less 3.5% (currently 2.5% p.a.); interest paid on portion of account balance under $10,000 is Prime less 5.5% (currently 0.5% p.a.)

(c) Scotia Powerchequing Account

1. minimum daily account balance of $2,000
2. all debit transactions free
3. no apparent minimum balance requirement but untiered interest paid on account balance of $25,000 is 0.05% p.a.; untiered interest paid on account balances between $10,000 and $24,999 is 0.025% p.a. and zero on small account balances
4. if daily balance falls below $2,000, a monthly fee of $3.50 covers the first 15 non-service debit transactions and $0.50 per such transaction thereafter ($1.00 for teller-assisted withdrawals and debits)

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[2] Information as of July 9, 2006 on Scotiabank website www.scotiabank.ca

(d) Scotia Value Account

1. same interest rates as Scotia Powerchequing Account
2. monthly fee of $11.95 covers first 50 debit transactions and certain other services such as certified cheques
3. additional debit transactions cost $0.50 each.

(e) Basic Banking Plan Account

1. monthly fee of $6.50 covers first 50 self-service debit transactions
2. additional debit transactions cost $0.50 each ($1.00 for teller-assisted withdrawals and debits)
3. interest rate information not available.

(f) Basic Banking Account

1. monthly fee of $3.95 covers 12 debit transactions including up to four teller transactions
2. $1.00 fee for each additional teller-handled cash withdrawal or deposit
3. $0.50 fee for each additional debit transaction, bill payment, cheque
4. interest rate information not available

[17] Accordingly, some of these accounts charge Scotiabank depositors explicit fees for each debit transaction, including an online debit payment through the GPAY Service. These fees are either $5.00 each (in the Money Master High Interest Account) or $0.50 after a certain number of debit transactions in the month (Basic Banking, Basic Banking Plan, Scotia Value). One plan (Scotia One Service) offers unlimited debit transactions without explicit charge; Scotia Powerchequing offers unlimited debit transactions subject to a minimum daily account balance.

[18] It is sometimes suggested that banking transactions are “free” to the depositor when the bank does not charge an explicit fee. This view is mistaken; depositors always pay for transactions, perhaps in the form of minimum balances at reduced interest rates or simply low interest rates. The only question is which depositors pay for those transactions. Since the same minimum balances and interest rates apply to all depositors with the same type of account, it is clear that even those depositors who do not make debit transactions effectively pay a portion of the costs imposed on the bank by those depositors who do.

Interac Online

[19] Interac Online, developed by Canadian financial institutions through Interac Association and Acxsys Corporation of Toronto, is a new online debit payment service that allows consumers to pay for goods and services purchased at merchant websites directly from their bank accounts. Three merchants (The Source by Circuit City, CompuSmart, and La Senza began to offer Interac Online in December, 2005.) As of December 7, 2005, more than eighty merchants had signed up to offer Interac Online.

[20] Acxsys Corporation offers the Interac Online service to consumers through financial institutions. The Royal Bank of Canada, Bank of Montreal, Scotiabank, Canadian Imperial Bank of Commerce and Toronto Dominion Bank were offering or expecting to offer Interac Online to depositors by early 2006.[3]

[21] Acxsys Corporation offers the Interac Online service to merchants through a certified payment provider (also referred to as an "acquirer"), the first of which was Moneris Solutions Corporation, Canada's largest processor of debit and credit card payments.[4] Chase Paymentech has announced that it will become an acquirer.[5]

[22] Acxsys Corporation also certifies Third Party Service Providers that provide services to merchants that wish to offer the Interac Online payment method.[6] It appears that no Third Party Service Providers have been certified as yet.[7]

[23] Acxsys Corporation is owned by eight financial institutions, Bank of Montreal, Canadian Imperial Bank of Commerce, Royal Bank of Canada, Scotiabank, TD Canada Trust, National Bank of Canada, Fédération des caisses Desjardins du Québec, and Credit Union Central of Canada.[8]

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[3] "Banks to offer debit for online shopping", Toronto Star, Thursday May 2, 2005 at C1 (available at http://www.interaconline.com/news_en/May5Toronto%20Star2005.pdf)

[4] Acxsys Corporation press release, "First Merchants Offer Interac Online in Time for the Holiday Season", December 7, 2005 (available at http://www.interaconline.com/press_en/IO%20Consumer%20Release%20EN%20FINAL.pdf)

[5] Interac Online. http://www.interaconline.com/merchants_acquirers.php

[6] Interac Online. http://www.interaconline.com/merchants_providers.php

[7] Interac Online. http://www.interaconline.com/merchants_thirdparty.php

[8] Acxsys Corporation. http://www.acxsys.ca/about.php

Some Requirements of S.75 of the Act

[24] S.75 of the Act, which governs refusals to deal, states in part:

Refusal to Deal

Jurisdiction of Tribunal where refusal to deal

75. (1) Where, on application by the Commissioner or a person granted leave under section 103.1, the Tribunal finds that

(*a*) a person is substantially affected in his business or is precluded from carrying on business due to his inability to obtain adequate supplies of a product anywhere in a market on usual trade terms,

(*b*) the person referred to in paragraph (*a*) is unable to obtain adequate supplies of the product because of insufficient competition among suppliers of the product in the market,

(*c*) the person referred to in paragraph (*a*) is willing and able to meet the usual trade terms of the supplier or suppliers of the product,

(*d*) the product is in ample supply, and

(*e*) the refusal to deal is having or is likely to have an adverse effect on competition in a market,

the Tribunal may order that one or more suppliers of the product in the market accept the person as a customer within a specified time on usual trade terms unless, within the specified time, in the case of an article, any customs duties on the article are removed, reduced or remitted and the effect of the removal, reduction or remission is to place the person on an equal footing with other persons who are able to obtain adequate supplies of the article in Canada.

[25] Thus, the Act requires that a market be determined with respect to a refusal to deal and further requires that the refusal have an adverse effect on competition in that market in order for the Tribunal to make an order. However, the Act gives no guidance on how the market and the adverse effect should be identified. It appears that the Act requires a refused party to demonstrate more than the negative impact of the refusal on its own business or financial position, as such would not necessarily indicate an adverse effect on competition.

[26] In its recent public discussion paper on exclusionary abuses (the "EU discussion paper"), the European Union's DG Competition proposed the following with respect to terminations of supply:

> The termination of one individual customer from the downstream market does not in itself constitute an abuse. An abuse may only arise when the termination is likely to have a negative effect on competition in the downstream market. This should however not be understood to mean the complete elimination of all

competition. The extent to which the termination of one customer has an impact on the level of competition depends on the pre-existing competition on the downstream market. In some cases, the termination of one customer may have a detrimental effect on the level of competition; in other cases the impact may be small to insignificant. For instance, if there are several competitors in the downstream market and the supplier of the input is not itself active in that market, the impact on competition of the termination may be small unless the exclusion is likely to lead to collusion. However, if the input owner is itself active in the downstream market and terminates supplies to one of its few competitors, it will normally be presumed that there is a negative effect on competition in the downstream market.

The identity of the excluded competitor may be important for the assessment of the effect on the level of competition of the exclusion. The exclusion of a particular competitor may have a special effect on competition, for instance, if it follows a different business model than the established competitors on the market, while the exclusion of a competitor similar to the established competitors may not have the same negative effect on competition.[9]

[27] The EU discussion paper, which is not a statement of policy or guideline, nevertheless highlights the role of market definition in evaluating terminations of supply. It further notes that a termination may have a negative effect on competition even if it does not result in the elimination of all competition in the downstream market. Moreover, a negative effect on competition may be inferred without detailed inquiry when the refusing party is vertically integrated and has few competitors in the downstream market.

[28] There are of course differences between the Act and the European competition regime. As indicated in the purpose clause, the Act is fundamental economic framework legislation whereas the European competition regime is more directly concerned with consumer protection. The latter treats refusal to deal under the abuse of dominance provisions of the European Treaty, whereas the Act treats refusals under s.75 rather than s.79. Related issues may lie in the extent of the inquiry into effects permitted under s.75, in particular whether any anti-competitive effects are to be weighed against pro-competitive effects, such as efficiencies, in determining the refusal's "adverse effect on competition". Such matters are primarily matters of law and are beyond the expertise of an economist.

<u>Issues Pertinent to Market Definition in Antitrust/Competition Policy</u>

[29] It is useful to begin the process of defining relevant markets by asking how Scotiabank's termination of B-Filer's biller status and access to EMT business deposit accounts could affect various economic agents. Most obviously affected are Scotiabank's depositors who wish to use the GPAY Service. Here it may be argued that those depositors have other means of payment that are good substitutes for the GPAY Service, so the question is whether these other means of payment are part of the relevant market for Scotiabank depositors.

[30] Second, online debit payment service providers compete for merchants. Here it may be argued that Scotiabank's termination has no or limited impact on B-Filer's online merchants because they can easily shift to other means of payment. Thus, the market definition question is whether the various alternate means of payment are good substitutes for the merchants currently using the GPAY Service.

[31] Third, it may be argued that Scotiabank's termination of B-Filer's biller status and of B-Filer's access to business accounts at Scotiabank has no or limited effect on B-Filer's business because it can obtain adequate supplies of business accounts elsewhere. This poses the question whether those accounts available elsewhere are good substitutes for the Scotiabank biller status and Scotiabank's business accounts.

[32] Whether these various alternatives are or are not part of the market referred to in s.75 of the Act depends critically on the concepts and procedures adopted for delineating such markets because the provisions of s.75 provide no guidance. Competition policy has dealt most thoroughly with procedures for market definition in merger review. As described in the merger guidelines of the enforcement agencies in Canada and the United

[9] European Commission. DG Competition. "DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses", Brussels, December 2005 at 63-64, ¶222-223 (available at

States, the "hypothetical monopolist approach" calls for examination of substitutability in response to a small but significant and non-transitory price increase ("SSNIP") in a narrow product and/or geographic market[10]. These guidelines typically define significance at the 5% level and non-transitory as a year or more. There is some indication that European competition authorities also rely on the SSNIP test[11]. If, due to the resulting loss of sales, a monopolist could not impose such a price increase, then that provisionally adopted market must be expanded until a set of products and areas is identified over which a monopolist would impose a significant and non-transitory price increase. That market, which is generally the smallest set of products that meets the criterion, will be taken as the relevant product market for competition policy inquiry.[12]

[33] From this perspective, the mere existence of alternatives is not sufficient to establish markets that are relevant for purpose of competition policy. To illustrate, a house may be constructed with bricks or with wood. In the event that bricks are not available, the fact that the homebuilder uses wood does not imply that bricks and wood are, in economic terms, substitute materials in homebuilding. That conclusion requires that both wood and bricks be available and that purchasers substitute one for the other in response to changes in relative prices.

[34] If the further question arises whether bricks are in the same product market as wood in delineating the relevant market for a merger among wood producers, the appropriate test under the merger guidelines is whether a wood monopolist would impose a small but significant and non-transitory price increase, or whether it would lose so many customers to other products that the provisionally-adopted market consisting only of wood should be expanded to include another product. Then, depending on the

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http://ec.europa.eu/comm/competition/antitrust/others/discpaper2005.pdf)

[10] Canada. Competition Bureau. Merger Enforcement Guidelines, September, 2004 at ¶3 (available at http://www.competitionbureau.gc.ca/internet/index.cfm?itemid=1245&lg=e)
United States. Department of Justice. Antitrust Division. Horizontal Merger Guidelines, Issued April 2, 1992, revised April 8, 1997 at ¶1 (available at http://www.usdoj.gov/atr/public/guidelines/hmg.htm).

[11] Two papers call attention to the adoption of the "SSNIP" test by the European Commission as an example of convergence by European authorities toward the American approach to market definition. See Merit E. Janow, "Transatlantic Cooperation on Competition Policy" and James S. Venit and William J. Kolasky, "Substantial Convergence and Procedural Dissonance" in Evenett, S. et al. (eds.), <u>Antitrust Goes Global: What Future for Transatlantic Cooperation?</u>, The Brookings Institution, Washington, 2000 at 50 and 84 respectively.

procedures adopted for sequential expansion of the market, the relevant product market may or may not include bricks[13]. Thus, even where alternatives to a given product exist, they are not necessarily in the product market that is relevant for the purpose of merger review.

[35] In a recent merger review regarding movie theatres, the Competition Bureau determined that in-theatre first-run exhibition of motion pictures was the relevant market even though the same films were available for in-home viewing after release to theatres[14]. Thus, the demonstration that alternatives exist to the provisionally adopted market is insufficient for the purpose of merger review; what must be established is that the marginal customer would be induced to shift to those alternatives.

[36] The approach to market definition in merger review can be applied to other cases including monopolization and refusal to deal. As noted in the EU discussion paper, the principal concern in this regard is that the market will be defined too widely[15]. In merger review, the base level for evaluating the hypothetical price increase is the price prevailing in the market at the time of the merger. To use the prevailing price in monopolization cases may be inappropriate because of the well-known *Cellophane* fallacy by which the existence of many substitutes is an indication of successful monopolization rather than of the absence of monopoly power. Accordingly, where the *Cellophane* fallacy arises, the appropriate adjustment is to adopt the competitive price rather than the prevailing price as the base in market definition.

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[12] I have provided an intuitive explanation of the hypothetical monopolist approach to market definition. See "The Hypothetical Monopolist Approach Reconsidered-Part 1", Canadian Competition Record, Fall, 2005, at 96-106.

[13] According to the procedure in the US Horizontal Merger Guidelines, the market is expanded by adding the next best substitute, defined as the alternative which, if available in unlimited quantities at constant prices, would account for the greatest value of diversion of demand in response to a SNIP. See fn 2,supra at fn.6.

[14] Competition Bureau. "Competition Bureau Screens Cinema Merger: Cineplex Must Sell off 35 Theatres", Ottawa, June 13, 2005). The press release stated in part:

> The Bureau examined the full competitive impact of the merger in each local market where the parties were in competition. It considered consumer alternatives such as DVDs, Pay-Per-View and Video on Demand, but concluded that the exhibition of first run motion pictures continues to be a distinct product market. The Bureau also concluded that there are barriers to entry into the industry that include the need to find suitable locations, the costs associated with a specialized building and access to commercially valuable motion pictures. …
> (http://www.competitionbureau.gc.ca/internet/index.cfm?itemid=1866&lg=e)

[15] See fn.9 supra, at 7, ¶13.

[37] Even in monopolization cases, there may be no *Cellophane* fallacy and in such cases market delineation properly follows the approach in merger cases without adjusting the base price level. Referring to market definition under the Sherman Act in the United States, one leading authority writes:

> Section 2 plaintiffs commonly allege that a rival (recently) has embarked on a course of conduct that constitutes an unlawful "attempt to monopolize" because there is a "dangerous probability" that the conduct, if not enjoined, would create monopoly power. The conduct, for example may be predatory pricing or a refusal to deal, and the complaint is typically filed shortly after the defendant embarks on the challenged course of conduct. Pleading the case as an attempt to monopolize, rather than accomplished monopolization, lessens the plaintiff's burden in court. Pleading the case this way also raises an issue much like that in a merger case: Assuming the conduct has the alleged exclusionary effect, would the likely result be the creation of monopoly power.[16]

Thus, the application of the concepts and procedures in merger review can avoid the problem of over-broad definition of the market in other cases, including refusal to deal, without adjustment where the *Cellophane* fallacy does not arise.

[38] As I have discussed elsewhere, the examination of substitutability in merger cases requires the knowledge of the price-elasticity of demand for the product under review.[17] In many cases, such detailed statistical information is not available. Instead, the degree of substitutability must be inferred from other conditions and information about the product. As the EU discussion paper notes,

> Another approach is to examine the characteristics and intended use of the products concerned and to assess whether they are capable of satisfying an inelastic consumer need. It is thus examined whether the characteristics of the products and their intended use are such that they differentiate the products in question from other products to such an extent that they are only to a small degree interchangeable with such other products and therefore not effectively constrained by them at competitive prices. In making this assessment regard must in particular be had to the needs of

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[16] See Werden,G. "Market Delineation under the Merger Guidelines: Monopoly Cases and Alternative Approaches", Review of Industrial Organization, 16, 2000 at 211.

> marginal consumers. In most cases it is not decisive that a certain group of consumers does not consider the products in question to be good substitutes. What matters is that a sufficiently large number of consumers do consider that a product is a good substitute for the product supplied by the undertaking concerned.[18]

[39] As noted above, several issues that arise in evaluating Scotiabank's termination of B-Filer's biller status and access to EMT business accounts are essentially questions of market definition. I analyze each such issue within the conventional framework of market definition in competition policy discussed in the EU discussion paper and which emphasizes substitutability.

<u>Payment Systems as "Two-sided Markets"</u>

[40] As a preliminary matter, it should be noted that methods of payment such as cash, cheques, credit and debit, operate in what are known as "two-sided markets". For example, a merchant will not accept a credit card unless there is a large number of customers that hold and use that card. Similarly, a customer will not hold a credit card unless there is a large number of merchants that will accept it as a means of payment. If an entrepreneur can realize a profit by offering a credit card, it must ensure that both merchants and customers will accept it.[19]

[41] Software operating systems raise the same set of issues. An entrepreneur that wishes to develop and sell an operating system (such as Microsoft's Windows) must have a system that gets application developers to write programs that computer users want to use. Computer users will adopt an operating system that permits many applications and developers will develop applications for an operating system that attracts many users.

[42] Pricing in two-sided markets differs from pricing conventional goods and services. For example, Microsoft gives developers free access to its Windows operating system, but computer users pay for that system either directly or in the price they pay for a computer on which it is pre-installed. Microsoft could have decided to charge the developers for access and charge computer users nothing, or some combination of prices

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[17] See fn.12 supra.

[18] See fn.9 supra, at 8, ¶18 (omitting footnotes)

to both sides. Its profitability depends critically on the way it recovers its costs and profits: if Microsoft had charged developers but not users, it is possible that many fewer applications would have been developed and many fewer computers sold, even to the point where producing an operating system may not have been profitable to it.

[43] Speaking somewhat generally, the prices charged in two-sided markets need not correspond to the costs incurred by the entrepreneur on each side. Microsoft charges application developers nothing, but it still incurs costs in designing its Windows system and making it available to them.

[44] The same considerations apply to payment methods including online debit. To be profitable, a provider of online debit must ensure that sufficient merchants and customers will accept its product, and it must arrange its pricing to both sides so as to recover its costs and earn a profit. Hence, for example, B-Filer charges bank depositors nothing for using the GPAY Service; its revenue comes from transaction fees paid by merchants.

[45] The two-sided nature of payment systems, and online debit payment in particular, is an important concern in the analysis of relevant product markets and the adverse effect on competition that follows.

Alternate Payment Systems and Scotiabank Depositors

[46] The alternatives available to those Scotiabank depositors wishing to use the GPAY Service following the termination of B-Filer's biller service include (a) online debit payment at other banks where B-Filer is a biller (b) online payment with credit cards at the merchant website (c) offline payment by cheque (d) in-store purchasing and payment by cash, debit or credit card at the point of sale ("POS"), (e) online "electronic wallets" such as PayPal and (f) online debit payment through Interac Online. As noted above, the market definition process asks what those depositors would likely do if Scotiabank had simply imposed a SSNIP of 5% on their online debit payments through the GPAY Service.

(a) Online payment at other banks

[19] See, generally, Evans,D.S. and R. Schmalensee, Paying with Plastic: The Digital Revolution in Buying and Selling, second edition, The MIT Press, 2005

[47] Conceptually, Scotiabank could impose a selective SSNIP in the GPAY Service in a number of ways. Most obviously, it could increase the applicable account-level debit transaction fee for using that Service. As indicated above, that fee is $0.50 per transaction for its transaction accounts. However, those accounts may also offer a certain number of debit transactions that do not attract that fee. If the Scotiabank depositor has such an account and has not yet reached the limit at which the explicit transaction fee applies, he/she is, in one sense, paying nothing for the next transaction and therefore a SSNIP of 5% results in an increase of zero and has no impact on depositor behaviour at that time. Under such reasoning, the relevant product market is immediately limited to the GPAY Service at Scotiabank because Scotiabank depositors will not open transaction accounts at other banks in consequence.

[48] However, this price increase, because it also applies to all future transactions, could still be expected to affect depositor behaviour in the future. In a wider sense, moreover, the depositor is paying, if implicitly, for the next transaction by accepting the reduced interest rate paid on such accounts. Scotiabank could impose a SSNIP by further reducing the interest rate on accounts of its depositors who use the GPAY Service. Alternately, it could impose a SSNIP in the monthly fee paid by its depositors who use the GPAY Service, or by reducing the number of transactions that attract explicit fee. Thus, it becomes relevant to ask what Scotiabank depositors would do in the event of a SSNIP in the GPAY Service at Scotiabank.

[49] To continue to use the GPAY Service following a significant price increase therein at Scotiabank, a depositor at Scotiabank could simply bear that increase or open the required personal chequing or other transaction account at another financial institution where B-Filer is a biller, thereby maintaining accounts at both institutions.

[50] This shift is unlikely. A depositor at Scotiabank who maintained the transaction account at Scotiabank would have to manage bank transactions at both of, and between, the two financial institutions and, likely, to shift funds between them frequently. In addition to the inconvenience and additional recordkeeping, these transfers would increase the number of banking transactions and, depending on the terms of the specific bank plan at Scotiabank noted above and at the new financial institution, the depositor would pay increased bank fees and charges as he/she transferred funds out of Scotiabank to the account at the other bank and vice versa. These transfers could be accomplished, for example, by way of EMTs, leading to an additional $1.50 charge to the Scotiabank depositor for each such transfer out, in addition to any account-level transaction fees for the withdrawal that may be applicable under the Scotiabank deposit plan. In addition, the new financial institution may impose fees and transaction charges for moving funds back to the Scotiabank account by way of EMT or otherwise, although these would depend on the type of account opened.

[51] It is possible that the Scotiabank depositor could largely escape these explicit transaction fees by selecting the appropriate accounts at Scotiabank and at the new financial institution where B-Filer is a biller. It is highly likely, however, that the depositor arranging banking facilities in this way will incur real costs in the form of flat monthly account fees, minimum account balance requirements, tiered interest or simply low interest where explicit transaction fees are not charged at all or below certain limits. At the margin, i.e. when the Scotiabank depositor determines whether it is worthwhile to open an account at a new financial institution while maintaining a Scotiabank account, he/she will take all of these factors into consideration. It is more likely than not that the Scotiabank depositor would choose to bear the price increase that Scotiabank imposes on GPAY Service debit transactions than maintain dual accounts at separate financial institutions.

[52] It is also possible that, in the event that Scotiabank imposed a small but significant increase in the price of the GPAY Service, its depositors would close their Scotiabank accounts and move to another financial institution where B-Filer was a biller. Having regard to the factors discussed above, this seems highly unlikely, especially if those depositors have multiple accounts and significant other business with Scotiabank. Moreover, according to recent survey research on Canadian retail banking, both online and non-online banking customers are highly unlikely to switch to another chequing account provider.[20] The same research found that for online banking customers, the principal reason for staying with their current chequing account provider is that it has the

[20] See Deutsche Bank Research, "E-Banking snapshot", No. 14, July, 2005 (available at http://www.dbresearch.com/PROD/DBR_INTERNET_DE-PROD/PROD0000000000185427.PDF)

most convenient branch and/or automatic teller machine; the second reason given was that switching was “too much trouble”.

[53] It is true that bank customers do change banks; some perhaps do so frequently. Reasons may include change in family circumstances, relocation, inability to obtain other desired services, etc. The question here, however, is the extent to which a Scotiabank depositor would switch to another financial institution solely due to the increase in the account-level fee applied to transactions through the GPAY Service. Research on banking trends in the United States finds that people choose their chequing account provider mainly on the basis of proximity and availability of multiple banking products; interest rates and fees are not that important.[21]

[54] Thus, although no final conclusion can be reached without knowledge of the applicable fees and charges at other financial institutions, it is more likely than not that the Scotiabank depositor would find it more expensive to open an account at another financial institution where B-Filer was a biller than to bear the SSNIP in the price of the GPAY Service imposed by Scotiabank. Taking all of these considerations into account, it is quite clear that bank accounts at other financial institutions that accept B-Filer as a biller are not part of the relevant market for Scotiabank depositors who wish to use the GPAY Service.

(b) Online payment by credit card

[55] Scotiabank depositors might, of course, pay online by credit card for purchases at the merchant’s website in the event of a small but significant increase in the price of the GPAY Service by Scotiabank.

[56] Supportive of this switch to online credit cards is the apparently large number of merchants that accept online debit payment through the GPAY Service that also accept online payment by credit cards. Having regard to the two-sided nature of payment systems, this merchant acceptance suggests that large numbers of their customers hold those credit cards. Indeed such customers may be paying online exclusively by credit card; the relevant information is not available.

[21] See Myron Kwast, Martha Starr-McCluer and John D, Wolken,"Market definition and the analysis of antitrust in banking", The Antitrust Bulletin, Winter, 1997 (also available at http://www.federalreserve.gov/Pubs/oss/oss2/papers/antibull97.pdf)

[57] Proprietary research for Scotiabank regarding online debit payment service (the "iDebit" concept, the name apparently used by Scotiabank for what is now Interac Online) indicates **[REDACTED]**.[22] The same study also finds that **[REDACTED]**. However, **[REDACTED]**.[23] Indeed, **[REDACTED]**.[24]

[58] Such evidence tends to suggest that **[REDACTED]**. Accordingly, the fact that many customers pay B-Filer's merchants exclusively by online credit card does not establish that those customers who use the GPAY Service would switch to online credit card payment.

[59] One reason is that Scotiabank depositors who use the GPAY Service may not hold credit cards whether issued by Scotiabank or by other issuers. Direct evidence on this question was sought during discovery, but the representative of Scotiabank was unable to state how many of those depositors carried credit cards issued by Scotiabank.

[60] What is known is that Scotiabank issues debit cards to all its depositors with little apparent restriction. These cards enable depositors to access their accounts through Scotiabank's automated teller machines ("ATM"), to withdraw cash at other banks' ATMs, and to use Scotiabank's online services including bill payment and debit payment at the POS. There is further indication that Scotiabank has **[REDACTED]**.[25] This evidence tends to suggest that Scotiabank deposit customers using the GPAY Service would not switch to credit cards.

[61] Credit card issuers including Scotiabank have established criteria for determining which customers will receive those cards, including age, income, creditworthiness, employment status, etc. The Scotiabank online credit card application form requests information on Gross Monthly Income, Monthly Housing Costs and Other Monthly Obligations as further defined on the form.[26] Scotiabank has targeted its iDebit program to certain depositors and these depositors do not necessarily qualify for credit card issuance.

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[22] [REDACTED] It is not clear how PayPal processed transactions at that time.
[23] ibid, at 6
[24] ibid, at 6
[25] [REDACTED]
[26] Scotiabank credit card information and online application form are available at http://www.scotiabank.com/cda/content/0,1608,CID517_LIDen,00.html#

[62] Available evidence on the demographics of cardholders indicates that interest in online debit payment is strongest among younger online bankers/shoppers. In a survey cited by Interac Online, about 50% of respondents aged 15 to 24 said they are "very interested" in an online debit payment option and would be “very likely” to use Interac Online. Given the issuers’ criteria for credit card distribution, this age group is the least likely to hold credit cards. About 40% of respondents in the 25- to 54- year-old age bracket and 30% of those over 55 years of age said they would be "very likely" to use an online debit option[27].

[63] The third issue is whether the characteristics of debit and credit cards make their use interchangeable to consumers. Whether Scotiabank depositors who also hold credit cards would use them to make online payment to B-Filer’s merchants in the event of a small but significant increase in the price of the GPAY Service is hard to determine. Credit cards allow consumers to defer payment until the end of the periodic billing period, and may offer inducements in the form of rewards that debit cards in Canada generally do not offer. On the other hand, credit cards have revolving credit arrangements, often at high interest rates on unpaid balances whereas debit payment allows for the immediate electronic transfer of funds from the purchaser’s bank account. Credit card issuers place limits on the amount of credit the cardholder may access in a given period and perhaps on the size of the individual credit card transactions as well. Such limits may lead credit cardholders to use their debit cards in order to avoid hitting those limits and/or to reduce interest charges. They may also use debit where their ability to borrow generally is constrained. Recent research on payment choice at the POS in the United States indicates that debit is regularly used by credit cardholders who do not pay their monthly balances in full, who face binding credit limits, and by consumers who lack a credit card.[28] Such features tend to suggest that certain credit cardholders are more inclined to use debit than vice versa, at least at the POS.

[27] Interac Online. “Younger Consumers Are More Likely To Use Interac Online”, available at http://www.interaconline.com/media_research.php. B-Filer asked for the full study during discovery but the report was not produced. I reserve the right to modify my views when and if the report becomes available.

[28] See Zinman,J. “Debit or Credit?”, paper delivered at Federal Reserve Bank of Boston conference “Consumer Behaviour and Payment Choice: How and Why Do Consumers Choose Their Payment Methods”, October 27-28, 2005 (available at http://www.bos.frb.org/news/conf/payments2005/zinman.pdf)

[64] It also appears that consumers are concerned about the undesirable disclosure of information to the merchant when payment is made by credit card. A recent survey found that this is a serious issue for online shoppers and bankers.[29]

[65] What is known is that for payment at the POS, both debit and credit card usage is high in Canada. In 2004, Canadians made 2.8 billion debit card transactions or 88 transactions per person worth over $124 billion and an average transaction size of $44. Canadians made fewer but larger purchases via credit cards: there were 1.8 billion transactions or 55 transactions per person for a total value of $181 billion. The average credit card transaction was more than $100.[30] Thus, it appears that credit and debit cardholders use their cards for different purposes and purchases and this, together with the other available information, tends to suggest that Scotiabank depositors would not switch to online payment by credit cards in significant numbers in the event of a small but significant increase in the price of the GPAY Service.

(c) Offline payment by cheque

[66] A further payment option available to Scotiabank depositors is to pay by cheque after making online purchases at the merchant's website. It is not clear that B-Filer's merchants would accept such payments, in part because of the risk of loss due to insufficient funds. As relevant is the time delay between the purchase transaction and receipt of the cheque through the mails and the associated cheque-handling delays and costs. Typically referred to as the "float", businesses strive to minimize such costs, in part through online payment systems.

[67] Payment by cheque is often possible where the purchase transaction takes place at the merchant's premises. In-store purchasing is not possible where merchants are "web-only" businesses. Even where merchants accepting online payment through the GPAY Service do have premises, they may be very far away from their customers who use that service. Accordingly, the costs and inconvenience of travel further limit the use of cheques.

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[29] Interac Online. "Consumers' Perceptions Of The Benefits Of Interac Online", available at http://www.interaconline.com/media_research.php.

[30] See Taylor, V. "Trends in Retail Payments and Insights from Public Survey Results", Bank of Canada Review, Spring, 2006 at 27.

[68] More generally, due to the various costs of the float and the availability of superior methods of cash management, payment by cheque has been steadily declining in Canada. In 2000, approximately 1.7 billion transactions were paid by cheque ($5.5 trillion face value); in 2004, there were approximately 1.4 billion cheque-settled payment transactions ($3.5 trillion face value).[31]

(d) Cash payment

[69] It is also unlikely that Scotiabank depositors would abandon online debit payment for cash payment to any significant extent should the price of the GPAY Service increase. Cash can only be used as a means of payment for in-store purchases and most of B-Filer's merchants are web-based and do not have physical presences. Where merchants do have physical facilities, they may be very far away from the depositor's location hence the cost and inconvenience of travel would dissuade them from in-store purchasing. Where the merchants are nearby, the depositor would have to carry large amounts of cash, with the attendant inconvenience and risk of loss. Cash payment contradicts the basic motivation for online debit payment which is the convenience to shop and pay when convenient for the customer.

[70] Finally, the use of cash to complete transactions in in-store purchasing is declining and limited to small-value payments. The recent study by the Bank of Canada indicates that:

> Since their inception in 1994, debit cards have almost completely displaced cheques, and, to a certain extent, cash as a method of making retail payments at the POS. Credit cards may have also affected the use of cash, but debit cards currently represent the closest substitute. Considering the trends in electronic payments, there is some indication that cash usage at the POS has been in relative decline, despite the growth in the number of bank notes in circulation.[32]

Although the Bank of Canada refers to debit as a substitute for cash and cheques, it does not indicate mutual interchangability. Rather it indicates that consumers are substituting *away from* cash and cheques to debit.

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[31] Committee on Payment and Settlement Systems. Statistics on payment and settlement systems in selected countries: Figures for 2004, Bank for International Settlements, CPSS Paper No. 74, March 2006, ("BIS Study") Tables 7,8 at 19-20 (http://www.bis.org/publ/cpss74.htm)

[32] See fn. 30, supra, at 27. (Interac Direct Payment became available nationally in 1994.)

[71] In this connection, it is also noteworthy that the number of withdrawals at ATMs in Canada, that were deployed to reduce in-branch transactions, has itself declined[33]. Thus, it is clear that cash is not a good substitute for other methods of payment, and it is highly unlikely that Scotiabank depositors would resort to cash in the event of an increase in the price of online payments generally or the GPAY Service in particular.

(e) Electronic wallets

[72] Other payment services, sometimes referred to as "electronic wallets", allow an individual to transfer funds into an account and then transfer those funds to merchants' accounts in payment for goods and services. In the case of PayPal[34], an accountholder must transfer funds in from time to time to make continuous use of the account for payment purposes. For a PayPal accountholder in Canada, there is a 6-8 business-day delay between the time the accountholder initiates the transfer from his/her bank account and the time when the funds appear in the PayPal account.

[73] When the payment to the merchant exceeds the balance in the PayPal account, PayPal, immediately credits the account with the required additional funds and requests that amount from the Canadian accountholder's bank account. The accountholder must also provide a backup funding source such as a credit card, debit card or alternate bank account.

[74] In the event that the GPAY Service were no longer available to Scotiabank depositors, they could and likely would turn to electronic wallets such as PayPal. However, when both online payment options are available, it is not clear that they would switch to those electronic wallets in the event of a SSNIP in the GPAY Service, because those payment services impose costs on Scotiabank depositors. Principal among these costs are the foregone interest that results from holding balances in a PayPal account rather than in an interest-bearing Scotiabank account, the need to transfer funds to the PayPal account in advance to meet the expected online spending, and the 6-8 business-day delay in accessing transferred funds.

[33] See "Indicators of the use of payment instruments and terminals by non-banks: volume of transactions", BIS Study, Table 7 at 19. Note however that the value of withdrawals from ATMS is increasing. Ibid, Table 8.

[34] These details are taken from the PayPal website, at www.PayPal.com.

[75] On this basis, the relevant product market that includes the GPAY Service does not include electronic wallets.

(f) Interac Online

[76] If Scotiabank imposed a SSNIP on its depositors' account transactions resulting from their online debit purchases through the GPAY Service, but not on such transactions resulting from their online debit purchases through Interac Online, then those depositors would give serious consideration to switching to Interac Online.

[77] **[REDACTED].** Accordingly, it would be cheaper for a Scotiabank depositor to make online payments via Interac Online than via the GPAY Service. To illustrate, if the depositor had used up the free withdrawals, then the depositor would pay Scotiabank 52.5¢ due to the SSNIP for the next online debit payment through the GPAY Service and 50¢ through Interac Online.

[78] If the number of no-fee transactions were not yet exhausted in the month, the marginal payment to Scotiabank would be zero whether the depositor continued to use the GPAY Service or switched to Interac Online until the limit was reached. However, as indicated above, Scotiabank could impose a SSNIP on depositors using the GPAY Service in other ways, such as reducing the interest rate, or increasing the monthly fee. These steps would likely lead Scotiabank depositors to switch to Interac Online.

[79] The essential issue is whether the merchants that Scotiabank depositors currently pay through the GPAY Service would be available through Interac Online. This is not the case at the present time and Scotiabank has made it quite clear that Interac Online will not allow its facilities to be used by those merchants whose transactions generate 98% of B-Filer's volume.[35] Scotiabank's statement may be too harsh in light of the fact, noted above, that certain banks have continued to give B-Filer biller status. Nevertheless, on Scotiabank's view, looking only at B-Filer's current merchant base, Interac Online is not a good substitute for the GPAY Service and the Scotiabank depositors currently using the GPAY Service are unlikely to switch because their merchants would not be accepted on Interac Online.

[35] Scotiabank Response to Amended Notice of Application, June 22, 2006 at ¶72. Scotiabank also states that the "Applicant's business is not in competition with that of Interac Online".

[80] However, there are indications that B-Filer is attempting to compete with Interac Online. As noted above, through its marketing efforts, B-Filer is attempting to attract the same merchants or categories thereof that Interac Online seeks to attract (even if Interac Online does not seek to attract most of B-Filer's current merchant base). Thus far, B-Filer has enjoyed limited success in this regard, having signed up only the Princess Margaret Hospital Foundation. If its merchant recruitment efforts are successful, then it is highly likely that Scotiabank depositors would find Interac Online to be a good substitute for the GPAY Service and would likely switch to it in the event that Scotiabank increased the price for using the GPAY service significantly, in the knowledge that they could find the goods and services they seek to purchase.

[81] For this to be true, it would not be necessary for B-Filer and Interac Online to sign up the same merchants. Indeed, a merchant sought by both is likely to sign up with one or the other. Rather, it would suffice that they attract the same categories of merchants, e.g. computer retailers.

[82] Market definition should take into account the principal economic concern, that payment systems are two-sided markets. If the product at issue were part of a conventional, one-sided market, then perhaps it would suffice to observe that current Scotiabank depositors are unlikely to switch to alternate means of payment in the event of a SSNIP in the GPAY Service. However, in a two-sided market, merchant behaviour will affect the decisions of Scotiabank depositors and, as noted below, depositor behaviour will influence merchant decisions. In discussion of market definition above, it was clear that Scotiabank depositors <u>could</u> use other means of payment to complete transactions with B-Filer's merchant base. In order to continue to maintain that possibility in relation to Interac Online, it must be assumed, if only for analytical purposes (i.e. without making a forecast as to B-Filer's likely success or failure in merchant recruitment), that B-Filer could recruit sufficient merchants in the future and that Interac Online would be a good substitute for Scotiabank

<u>Alternate Payments and Merchants</u>

<u>[83]</u> As noted above, the merchants that currently accept online payment through the GPAY Service pay B-Filer a percentage of the value of each transaction. Their responses to a small but significant increase in the transaction fee establish whether these merchants have good alternatives to the GPAY Service. For many of the reasons given above, the relevant product market for the merchants is narrow.

[84] By virtue of their web-based business, it is highly doubtful that online merchants would switch to cash or cheque. However, online credit card payment may have some attraction to those merchants. For example, depending on the card system adopted, the combined merchant discount and interchange fees charged to the merchants by their credit card transaction acquirers may be close to B-Filer's transaction fees.

[85] From the merchants' point of view, however, there are some significant differences between online credit card acceptance and the GPAY Service. Principal among them is "chargeback risk" that merchants bear in the event of fraud or improper use. According to information obtained from B-Filer, this chargeback risk is much lower for a merchant using the GPAY Service, which has a 24-hour chargeback period. Thus, the merchants currently accepting payment through the GPAY Service enjoy a greater degree of finality of payment than with credit cards.

[86] According to B-Filer, its merchants' losses due to fraudulent transactions are insignificant **[REDACTED].** Online credit card transactions, like other "card not present" transactions, are susceptible to fraud. Certain fraud-control measures such as the 3-digit security code and address verification can be defeated if a thief has the card and knows the address of the cardholder. Visa's "Verified by Visa" is a recent initiative to address this concern.

[87] That a number, perhaps many, of B-Filer's participating merchants accept online credit card payment does not indicate that they would switch to credit cards in the event of a SSNIP to them in the GPAY Service. Indeed, due to the two-sided nature of payment systems, it is likely that those merchants would accept online credit card payment whether or not the GPAY Service were available. From the merchant's perspective, the key issue is whether there is a large number of credit card holders to make it worthwhile for them to accept online credit card payment. As indicated above, this appears to be the case, apparently among so-called "convenience users" of credit cards, those who pay their card balances in full, maximize rewards, and avoid the interest charges. Such users are unlikely to use debit.

[88] Whether B-Filer's merchants would switch to PayPal or similar pre-funded electronic wallets in the event of a SSNIP in B-Filer's merchant fees depends on a number of factors including the merchant fees, chargeback period, and settlement period of the new provider. PayPal's standard rate for merchants in the United States is 2.9% of the transaction amount plus $0.30, which may be close to B-Filer's current maximum merchant fee **[REDACTED]**.

[89] Without doubt, however, a major consideration for merchants considering switching is whether their online customers would switch to the new electronic wallet payment provider as well. Switching by Scotiabank depositors would entail some initial time costs but these costs do not appear high. However, as noted above, the prefunded electronic wallet payment approach is not as convenient as the GPAY Service. An important further issue is whether Scotiabank would allow its depositors to give PayPal the required access to its depositor accounts so that they could continue to deal with B-Filer's merchants; Scotiabank's attitude in this regard is not known.

[90] In light of the number and significance of unknown factors that bear on the merchant's decision to switch to electronic wallets, a conservative conclusion is that some merchants would likely switch in the event of a SSNIP in B-Filer's merchant fees, but a significant number would continue to use the GPAY Service.

[91] From the perspective of most of B-Filer's existing merchants, Interac Online is not available. For merchants that B-Filer hopes to recruit, Interac Online would be a good substitute because it is likely that the Scotiabank depositors would switch to it if they switched. On this basis, and taking into account the two-sided nature of payment markets, B-Filer's merchant recruitment efforts as discussed above, and the likelihood that an online merchant would sign up with either B-Filer or Interac Online but not both, the product market that is relevant to online merchants includes the GPAY Service and Interac Online.

[92] Thus, there is a market for merchants, in which only B-Filer and Interac Online compete to provide online debit payment service. In this market, B-Filer also competes with transaction acquirers on various dimensions including merchant transaction fees and service quality.

<u>Are EMTs Part of the Relevant Product Market?</u>

[93] The fact that B-Filer established accounts to receive EMTs at the Royal Bank of Canada and Scotiabank when other banks identified above and then Scotiabank terminated its biller status does not establish that biller status and EMTs are in the same product market. As noted above, if an alternate product is not available for choice, it cannot constrain the small but significant price increase that the test for market definition relies upon. Rather, the test is whether B-Filer would have shifted to alternatives to Scotiabank's biller status if Scotiabank had increased its access (or similar charges) fees for that status by a small but significant amount. If so, there is an argument that the product market consisting only of Scotiabank biller status is too narrow.

[94] Biller status at other banks that continue to provide that status to B-Filer is not a good substitute for biller status at Scotiabank. Biller status at those other banks allows B-Filer to process payments for those banks' depositors but does not allow it to process payments for Scotiabank depositors.

[95] It appears that business accounts at the Royal Bank of Canada and Scotiabank were the next best alternative to biller status at Scotiabank when B-Filer had biller status there, so the question may be asked whether those accounts are part of the relevant product market when both they and Scotiabank biller status are available.

[96] On the basis of the information available, it appears that if Scotiabank had raised the price of biller status to B-Filer by a small but significant amount, B-Filer would have borne this increase rather than switch to processing by way of EMTs because of the costs and disadvantages thereof in comparison to biller processing. First, each bank that permits its depositors to send EMTs imposes a per-transfer fee; Scotiabank charges a depositor $1.50 per EMT, in addition to any applicable account-level fee, unless its deposit plan provides otherwise. Such EMT transfer fees reduce the attractiveness of the GPAY Service to B-Filer's customers.

[97] Second, banks limit the number and/or aggregate value of EMTs their depositors may send over a particular period of time. For example, it is understood that the banks limit the maximum amount of money that may be transferred in a single EMT to $1,000 and further limit aggregate EMTs to $1,000 sent per day per depositor. While there may be reasons for these limits on EMTs, they also preclude the use of the GPAY Service for online payment for more expensive goods and services particularly when sales and similar taxes are taken into account. Such limits will be particularly significant if B-Filer seeks to expand its merchant base to include retailers and travel providers such as airlines.

[98] Third, payment by EMT is not final, as there is a 30-minute hold period following the initiation of the transfer during which time the depositor may cancel the EMT. This hold period exposes the online merchant to opportunistic behaviour by its online customers and reduces the attractiveness of the GPAY Service. B-Filer indicates that it now spends several hours per day dealing with cancelled EMTs.

[99] Fourth, to effect transfer by EMTs, B-Filer must establish accounts at a bank to receive such transfers. It appears that such accounts have been available to business customers only at Scotiabank (prior to termination thereof) and at the Royal Bank of Canada, which banks impose limits on the size and volume of deposits into those accounts. Scotiabank's limit on small-business customers permits deposit volume of $400,000 per month or $5 million per annum into such accounts.[36] Scotiabank does not permit commercial accounts to receive EMTs. As well, payment processing issues within Scotiabank required B-Filer to establish over 100 such small-business accounts at Scotiabank, which became administratively cumbersome to it.

[100] B-Filer also indicates that it has experienced processing problems, error messages, and unavailability of EMT facilities due to system shutdowns. According to B-Filer, the Royal Bank of Canada has indicated that it will not accommodate B-Filer's request for more such accounts or account profiles. B-Filer also indicates that it has hired a new person to help deal with EMTs and the associated problems.

[101] It appears that B-Filer used EMTs only to process online debit payments for depositors at banks that had not accorded it biller status. When both biller status and EMTs were available, B-File processed payments for that bank's depositors as a biller, not by way of EMTs. Thus, insofar as a particular bank is concerned, the availability of EMTs to its depositors does not establish that they are part of the relevant market for that bank's online debit payment services.

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[36] Scotiabank Response to Amended Notice of Application, June 22, 2006 at ¶38.

Summary and Conclusion Regarding the Relevant Product Market

[102] The relevant product market is established by asking whether online payers and online merchants would switch to alternate service providers and/or payment methods in large numbers after a small but significant and non-transitory increase in the price they pay for the GPAY Service. If they would, then it can be concluded that the product market consisting only of the GPAY Service is too small and must be broadened in some systematic way.

[103] The observation that other online payment methods exist and, apparently, have developed a profitable customer base is relevant to this inquiry but not dispositive. The key issue in delineating markets relevant to the purposes of competition policy is the degree of user substitution induced by a price increase.

[104] Absent good evidence on actual switching of this type, the test becomes a hypothetical experiment in which the features of the alternatives are examined and inferences about switching are drawn. In the current matter, there is little doubt that there would be some switching away from the GPAY Service, but the features of the alternatives that are available are such as to suggest that current online payers and online merchants using the GPAY Service would largely bear such an increase. The only additional debit payment product whose addition to the market is clearly justified is Interac Online, by virtue of its functional interchangeability with the GPAY Service, the competition between B-Filer and Interac Online for merchants, and the two-sided nature of payment systems.

[105] The same analytical approach can be used to determine whether EMTs are part of a relevant product market. This issue does not confront online payers using the GPAY Service; for those, the experience is very largely the same, if not identical, whether B-Filer processes a transaction as a biller or by way of EMTs. However, the issue does confront B-Filer.

[106] Here it is quite clear that EMTs are not a good substitute for biller status at Scotiabank and would not be used if the choice between the two online payment processing methods were available. Hence, the fact that B-Filer began to use the Royal Bank of Canada's accounts for receiving EMTs after Scotiabank's termination does not imply that EMTs are part of the same market as Scotiabank's biller status.

[107] Accordingly, there are three relevant product markets in light of the termination by Scotiabank:

(a) the market for online debit payment service for Scotiabank depositors who purchase at merchant websites, consisting of the GPAY Service and Interac Online

(b) the market for merchants, in which B-Filer competes with Interac Online transaction acquirers to offer transaction processing services, and

(c) in relation to the means of providing online debit payment to Scotiabank depositors, biller status at Scotiabank but excluding business accounts that accept deposit by EMTs.

[108] According to s.75 of the Act, an actionable refusal to deal must have or be likely to have an adverse effect on competition in a market. The product markets delineated above are markets in which such adverse effect may have occurred as a result of Scotiabank's termination of B-Filer's biller status. They are also the markets in which there could be an inadequate supply due to insufficient competition among suppliers.

Does Scotiabank's Termination Have an "adverse effect on competition"?

[109] To determine whether Scotiabank's termination of B-Filer's biller status and bank accounts has an adverse effect on competition, it is necessary to ask how competition will change as a result of that termination. A related inquiry shows why the effect is adverse.

[110] I understand that Scotiabank submits that it is entitled to rely on the defence of business justification for its termination[37]. This is a legal matter and, as an economic expert on issues of market definition and adverse effect on competition, I have made no inquiry nor formed any opinion on the proffered business justification or its adequacy as it is beyond my mandate and expertise. I have assumed, however, that the inquiry into the adverse effect on competition is distinct and separate from the determination as to the availability and adequacy of a business justification defence.

[111] As suggested above, the termination has not prevented B-Filer from serving its current base of Scotiabank depositors and the current merchant base that those depositors wish to purchase from. Through EMTs, B-Filer also continues to provide online debit

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[37] See Scotiabank Response, fn. 35 supra, at ¶101.

payment service to its existing merchants for those depositors at other banks where it does not have biller status. As indicated above, the termination of biller status has made it more costly for B-Filer to provide online debit payment service to Scotiabank depositors, and Scotiabank's termination of B-Filer's bank accounts means that B-Filer must rely solely on business accounts at the Royal Bank of Canada to process online debit payments by EMTs from depositors at all banks where it does not have biller status.

[112] However, the terminations have not driven B-Filer from the market that it currently serves, and these negative effects on B-Filer do not by themselves constitute an adverse effect on competition. Doubtless, however, B-Filer is a less efficient provider of online debit payment service after the terminations than before.

[113] The major effect on competition arising from Scotiabank's terminations relates to the future market for online debit payment service. To participate in the expected significant increase in online shopping and payments, B-Filer must be able to process much larger transaction volumes than it processes now. The most efficient way to process larger volumes of transactions from Scotiabank depositors is with biller status at Scotiabank.

[114] Scotiabanks terminated all of B-Filer's accounts, the Royal Bank of Canada has refused to allow B-Filer to increase its business accounts and profiles, and no other banks offer such accounts to B-Filer. Accordingly, B-Filer will be unable to expand its processing capacity by way of EMTs which are the only alternative for providing online debit payment to depositors of banks at which it is not a biller. It is not simply the unavailability of adequate supplies of business accounts to accommodate expansion via EMTs but also the limits on transaction size and volumes of those accounts that prevent B-Filer from processing more transactions.

[115] A second competitive impact occurs in the market for online debit payment service to merchants. By preventing B-Filer's expansion, there will be insufficient competition among transaction acquirers and, likely, higher merchant fees.

[116] Accordingly, Scotiabank's termination will adversely affect competition and thereby economic efficiency in the market for online debit payment service and in the market for merchants.

(a) Growth of online commerce

[117] Online commerce is growing in Canada. According to a recent survey by Statistics Canada, internet sales (not necessarily accompanied by online payment) by private firms in Canada exceeded $36 billion in 2005, up from approximately $24 billion in the previous year. While these sales include both business-to-consumer and business-to-business, retailers reported sales of $5.4 billion in 2005 versus $3.0 billion in 2004. Among businesses in the retail trade sector, 42% had a Web site as compared with 38% in 2004.[38]

[118] According to independent market research and projections, the expected growth in online activity is reflected in number of households online, which, in Canada, is expected to rise 22% between 2003 and 2007, from 7.4 million to 9 million (eMarketer, June 2004).[39]

[119] Looking only at adults, Internet penetration in Canada is higher than in any other country, with over 70% of adults having used the Internet in the past 30 days (Ipsos-Insight, January 2004).[40]

[120] The same research found that Canadians spent over $3 billion on Internet shopping in 2003, an increase of 25% over the previous year (Statistics Canada, The Daily, Internet Use in Canada #56F0003XIE, September 23, 2004). The total number of Internet shopping transactions rose to 21.1 million orders in 2003, up from 16.6 million a year prior (Statistics Canada, The Daily, Internet Use in Canada #56F0003XIE, September 23, 2004). Online shopping in Canada is expected to grow to $12.2 billion in 2008 (Forrester Research, October 2003).[41]

[121] Accordingly, even if it can be said that B-Filer is able to offer consumers a satisfactory alternate online debit service through EMTs via accounts and profiles at the Royal Bank of Canada today, then it is a reasonable conclusion that without expansion of those facilities, B-Filer will not be able to offer online debit payment choice to online shoppers in the future.

[122] It is of further interest that projected growth in online shopping will include high-priced items. Independent research has predicted that the top 5 categories by dollar

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[38] Statistics Canada. “Electronic commerce and technology 2005”, The Daily, April 20, 2006 at 6-8
[39] Interac Online. “Summary of Market Trends”, available at www.interaconline.com/media_research.php
[40] ibid.
[41] ibid.

volume of online purchases by 2008 will be Travel, Apparel, Home Products, Auto/Auto Parts and Consumer Electronics.[42] In this regard, the current transaction limits on EMT business accounts at the Royal Bank of Canada will constrain B-Filer's ability to process online debit payments in these areas, among others, into which it hopes to expand and thereby offer consumers an online debit payment choice.

[123] In addition to the lack of additional accounts for processing EMTs, the $1,000 transaction-size limits on those accounts indicate that B-Filer will not be able to process transactions from the merchants it seeks to recruit in Travel, Apparel, Home Products, etc. The lack of accounts and the account limits severely limit B-Filer's ability to compete with its nearest competitor, Interac Online, in the future.

(b) Competition in Merchant Acquiring

[124] Merchants participating in Interac Online must have an agreement with an acquirer to process transactions. B-Filer provides these services to its current merchant base, but if its growth is restrained or prevented, merchants will face limited choice of acquirers. As noted above, Moneris is the only acquirer currently certified by Acxsys Corporation; Chase Paymentech will apparently enter the market in the near future.

[125] B-Filer's inability to expand means that it will be less able to constrain the merchant fees and discounts that acquirers will charge in the future.

(c) Other efficiency considerations

[126] Speaking generally, that a company has found it in its interest to supply an input to a customer in the past shows that at that time the company found it efficient to engage in that supply relationship. Especially when the customer has made investments connected with the supply relationship, continuation of that supply relationship should be pro-competitive unless or until other developments or data indicate inefficiency.

[127] In the current matter, it appears that Scotiabank did not terminate B-Filer's biller status and close its bank accounts for reasons of superior efficiency. I understand that Scotiabank has not claimed that increased efficiency was the reason for the termination.

[128] There are, however, efficiencies associated with continuation of the supply relationship between Scotiabank and B-Filer that may be particularly significant in light of the expansion of online commerce. B-Filer performs an aggregation function and

[42] Interac Online. "Forrester Category Research", available at www.interaconline.com/media_research.php

makes online debit payment possible for those merchants that either do not qualify for, or do not seek, biller status at each of the financial institutions where its customers have deposit accounts. To illustrate, suppose that there are 20 merchants and customers thereof at each of 5 banks. Each merchant could, subject to the banks' rules, obtain biller status at each bank and thereby obtain online debit payment service. This would require 100 such biller relationships between merchants and banks.

[129] Accepting online debit payment through B-Filer's GPAY Service would require only 25 relationships: 20 merchant relationships with B-Filer and one relationship between B-Filer and each of the 5 banks.

[130] The efficiency of the supply relationship is even greater if, by reason of size or low volume of transactions, a particular merchant does not qualify for biller status at a bank. Thus, it may be inefficient for a bank to give that merchant biller status. By aggregating all such merchant transactions, B-Filer makes it possible both for those merchants to obtain the benefits of online debit payment and for the bank in question to deal with efficient transaction volumes.

[131] As online commerce grows, the ability of aggregators such as B-Filer to efficiently aggregate transactions of small merchants will improve the efficiency and adaptability of the Canadian economy.

[132] A second efficiency concern is the impact that the termination may have on incentives to invest and innovate, i.e. dynamic efficiency. B-Filer has engaged in software and systems development and it appears to be the first to introduce online debit payment to merchants and bank depositors in Canada. If it can no longer offer that service as a biller and if its expansion is curtailed by lack of EMT accounts, then its investment in software and systems development is placed at risk even though there appears to be a market for online debit payment.