Competition Tribunal | Tribunal de la Concurrence

CT - 1995 / 002 – Doc # 93a

IN THE MATTER OF an application by the Director of Investigation and Research under sections 79 and 105 of the *Competition Act*, R.S.C. 1985, c. C-34;

AND IN THE MATTER OF an abuse of dominant position in the supply of shared electronic network services for consumer-initiated shared electronic financial services.

B E T W E E N:

The Director of Investigation and Research
Applicant

- and -

Bank of Montreal
The Bank of Nova Scotia
Canada Trustco Mortgage Company
Canadian Imperial Bank of Commerce
La Confédération des caisses populaires et d'économie Desjardins du Québec
Credit Union Central of Canada
National Bank of Canada
Royal Bank of Canada
The Toronto-Dominion Bank
Interac Inc.

Respondents

- and -

TelPay, A Division of CTI-Comtel Inc.
Retail Council of Canada
Canadian Life and Health Insurance Association Inc.
Midland Walwyn Capital Inc., Richardson Greenshields of Canada Limited, Mackenzie Financial Corporation and Trimark Investment Management Inc.

Intervenors

REASONS FOR CONSENT ORDER

Date of Hearing:

March 4, 5 and 6, 1996
April 15-19, 22, 25-26, 1996

Members:

McKeown J. (presiding)
Dr. Frank Roseman
Noël J.

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GUIDE TO ACRONYMS

ABM	automated banking machine
ACSS	automated clearing settlement system
CDIC	Canada Deposit Insurance Corporation
CLHIA	Canadian Life and Health Insurance Association
COIS	consent order impact statement
CPA	Canadian Payments Association
DCFI	directly connected financial institution
DCNFI	directly connected non-financial institution
DCO	draft consent order
EFT	electronic funds transfer
FI	financial institution
GMAC	General Motors Acceptance Corporation
ICSS	indirectly connected participant in a shared service
IDP	Interac direct payment
IMN	inter-member network
PCS	Preferred Client Service
PIN	personal identification number
POS	point-of-sale
RCC	Retail Council of Canada
SCD	shared cash dispensing

SEFS	shared electronic financial services
SENS	shared electronic network services
SGMF	tatement of grounds and material facts

COMPETITION TRIBUNAL

REASONS FOR CONSENT ORDER

The Director of Investigation and Research

v.

Bank of Montreal et al.

I. INTRODUCTION

On December 14, 1995, the Director of Investigation and Research ("Director") applied to the Tribunal pursuant to sections 79 and 105 of the *Competition Act*[1] ("Act") for an order, the terms of which had been agreed upon by the Director and the respondents. The subject matter of the application is the electronic banking network created by nine of the respondents in the mid-1980s, called "Interac".[2] The Director alleges, and for the purposes of this application, the respondents do not dispute, that through their control over Interac and the enactment of exclusionary by-laws governing membership in and operation of the network, they have engaged in joint abuse of dominance contrary to section 79 of the Act. The Director asks that the Tribunal

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[1] R.S.C. 1985, c. C-34.

[2] Members in the network are part of the Interac Association, an unincorporated entity. The network and the association will both be referred to as "Interac" unless greater precision is required in the particular context.

approve the draft consent order ("DCO") which he and the respondents have agreed on as an effective cure for the competitive problems arising from the respondents' behaviour.

The ten respondents in this application are the six largest Canadian chartered banks, a trust and loan company, two co-operatives representing various *caisses d'épargne et de crédit* and credit unions, respectively, and Interac Inc., a corporation which is wholly owned by the other nine respondents. In simple terms, Interac consists of the automated banking machines ("ABMs"), point-of-sale ("POS") terminals and customer accounts of the various members which are linked together by software which allows the members to communicate. Interac Inc. owns the software that is used in the operation of the network, the inter-member network ("IMN") software. Individual members own or control the other elements. POS terminals and ABMs which are part of the network are identified by the Interac trademark.

This case is only the second consent proceeding to come before the Tribunal which involves abuse of dominance as opposed to a merger. The first abuse of dominance consent proceeding was also a joint abuse of dominance case[3] but it generated little controversy. There were only two public comments filed and no requests for leave to intervene were received. Although the parties presented oral argument, no evidentiary hearing was held.

In contrast, this case was subject to extensive public commentary and vigorous intervention, with significant overlap between the persons participating in each fashion. Seven

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[3] *Director of Investigation and Research v. AGT Directory Limited* (18 November 1994), CT9402/19, Consent Order, [1994] C.C.T.D. No. 24 (QL).

comments were filed and four of the commenters applied for and were granted intervenor status. The commenters who did not also intervene were Daniel Bellemare, a Montreal lawyer who takes an interest in competition law and policy, the Amex Bank of Canada, currently a member of Interac, and the Retail Merchants' Association of British Columbia. The Retail Council of Canada ("RCC"), the Canadian Life and Health Insurance Association ("CLHIA"), a group consisting of four investment companies ("Midland et al.") and TelPay, a division of CTI-Comtel Inc. ("TelPay"), which operates a telephone bill payment service, commented and were granted leave to intervene. The first three intervenors, who represent retailers and institutions that compete with the respondents in the broad financial services sector, were granted the right to call evidence on a limited basis. The parties also called evidence, resulting in a total of 11 hearing days ending in late April. The substance of the comments and any relevant evidence will be referred to where appropriate in the reasons which follow.[4] The concerns expressed by the Retail Merchants' Association of British Columbia largely parallel those raised in more detail by the RCC and will not be referred to independently.

This case, therefore, represents the first occasion on which difficult issues unique to a joint abuse of dominance consent proceeding were raised by the participants and must be addressed by the Tribunal. In addition, the Tribunal in this proceeding had to deal with complex

[4] Mr. Bellemare's comments merit only brief consideration. Mr. Bellemare's view is that the draft consent order will be ineffective as it includes only "behavioural" remedies and does not re-establish a competitive market structure. He argues that the "efficiencies" in the Interac network alleged by the Director should not be taken into account and that the appropriate remedy is divestiture of Interac to a third party which does not require access to the network for its business. Both parties duly responded to Mr. Bellemare's comments. Insofar as Mr. Bellemare's proposed solution would involve replacing the current shared monopoly of the respondents with a single "third party" monopolist, it did not strike us that this would be an improvement.

issues relating to the scope of the application. The application deals with the financial services sector of the Canadian economy. Financial services are subject to various regulatory and legislative regimes based on far-reaching policy choices. Sorting out the nature of the role posited by the Director for the DCO within this framework and whether the DCO would be effective in that role, in light of the evidence and the argument put before us, proved to be exceedingly difficult.

II. BACKGROUND INFORMATION

Starting in the 1970s, Canadian banks and trust companies began to offer their customers electronic access to their chequing or savings accounts through ABMs and the use of an encoded card issued by the customer's bank (called a "debit card") in conjunction with a unique personal identification number ("PIN"). Customers could only use their card at the ABMs owned by their bank or trust company (the institution's "proprietary network") and generally the only service available was cash dispensing.

In the 1980s, banks and trust companies began to enter into sharing arrangements in order to allow their cardholders to use the ABMs deployed by another institution. The Royal Bank of Canada and the Bank of Montreal each connected with a different international shared ABM network[5] and then offered other Canadian institutions connection to their proprietary networks to access the international network. In late 1984, the five major Canadian VISA-issuing

[5] The "Plus" and "Cirrus" networks, respectively.

institutions[6] announced their intention to inter-connect their proprietary networks to form a shared domestic network to be called Interac. By late 1985, they had been joined by the four largest MasterCard-issuing institutions.[7]

The nine founding members of Interac are the respondents in this application. They are also referred to as the "charter members" of Interac. Other members have since joined Interac as "sponsored members"; there are presently 18 such members for a total of 27 members. Charter members are presently the only members who may be "directly connected" to the network.[8] That is, only charter members can develop and control a "switch" which allows direct access to the IMN software and the network. Sponsored members are indirectly connected to the network; they must use the switch of a charter member.

At present, two banking services are available to consumers through Interac: shared cash dispensing ("SCD") and Interac direct payment ("IDP"). The SCD service was the first shared service offered by Interac when it became operational in 1986. The SCD service allows anyone who has a debit card or a credit card, issued by a member of Interac, to withdraw cash from an

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[6] The Bank of Nova Scotia, the Confédération des caisses populaires et d'économie Desjardins du Québec, Canadian Imperial Bank of Commerce, Royal Bank of Canada and the Toronto-Dominion Bank.

[7] Bank of Montreal, Canada Trustco Mortgage Company, Credit Union Central of Canada and National Bank of Canada.

[8] The Laurentian Bank of Canada was a tenth charter member of Interac from May 1988 to May 1989. Although it is now a sponsored member, the Laurentian Bank remains directly connected to Interac for shared cash dispensing.

account with that institution, or as an advance against the credit card, through the ABM of another member of Interac.

In 1989, the charter members announced their plans to introduce IDP as a shared Interac service. A pilot project was launched in Ottawa in late 1990; nation-wide introduction of the IDP service was finally completed in 1994. The IDP service allows for electronic funds transfer at a point of sale. From a POS terminal rented to a retailer by an Interac member, a customer can use his or her debit card to pay for a purchase by causing funds to be transferred directly from his or her account to the retailer's account.

The current members of Interac participate in the network as both "issuers" and "acquirers" or as issuers only. An issuer is a member that holds accounts and issues debit or credit cards, or both, to its account holders to permit them to access their funds electronically. An acquirer is a member that deploys ABMs and POS terminals. Each transaction using the network involves the participation of both an acquirer and an issuer. When a consumer uses an ABM or POS terminal, the Interac member that owns the ABM or POS terminal "acquires" the transaction and transmits a request for authorization through the network to the member that issued the card being used. The issuer responds by authorizing or denying the request. Upon receipt of authorization, the acquirer dispenses cash or effects the POS funds transfer.

III. CONTENT OF THE APPLICATION

As this application is brought pursuant to section 79 of the Act, the Director's application closely tracks the wording of that section. In the Statement of Grounds and Material Facts ("SGMF") the Director alleges that the respondents jointly through Interac have substantial or complete control of a class or species of business in Canada; that is, they have joint market power in a relevant market. The relevant market identified by the Director is the supply of shared electronic network services ("SENS"), also referred to as the "intermediate" market. The respondents are alleged to have engaged in a practice of anti-competitive acts which has had, is having and, unless restrained, is likely to continue to have the effect of preventing or substantially lessening competition in Canada in *two* markets. The first market is the intermediate market for the supply of SENS. The second market is the "retail" market for the supply of shared electronic financial services ("SEFS") to consumers.

In more descriptive terms, the intermediate market is the market for the supply of shared, or network, services required for a network participant to provide a consumer to whom a card has been issued by a financial institution with on-line electronic access to an account held by the financial institution from which funds are payable on demand by the consumer. The term "financial institution" or, as it will be referred to in these reasons "FI", is defined in the DCO in a detailed and precise fashion.[9] Institutions commonly considered as "financial institutions", like the insurer or investment company intervenors, do not qualify as "FIs" under the DCO. An FI under the DCO is a deposit-taking institution which is a member of the Canadian Payments

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[9] Paragraph 1.

Association ("CPA").[10] These include banks, trust or loan companies, credit union centrals and provincial government agencies like the Alberta Treasury Branches or the Province of Ontario Savings Offices. There are about 155 qualifying FIs in Canada. Twenty-seven of these (including two "centrals" of credit societies) are already members of the Interac Association.

The intermediate market consists of the Interac network, comprising the ABMs and POS terminals available for Interac use (as opposed to purely proprietary ABMs and terminals), the IMN software, switches and other components allowing electronic messages to pass between members and the co-operative arrangements between members which establish the permissible uses of the network by members. The players in this market are Interac and the charter members as suppliers and those persons who are either current or potential "purchasers" of SENS, including both FIs and non-FIs like retailers, other service providers, transaction processors and terminal deployers.

The intermediate and the retail market are inextricably linked. The reason that players in the intermediate market demand access to SENS or to the Interac network is to provide SEFS to consumers; SENS are an "input" into SEFS. As the Director phrased it, the business of Interac is the supply of SENS "that enable network participants to provide consumer-initiated shared electronic financial services . . .". The retail market as defined by the Director does not encompass any and all possible electronic financial services but only the shared services that

[10] These two elements may overlap, that is, one may imply the other. Bradley Crawford, the parties' expert on banking law, defines a deposit as "a debt of a particular kind of financial institution: one that is a member of the payments system in the currency area in which the deposit is located." Expert Affidavit of B. Crawford (29 March 1996): Exhibit R-15 at para. 19.

allow a consumer using a card *issued by an FI* electronic access *to an account held by that FI* from which funds are payable on demand by the consumer from a terminal (ABM or POS) owned and operated by an Interac member other than the FI where the consumer's account is located.

The Director alleges that the respondents together substantially or completely control the supply of SENS throughout Canada through Interac. They jointly control the Interac Association and they formulate the various by-laws, standards and operating regulations that govern the operation of the network.

The other shared networks in Canada and the proprietary networks do not provide a close substitute to Interac for consumers, retailers or FIs and other potential participants in shared electronic networks. These networks are generally of limited size and geographic coverage and thus offer consumers a smaller choice of ABMs or POS terminals and more limited convenience than Interac. Interac handles more than 90 percent of the SCD transactions in Canada. There is no shared electronic funds transfer at POS service available in Canada other than IDP.

The Director also points out that the charter members, or subgroups of the charter members, control other financial services organizations that could otherwise create a more competitive environment. A subgroup of the charter members controls the VISA credit card association in Canada which controls and manages the shared international Plus network. Another distinct subgroup of charter members controls the other major credit card association in

Canada (MasterCard). The charter members also have the votes to appoint a majority of the board of directors of the CPA, which has developed standards and rules pertaining to consumer-initiated shared ABM and EFT/POS transactions. A subgroup of the charter members controls CANNET, a company which until recently was the predominant supplier in Canada of electronic credit card authorization services and which carries all Interac SCD transactions.

The charter members of Interac are alleged to have engaged in a practice of anti-competitive acts by enacting by-laws with an "exclusionary" purpose or effect, namely to preclude or limit competition in the market for the supply of SENS to other potential network participants. The portions of the Interac by-laws that are alleged to be exclusionary are those which deal with eligibility for membership in Interac (charter and sponsored) and Interac fees and services. It should be noted at the outset that, at present, sponsored members have no effective vote on significant issues requiring amendment of the by-laws.

Five of the charter members, the VISA issuers, are also alleged to have structured the Plus network which they control and manage in Canada, in particular the admission fees for new sponsored members, in such a way as to inhibit or exclude competition with Interac for domestic SCD transactions. Plus provides access to only 75 percent of the ABMs connected to the Interac SCD service, yet a new member pays the same amount to join Plus for domestic ABM transactions as it would to join Interac. The latter anti-competitive practice is not particularly significant as the Director's position is that once the Interac situation is cured by the DCO the

anti-competitive acts regarding Plus no longer have the effect of substantially lessening competition.

The Director alleges that the enactment of restrictive Interac by-laws by the charter members has resulted in and continues to cause a substantial prevention or lessening of competition in the intermediate and the retail markets. As paragraph 63 of the SGMF states:

> In particular, the practice of anti-competitive acts has enhanced and facilitated the exploitation of the Respondents' market power in both markets. . . . is manifested by: (a) the restriction of access to the Interac network for various categories of intermediate market participants, including service suppliers and service buyers; (b) a lack of competition in Acquirer pricing to consumers of Shared Services across the network; and (c) a lack of innovation in the types of services and products available in both the market for Shared Electronic Network Services and the market for Shared Electronic Financial Services.

In order to cure the substantial lessening of competition, the Director asks the Tribunal to approve the DCO. The "main thrust" of the DCO, as set out in paragraph 5 of the Consent Order Impact Statement ("COIS"), is to introduce "appropriate competitive discipline" into these markets by

> opening up direct connection access to the network for firms other than the nine Charter Members (including non-Financial Institutions), by revising the governance structure of Interac to ensure they have greater representation on the Interac Board, and by removing existing barriers to competition in respect of pricing and the offering of new services.

IV. TEST FOR APPROVAL

The basic test for assessing a draft consent order in a merger case is set out in *Director of Investigation and Research v. Air Canada*. The Tribunal stated:

> The tribunal accepts the Director's argument that the role of the tribunal is not to ask whether the consent order is the optimum solution to the anticompetitive effects which it is assumed would arise as a result of the merger. The Tribunal agrees that its role is to determine whether the consent order meets a minimum test. That test is whether the merger, as conditioned by the terms of the consent order, results in a situation where the substantial lessening of competition, which it is presumed will arise from the merger, has, in all likelihood, been eliminated.[11]

In an abuse of dominance case, the analogous test for assessing the proposed consent order is whether the consent order will in all likelihood eliminate the substantial lessening of competition which is presumed to result from the practice of anti-competitive acts identified in the application. Both parties and the intervenors that addressed the issue of the applicable test formulated the test in broadly similar terms.

The parties, and particularly the Director, bear the ultimate burden of proving to the Tribunal that the DCO meets the minimum test. As a practical matter, however, since the Tribunal treats the Director's proposal with initial deference and will assume at the outset that the proposed consent order will, in fact, meet its stated objectives,[12] evidence that the DCO is not adequate will come, one way or another, from the intervenors. In effect, once the Director makes a *prima facie* case, the intervenors point out the flaws in the proposal.

The parties urge on us two features of an abuse of dominance consent application that they argue distinguish it from a merger consent application. Counsel for the Director argued that,

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[11] (1989), 27 C.P.R. (3d) 476 at 513-14, 44 B.L.R. 154, [1989] C.C.T.D. No. 29 (QL).

[12] *Director of Investigation and Research v. Imperial Oil Limited* (26 January 1990), CT 8903/390, Reasons and Decision at 14 [1990] C.C.T.D. No. 1 (QL) (Comp. Trib.).

unlike the merger context, the DCO does not sanction any conduct within the scope of the Act that has an admitted anti-competitive effect. Both parties emphasized the role of subsection 79(3) of the Act.

The first argument is somewhat puzzling given the application before us. It is indisputable that an abuse of dominance case differs fundamentally from a merger case. In a merger consent proceeding, the nature and extent of the merger itself is a fact. The Director identifies the effects arising from the merger about which he is concerned (which together form the substantial lessening of competition in a relevant market) and puts forward a draft consent order on the basis that it cures enough of the adverse effects to ensure that any lessening of competition which remains is not "substantial". In an abuse of dominance case, there is no given. The Director, in bringing the application, must identify the particular acts which he alleges are anti-competitive. An integral part of that process is defining the relevant market.

While it would not be surprising to find that a draft consent order in an abuse of dominance case addressed all the anti-competitive acts identified in the application, that is not true in this case. The activities of those of the respondents which control the Plus network are included in the SGMF as a practice of anti-competitive acts but the DCO does not attempt to address those practices on the grounds that if the Interac problem is cured, the Plus restrictions cease to have substantial effect. We see no reason to object to this approach. Prohibiting some of the anti-competitive acts or taking some other positive action may result in a situation where the

substantial lessening has been cured despite the continuing presence of other acts identified as anti-competitive.

In any event, counsel for the Director did not indicate any consequences for our application of the test for approval that would flow from the fact that the DCO supposedly does not sanction any remaining anti-competitive conduct. Thus, we can go no further than to recognize that there are certainly differences between merger cases and abuse of dominance cases. In both cases, however, the Tribunal's inquiry will generally focus on the substantial lessening of competition and whether it has been cured.

With respect to subsection 79(3), the Director argues that the statutory objective set out in that subsection is "at the heart" of the remedy sought by the Director in this case. Subsection 79(3) reads:

> In making an order under subsection (2) [an order in addition to or in lieu of a prohibitory order under subsection (1), which directs such actions as are reasonable and necessary to overcome the effects of the practice of anti-competitive acts in the market], the Tribunal shall make the order in such terms as will in its opinion interfere with the rights of any person to whom the order is directed or any other person affected by it only to the extent necessary to achieve the purpose of the order.

We agree that the Tribunal's first goal must be to restore competition, or in other words, to eliminate the substantial lessening of competition. If there are alternatives available to it in achieving that goal, the Tribunal is required to adopt the least intrusive course of action. The fact of the respondents' consent to the DCO as proposed indicates that it is as minimal an impairment

of their rights as they were able to negotiate. Thus, it is not necessary for the Tribunal to inquire further into whether the DCO meets the test of not going beyond what is necessary. What is of concern is whether it meets the first and primary goal of removing the substantial lessening of competition. The respondents appeared to argue that the intervenors challenging the DCO bear an additional "burden" of showing that it is *both* necessary *and* reasonable to change the DCO before the Tribunal could turn the DCO down. We are of the view that if the DCO does not meet the required test of curing the substantial lessening, then it should not be issued. There is no "additional" burden on intervenors arising from subsection 79(3). Subsection 79(3) only comes into play when the Tribunal is fashioning a remedy; something which it does not have the power to do in a consent application. To the extent that the respondents are arguing that the DCO cannot be judged against solutions which were not within the Director's power to require in the DCO, this is a relevant point but one which goes to the scope of the application and the concomitant substantial lessening of competition and is dealt with below.

In the course of his argument, counsel for the Director referred to the decision of the United States District of Columbia Circuit Court of Appeals which overturned the refusal of the district court to enter a consent decree in *United States v. Microsoft Corp*.[13] To the extent that *Microsoft* held that the government's formulation of the issues to be addressed in a consent proceeding is completely immune from any judicial review and that the role of the court in reviewing a consent decree is narrowly circumscribed, based in part on issues arising from the

[13] (1995), 56 F. 3d 1448.

division of powers, we do not adopt the decision.[14] There are significant differences, constitutional and statutory, in our respective systems.

In our view, it is open to third parties participating in a consent proceeding before the Tribunal to challenge the Director's formulation of an abuse of dominance case brought on consent on the grounds that, for example, the Director has artificially or simply mistakenly drawn the boundaries of the relevant markets, has wrongly omitted some practice from the list of anti-competitive acts and, thus, has neglected to describe fully the effective substantial lessening of competition. Of course, since the Tribunal begins with a presumption that the Director is acting in the public interest, compelling evidence will be required to overturn his judgment on this basis.

V. DESCRIPTION OF THE DCO

The DCO requires that the respondents cause to be amended the Interac Association memorandum of association and by-laws and the Interac Inc. by-laws and shareholders'

[14] For example, the Court of Appeals states, *ibid.* at 1462, that "[w]hen the government and a putative defendant present a proposed consent decree to a district court for review under the Tunney Act, the court can and should inquire . . . into the purpose, meaning, and efficacy of the decree. . . . And, certainly, if third parties contend that they would be positively injured by the decree, a district judge might well hesitate before assuming that the decree is appropriate. But, when the government is challenged for not bringing as extensive an action as it might, a district judge must be careful not to exceed his or her constitutional role. A decree, even entered as a pretrial settlement, is a judicial act, and therefore the district judge is not obliged to accept one that, on its face and even after government explanation, appears to make a mockery of judicial power. Short of that eventuality, the Tunney Act cannot be interpreted as an authorization for a district judge to assume the role of Attorney General."

agreement as set out. The proposed amendments can be grouped under four headings, which correspond to the objectives that the Director submits will be achieved by the DCO.

A. ACCESS TO THE NETWORK

The Director submits that the effect of paragraphs 3(a) to (e), (r), (s), (t), 4(c) and (e) of the DCO will be to make access to the Interac network widely available to any commercial entity that is capable of providing a shared service or facilitating the provision of a shared service.[15] This, it is argued, provides the potential for entry of new members who may connect either directly or indirectly and may act as acquirers or issuers. The Director anticipates a significant increase in both direct and indirect connectors and forecasts that the resulting improvement in the diversity of interest among members will, in conjunction with other measures in the DCO, lead to a greater range of shared services offered in the retail market.

The majority of the listed measures (all except paragraph 3(t)) are directed at existing restrictions on membership in, or *direct* access, to Interac. The Interac by-laws impose strict criteria on charter membership which have effectively limited the group of charter members to the nine respondents. Charter members must be direct clearers in the CPA; they must be *both* issuers and ABM deployers, they must each invest an equal amount in the development of the common portion of a shared service and participate as a direct connector in all shared services

[15] Paragraph 4(c) eliminates a barrier to entry as a charter member, namely the requirement to surrender the shares in Interac Inc. for $1.00 upon losing that status. This is a minor provision and is not further discussed.

irrespective of the size of the charter member and expected usage of a particular shared service by that member. Charter members must also be shareholders in Interac Inc. (at a cost of about $15 to $20 million) and surrender their shares in Interac Inc. for $1.00 upon loss of charter member status.

The by-laws also confer significant benefits on the small group of FIs, namely the respondents, which qualify as charter members: only charter members may be direct connectors and only charter members vote on all matters of significance affecting the Interac shared services. Other FIs must connect to the shared services as sponsored members, through a charter member, in most instances at an additional cost to that incurred by a charter member, and have little say in the operations of Interac. According to the Director, the additional costs imposed on sponsored members competitively disadvantaged them relative to the charter members.

Nor is the group of sponsored members unrestricted. The by-laws require that sponsored members be FIs and issuers. Non-FIs cannot connect to the Interac shared services at all and no member can connect to acquire transactions only.

Paragraph 3(a) of the DCO provides that the requirement that a member of Interac be a CPA member shall be revoked and replaced by a provision that membership in Interac is open to all commercial entities, with the proviso that the status of issuer in Interac may continue to be restricted to FIs. The effect of this measure is to open membership for acquiring transactions in Interac, but not for card issuing, to all commercial entities.

Further, the DCO provides that any member may become a direct connector (paragraph 3(d)) and members need not be both issuers *and* acquirers (paragraph 3(e)). Thus, FIs who wish to participate in Interac as issuers only are no longer restricted to indirect connection, while non-FIs are allowed to participate as acquirers only and may connect directly where previously any participation by them was barred. The board may, however, establish reasonable criteria and regulations for direct connection and for participation of any member (paragraphs 3(b) and 3(c)). Related provisions ensure that any potential direct connector can get access to the information and specifications necessary in order to determine their ability to connect directly and in order to achieve actual connection (paragraphs 3(r) and 3(s)). Another incidental matter is dealt with in paragraph 4(e) which guarantees that every member participating in a shared service that uses the Interac trademark will be granted a reasonable trademark licence by Interac Inc. at no charge.

Paragraph 3(t) of the DCO deals with *indirect* access to Interac or access by non-members. The current by-laws prohibit Interac members from using the SCD or IDP services in conjunction with an account that is not an "eligible" account of a member. In particular, members are prohibited from offering the services in conjunction with "zero-balance, pass-through or sweep" accounts. It is worth setting out paragraph 3(t) in full:

> The requirement of the By-laws which stipulates that "an account shall not be an Eligible Account if it permits, by way of so-called "pass-through", "sweep" or "zero-balance" accounts or otherwise, access to accounts held by, or credit from, persons not Members in the Association", shall be revoked. Interac shall not impose any restriction or condition on access to the Services based on a Member Financial Institution's arrangements with its customers regarding the operation of Demand Accounts.

"Sweep", "zero-balance" and "pass-through" accounts were not described with any precision in these proceedings, either in the DCO and supporting documentation or in the evidence. In general, what is involved is a mechanism whereby funds resident with a non-FI, such as a brokerage firm, can be accessed by the customer of the non-FI through Interac using an FI with which the non-FI has an agreement as a gateway.[16] By removing the prohibition on these accounts and by dictating that Interac shall not interfere in the arrangements between member FIs and their customers, the DCO allows member FIs and non-FIs to devise an arrangement providing indirect access to Interac to the non-FI on whatever terms the FI and non-FI may negotiate.

Equally important is what the Director has to say about this provision in the COIS. At paragraph 14 of that document he states:

> While 3(a) permits the Interac By-laws to continue to prohibit commercial entities that are not Financial Institutions from being Issuers, relief measure 3(t) offers these entities indirect access to Interac by eliminating restrictions on a Cardholder's ability to access "pass-through", "sweep" or "zero-balance" accounts. The Director recognizes that, while certain commercial entities will not satisfy the criteria to be an Issuer, the elimination of restrictions on accounts eligible to be accessed through the Shared Services will facilitate indirect access to the system by non-Members.

[16] We will refer to all such arrangements as "sweeps" in the remainder of the reasons.

B. GOVERNANCE

Paragraphs 3(f) to (l) and 4(a) of the DCO deal with representation on the Interac Association board of directors and decision-making by the board. The Director describes these measures as directed at transferring the decision-making powers over shared services from the charter members to the board and ensuring that all members have "reasonable representation" in the board's decision-making process. The expanded representation of members, along with the likely broader range of interests among new members, he argues, will provide for a more competitive environment within Interac and in turn lead to enhanced innovation in services offered over the network.

Paragraph 3(g) makes the board solely responsible for all decisions relating to the administration and operation of the shared services. Paragraph 4(a) requires Interac Inc., which owns the IMN software used to provide shared services, to operate as a non-profit organization in the management of the IMN for Interac, thus precluding the charter members from exploiting their control of the IMN.

Paragraph 3(l) provides that each director shall have one vote and that decisions regarding enhancements to shared services, new shared services and interchange fees must be by simple majority. The board may determine the vote required (up to two-thirds majority) for all

other matters except those involving a "fundamental change"[17] which will continue to require a two-thirds majority vote. The Director submits that exempting new services and service enhancements from the current requirement of two-thirds majority will allow the interests of new members to be recognized despite the initially overwhelming volume of transactions, and hence power on the board, of the former charter members.

The remainder of paragraphs 3(f) to 3(k) deal with the composition of the board. Three classes of members in Interac are established: (1) directly connected FIs ("DCFIs") (2) directly connected non-FIs ("DCNFIs") and (3) indirectly connected participants in a shared service ("ICSS"), whether FI or non-FI. Except in a transition period when there may not be enough new DCNFI or ICSS members, there will be a minimum of 14 board members, of which a maximum of nine will be appointed by DCFIs, a minimum of two will be appointed by DCNFIs and a total of three will be appointed by ICSSs.

The member of a class with the largest annual message volume within the class will be guaranteed a board appointment but any one member may appoint only one board representative. As long as there are at least two DCNFIs and three ICSSs, those classes are guaranteed two and three seats, respectively; if there are fewer members in either class, the number of guaranteed seats will be reduced accordingly. DCFIs and DCNFIs are treated as a single class for the appointment of board members, except for the two board seats reserved for DCNFIs. Thus, there

[17] Defined as decisions of the board relating to security, minimum performance standards, use of the trademarks, Interac structure and membership criteria, board composition and voting rules, and fees (other than the interchange fees).

is the potential for DCNFIs to appoint more than two board members if any of them generate a message volume sufficient to rank in the top nine direct connectors. Indirect connectors are restricted to three board members irrespective of how they eventually rank in overall message volume of all members. The Director submits that these provisions increase the scale and diversity of representation on the board.

C. NEW SERVICES

The Director submits that paragraphs 3(h), 4(b) and 4(f) to (h) of the DCO create an additional incentive for the introduction of new electronic financial services. Currently, an amendment of the by-laws is required before any new service can be offered over the Interac network, whether the new service involves the participation of all members (a shared service) or some subgroup of two or more members (a bilateral/multilateral service). Thus, the charter members as a group determine the new services that will be allowed.

In order to stimulate the introduction of new services, paragraph 4(b) requires Interac Inc. to grant commercially reasonable software licences to allow members to use the IMN to connect directly to a service and to allow the direct connectors to connect other members indirectly to the service. The provision of new services is not left wholly in the hands of individual members, however. Paragraphs 4(f), (g) and (h) of the DCO set out a procedure for applying for approval of a new service, whether shared or bilateral/multilateral. The proponents of the new service must demonstrate to the senior management of Interac Inc. that the proposed service requires

networked on-line access to accounts at member FIs for its commercial viability, that the proposed service is not a shared service already offered by Interac and that the proposed service will not impact negatively on the technical operation of the IMN and existing services using the IMN. The board of Interac Inc. (the charter members) may only overturn the decision of senior management on the grounds that management did not properly investigate the claims of the proponents of the service and may only refer the decision back to senior management. The ultimate decision of senior management is subject to arbitration. The providers of a new service, if approved, must become members of Interac and pay all the costs of adapting the IMN to offer the new service.

The charter members would retain a measure of control over the operation of a new shared service through their extensive representation on the board of the Interac Association. With respect to a bilateral/multilateral service, paragraph 3(h) states that control of the operation of the service resides entirely with the participating members not the board, subject only to reasonable technical and security regulations put in place by the board.

D. FEES/PRICING

The Director submits that paragraphs 3(m), (n), (o), (p), (q) and 4(d) of the DCO will eliminate all constraints on competitive pricing in Interac.

Paragraph 3(m) prevents Interac from establishing and sharing among the charter members access fees charged to new members, although Interac will be permitted to recover the

direct and identifiable costs incurred in the course of admitting a new member. Paragraphs 3(m) and 3(n) together provide that Interac's revenue shall be derived entirely from a "switch fee" to be charged to users of the IMN on a per message basis. The switch fee will be based on the sum of the costs Interac incurs to deliver the service and the costs incurred by Interac in developing the IMN, net of any "service access fees" already collected.[18]

A "service access fee" is the fee required by the existing by-laws to be paid by a new sponsored member for access to each of the SCD and IDP services. For each service, the fee is currently set at $7.50 per card estimated to be issued within the first three years with a minimum fee of $100,000. There is a penalty for underestimating the number of cards that will be issued. The Director submits that the minimum service access fee discriminates against FIs with small card bases that might wish to become members of Interac. Likewise, the per card fee discourages entry by FIs with a potentially large card base because of the prohibitive cost and the penalties for underestimating the number of cards.

The service access fee of a new sponsored member is in part shared among the charter members, even though the new member will be connecting through a switch developed, owned and operated by a single charter member. The Director argues that this provision for sharing reduces the incentive for the existing charter members to recruit new sponsored members in competition with one another.

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[18] Paragraph 1 of the DCO.

The charter members currently collectively set an "interchange fee" for each of the SCD and IDP services and prohibit any member levying an additional fee (a "surcharge") on the cardholder of another member using the first member's ABM or POS terminal. The interchange fee is the per transaction fee paid by the card issuer to the acquirer. It is now set at $0.75 per transaction for SCD and $0.00 per transaction for IDP. The Director alleges that the interchange fee and the prohibition on surcharges have operated together to curtail competition among members for the deployment of terminals and the supply of SEFS to consumers.

Paragraphs 3(o), (p), (q) and 4(d) abolish the restriction on surcharges, require Interac Inc. to ensure that the IMN can support individualized pricing at the terminal level and prohibit members from engaging in discriminatory pricing against the cardholders of selected other members.

VI. SCOPE OF THE APPLICATION

We have already established that the test for approval is whether the DCO is likely to cure the substantial lessening of competition which is presumed to arise from the anti-competitive acts identified by the Director. In this case, however, because of the presence of constraints in the form of the CPA and its rules and the related policy implications, a further issue arises as to whether the adequacy of the DCO should be measured within or outside the scope of these constraints. Simply put, it is apparent to us that if the Director is suggesting that the DCO is adequate irrespective of these constraints we cannot agree with him. If, on the other

hand, the Director is suggesting that he has acted adequately within these constraints then we agree that he has done so.

At the outset, we note that we have had some difficulty in discerning the Director's position in this regard. This is most troublesome. The Director has a responsibility to ensure that the Tribunal fully understands the nature of the application and the position that he is advancing. The Director is the public official responsible for the administration of the Act. In a consent application, in particular, deference to the Director's judgment is urged upon the Tribunal. The Tribunal therefore relies heavily on the Director and his counsel to be upfront and comprehensive in making a consent application to the Tribunal.

There is ample opportunity for him to do so, starting with the written documentation required to be filed in accordance with the *Competition Tribunal Rules*[19] and progressing through the public comment process to the oral hearing, if such is held. In this case, we are of the opinion that the fundamental question of the scope of the application as it relates to the role of the CPA and the Director's position on this critical issue could and should have been made absolutely clear, starting with the notice of application and supporting documentation. This was not the case. The CPA receives only passing mention in the material filed. When describing the alternative relief considered in paragraph 32 of the COIS, the Director mentions only "litigation seeking structural relief, including a proposal to split the Interac network into competing networks." There is no reference to the possibility of forcing Interac to clear and settle outside

[19] SOR/94-290.

the CPA. It was only during the hearing that it became clear that this was a possibility and one which would free Interac's operations from the CPA rules.

While most of the relevant points were eventually canvassed one way or the other by the close of argument, there was a lack of direction and comprehensiveness in the presentation which did, and still does, trouble us. The Tribunal should not be required to piece together a coherent approach to a consent application from statements made here and there by counsel for the Director during oral argument. In the end, we have chosen to attribute to the Director the only position which, in our view, is capable of leading to the approval of the DCO.

Keeping the foregoing in mind, we understand the Director's position to be that there are significant and pervasive regulatory and policy constraints operating in this area, with particular relevance to the question of most importance to the intervenors (access to Interac). In the Director's view, these constraints effectively limit his ability to act and thus restrict the scope of the remedies that *could* have been placed before the Tribunal.

The constraints at issue in this application arise from the presence and the operations of the CPA. The Director chose to devise a remedy within the existing framework for clearing and settling and, therefore, subjected his proposed remedy to certain constraints inasmuch as the remedy impacted on the CPA's control over the payments system. We emphasize here that it is not simply by operation of law that the CPA comes to act as a constraint on the scope of the

application. In the course of deciding on how to approach the matters at issue in this application, the Director made two critical, and inter-related, decisions.

First, the Director decided that he was not going to challenge the continued use of the CPA clearing and settlement mechanism by Interac as an anti-competitive act. Second, the Director concluded that the Interac prohibition on direct card issuance by non-FIs and any attempt on his part to change that prohibition would involve issues going to the desirability of allowing non-FIs to permit their customers to transfer money that is held by them directly to a third party. He further concluded that it is within the authority of the CPA to make rules in this area and if those rules operate to constrain direct issuing or "what is tantamount to the same thing, some arrangement between an FI and a non-FI that the CPA considers goes to the integrity of its system, then that is wholly a matter for determination by the CPA."[20] The Director characterized the removal of the Interac prohibition on sweeps, which is included in the DCO, as a surrogate for direct issuance and determined that accommodation of that remedy is equally within the control of the CPA as a matter properly within its mandate and, thus, beyond the authority of the Director, the Tribunal and the Act.

Parliament, in its wisdom, created the CPA with the following objects:

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[20] Oral argument of counsel for the Director: transcript at 10:1767 (25 April 1996).

> to establish and operate a national clearings and settlements system and to plan the evolution of the national payments system.[21]

Within that specialized mandate, the CPA has broad powers. The CPA controls the definition of "eligible payment items", items which may be entered into the payments system. In particular, the board of directors of the CPA may, subject to the approval of the Governor-in-Council, make by-laws respecting, among other things, clearing arrangements, settlements and related matters. Subject to the by-laws, the board may make rules respecting clearing and settlement as it considers necessary. Members of the CPA may present payment items and shall accept and arrange for settlement of payment items in accordance with the by-laws and the rules.[22]

Items which are not eligible cannot be cleared and settled through its system. With reference to the DCO, this implicates two of the proposed remedial measures -- the admission of non-FI members as acquirers-only into Interac and the removal of the prohibition on sweeps and other arrangements providing non-FIs with indirect access to Interac in lieu of direct access as card issuers. With respect to the former, although it appears that the CPA rules will have to change to accommodate non-FI acquirers in Interac, Robert Hammond, the General Manager, disclaimed any significant concern on the part of the CPA about making such a change. He explained that the rules were developed in a particular context and that the CPA was examining the rules and considering a change. The CPA has some concerns about the latter issue but the only evidence before the Tribunal regarding its position is preliminary in nature.[23] How the CPA

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21 *Canadian Payments Association Act*, R.S.C. 1985, c. C-21, s. 5.

22 *Ibid*., ss. 18(d), 18(e), 19, 29.

23 More detail on what is known about the CPA's position is provided later in these reasons.

might act and the possible effects of those actions formed the focus of much of the evidence and argument before us.

Membership in the CPA is restricted by statute.[24] The parties' legal expert, Bradley Crawford, testified that only deposit-taking financial institutions that provide payments services to the Canadian public are eligible to be members. Only the banks and the Bank of Canada are required to be members; membership is optional for the others. Mr. Crawford commented further that, "it is important that membership be restricted to financial institutions of undoubted credit and reputation, in order to maintain public confidence in the payments system."[25] It was not disputed before us that the intervenors, even if they were Interac issuers, would not meet the CPA requirements for use of its settlement and clearing mechanism. As Mr. Crawford stated,

> no Intervenor is capable of conforming to those requirements, for a number of reasons, all derived from the closely inter-related laws that limit and control participation in the Canadian payments system:
>
> (a) no Intervenor is authorized to receive deposits from the public; and therefore,
>
> (b) no Intervenor is qualified to be admitted as a member of Canada Deposit Insurance Corporation ("CDIC"), or any other recognized deposit insurance provider or program; and therefore,
>
> (c) no Intervenor is qualified to be a member of the CPA; and therefore,
>
> (d) no Intervenor is qualified to use the ACSS or other facilities of the CPA [to] clear and [settle] its payment obligations with the members of that Association.[26]

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24 *Supra*, note 21, s. 30.

25 *Supra*, note 10 at para. 9.

26 *Ibid*. at para. 15.

There are 11 members on the board of the CPA, five chosen by the banks, two chosen by the trust and loan companies, two chosen by the credit union centrals, one chosen by the other deposit-taking institutions and one representative of the Bank of Canada, who acts as Chairman. Each member has a single vote but where a question arises at a meeting of the board or the executive committee (the Chairman plus at least two other directors) as to whether a proposed rule is in conformity with the by-laws, the Chairman decides and that decision is final.[27]

That the Director's initial decision to allow Interac to continue to use the CPA clearing and settlement mechanism was a choice, rather than an inevitable result flowing from statute or regulation was made clear in final argument. The Director's written argument states that there is no "direct relationship" between Interac and the CPA, "rather each and every member of Interac participates in the Canadian Payments Association for purposes of settlement." Further,

> [a]nother mechanism could be used for clearing and settlement, provided that it was one that was acceptable to and used by each of the other network members. However, at the present time, the ACSS is the only settlement facility in which all members participate. If the members of Interac clear and settle through the ACSS, they must comply with the Canadian Payments Association's requirements.[28]

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[27] *Supra*, note 21, ss. 8, 9, 10, 15, 19(2) and 20.

[28] Written argument of the Director at paras 139, 143.

The argument states only that the Director is not seeking to require the Interac charter members to create an alternative settlement mechanism in which all Interac members would have to participate. It does not say that such a course of action was never open to the Director.[29]

The Director has also, at least implicitly, taken the position that card issuance and indirect arrangements are matters of access to the payments system which raise questions going to the integrity and security of that system. This assumption was not challenged before us. The Director is of the view that because the DCO has been fashioned within the CPA system, issues are raised by its terms which appear to be clearly within the mandate of the CPA and thus are beyond the purview of this Tribunal.

Was the Director's choice to allow Interac to continue to clear and settle under the auspices of the CPA an appropriate one? Evidently, in order to force the respondents to create an alternative system, the Director would have had to litigate the matter. The result is by no means a foregone conclusion. In addition to the expense and delay attendant upon any litigation, in this case the Director would be faced with the additional challenge of steering his case between the obstacles created by the underlying jurisdictional and policy concerns with which the area is fraught. The regulated conduct defence would likely arise in one form or another. Broader policy issues such as will be addressed in the upcoming general review of financial institutions are also implicated by the subject matter of the application. On the other hand, a negotiated settlement provides some, although qualified, assurance of a positive result with fewer resources expended.

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[29] *Ibid.* at para. 144.

Choosing between the two is a delicate balancing act and, in the circumstances of this case, we cannot conclude that the Director's decision to proceed as he did was an inappropriate one.

We do note, however, that one of the arguments presented to us as a justification for maintaining Interac within the CPA on the basis of cost was unconvincing. In oral argument, counsel for the Director went as far as to say that the alternative to use of the CPA would be to require the respondents to participate in a clearing and settlement system that would be "inefficient and expensive for them".[30] There is little support for this proposition. The parties entered evidence through Mr. Hammond that the addition of the Interac business to the work of the CPA, even given the rapid growth from 1986-87 to date, did not result in the CPA incurring any additional capital or other costs to accommodate it. Likewise, Mr. Hammond confirmed that if all Interac transactions were settled in some other mechanism there would be not significant impact on the CPA budget as the system would still have to be maintained. While this reveals that the marginal cost to the CPA of processing Interac transactions is very low, it does not automatically follow that another system would be inefficient and expensive.

Another of the parties' witnesses, Liam Carmody, who has experience in developing electronic clearing systems in the United States, was asked about the cost of Interac having its own system. He responded that:

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30 Transcript at 11:2049 (26 April 1996).

> You could actually run a clearing system with Interac manually with ledger paper and a pencil. You are only settling between nine organizations. You are net settling every day, so the amounts of money aren't that great.[31]

Counsel for the Director pointed out that there would likely be more than nine members if the restriction on card issuance were removed. He went on to admit that he did not know what the costs involved would be but posited that if those costs were "more than zero" and the respondents still had to participate in the CPA where there would be unused capacity, there would be an "economic inefficiency".[32] We do not agree. The relevant question is not whether any cost greater than zero would be imposed on the respondents but rather whether the resulting removal of impediments to competition, that is the public benefit, justifies the imposition of whatever cost may result. Only if the costs are not justified would there be an inefficiency created.

Further, we would be naive if we failed to recognize that the charter members of Interac have the votes to appoint a majority of the board of the CPA, as noted by the Director in paragraph 57 of the SGMF. This is not an "arm's length" or neutral third party. It is also a fact that the respondents "compete" with entities like the intervenors for consumers' funds. In making the decision to clear and settle Interac transactions under the umbrella of the CPA, and thus incorporate CPA restrictions into the network, the respondents may have had several motivations.

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31 Transcript at 5:857 (16 April 1996).

32 Transcript at 11:2051-52 (26 April 1996).

While these facts cannot be ignored, the Director was also aware of them and he chose not to challenge either the use of the system or any of the acts of the respondents as members of the CPA as anti-competitive. Although we do not accept that the decisions of the Director in this regard are immune from review by the Tribunal, we are of the view that it would require something more compelling for us to, in effect, conclude that the Director erred in not including the continuing use of the CPA clearing and settlement mechanism (the source of the restrictions on card issuance and indirect arrangements) or the actions of the respondents as CPA members as anti-competitive acts. In any application, the Director is accorded considerable deference in setting the scope of the application; in a consent application this deference presents a barrier that is difficult to overcome. The intervenors in this proceeding did not, in fact, directly challenge that scope although they indirectly did so by adopting the ultimate position that the DCO is inadequate because it does not allow for card issuance in Interac by non-FIs.

The essence of the Director's approach to the DCO seems to be that, in fashioning it, the Director has "done what he could do" with respect to access to Interac and, on that basis, the Tribunal should approve the DCO even though there is a possibility that certain portions of it may have no effect because of actions validly taken within the regulated sphere. We believe that this is a reasonable interpretation of the Director's position, as it can be gleaned from the following statements, among others:

> The removal of the barriers to entry in the market for Shared Electronic Network Services . . . will permit market forces to operate as freely as current regulatory constraints (including those imposed by the Canadian Payments Association Act in the context of the continued use of the Canadian Payments Association's clearing system) . . . will allow and, in the Director's view, the DCO will likely remove the substantial lessening of competition that exists in these markets under the current Interac By-laws.

. . . .

> The Director submits that the DCO adequately addresses the practice of anti-competitive acts of the Respondents in the two relevant markets. While the Director may not be able to guarantee the effectiveness of the DCO, without it, there can be no effective competition in the relevant markets absent an order which removes the barriers to competition created by the Charter Members through Interac.[33]

In other words, the DCO must be assessed within the constraints within which the Director operated and there is no ground for interference by the Tribunal absent some compelling evidence that the Director improperly fettered his own discretion to act and unduly restricted the scope of the application. We have not found any such compelling evidence. Thus, in the final analysis, the fact that the DCO may prove ineffective because another body, presumably in the legitimate pursuit of its objects, cannot accommodate it is irrelevant to the Tribunal's assessment of the DCO. That is why we discarded the suggestion put forward by one of the intervenors that the application for the DCO should be rejected as premature. Awaiting action by the CPA so as to be in a position to evaluate it is not a practical option because neither the Director nor the Tribunal can compel the CPA to act to make rules governing sweeps. The Director might have waited indefinitely and, in the interim, any other benefits of the DCO would be delayed. In the circumstances of this case, the Tribunal can only ask whether the Director has effectively acted insofar as he could in proposing the DCO for our approval. We believe he has done so.

VII. DETAILED EVALUATION OF THE DCO: EVIDENCE AND ARGUMENT

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33 *Supra*, note 28 at paras 8 and 38.

As indicated above, the DCO will issue as proposed by the parties. In light of the fact that this is a complicated case involving difficult issues, we feel it is incumbent upon us to set out in some detail our analysis of the main arguments and evidence presented to us regarding the DCO. We made every effort to assess the DCO as a whole, as urged upon us by the parties.

A. RELEVANT MARKETS

The CLHIA and Midland et al. urged the Tribunal to refuse to issue the DCO as proposed on the grounds that the only way to alleviate the substantial lessening of competition identified by the Director is to allow the intervenors to issue cards. They argue that the DCO as formulated is ineffective to achieve its purpose because it does not provide them with effective access to Interac -- indirect access arrangements such as sweep accounts being an inadequate substitute for card issuance.

While these intervenors have not in so many words challenged the Director's definition of the relevant markets in this application as incorrect or artificially drawn, in particular the retail market, they have done so indirectly. The argument of CLHIA notes that while SEFS is the market defined in the application, it is a "subset" of the "financial services marketplace" and the wider context cannot be ignored.[34] Counsel stated that the banks and the insurers "clearly" compete in the financial services business. He further argued that the reason for including sweep

[34] Written argument of CLHIA at para. 20.

account access in the application was to improve access to Interac for other institutions. Likewise, the argument of Midland et al. opens:

> If the Director's application for approval of the Draft Consent Order (the "DCO") is approved, it will result in one sector of the financial services industry (deposit-taking financial institutions) having unfettered access to the Shared Electronic Network Services of Interac while non-deposit taking financial institutions are provided only illusory access. All financial service providers (deposit-taking institutions, insurance companies, investment dealers and others) compete to provide products and services to Canadian consumers. All providers of financial services require effective access to Interac to compete in the supply of Shared Electronic Financial Services.[35]

The position of the CLHIA and the four investment companies is that the denial to them of card issuing status by Interac weakens them in competing with the deposit-taking institutions for non-demand deposits because their clients, unlike those of the deposit-taking institutions, cannot access their funds electronically. Counsel for CLHIA went so far as to argue that Interac is an "essential facility" for his clients in competing with FIs for funds.

It is true, as pointed out by counsel for the CLHIA, that certain statements in the material filed by the Director support the intervenors' position regarding the wider context of the application. For example, paragraph 54 of the SGMF states:

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35 Written argument of Midland et al. at para. 1.

> Consumer demand for Shared Electronic Financial Services in Canada grew significantly over the period following the implementation of the SCD Service and eventually the IDP Service. In the face of that growing demand, it became essential for Financial Institutions to connect to the Interac Shared Services in order to retain their customer base and to compete effectively in other retail financial services markets. Access to Interac's Shared Electronic Network Services is *equally and increasingly essential for other financial institutions*, retailers, service providers and others *who compete with Financial Institutions in the retail financial services markets.* (emphasis added)

Other statements in the materials, taken in isolation, may create the same ambiguity.

It is indisputable, however, that both the retail and intermediate markets in the application are clearly limited to accounts *held by FIs*. The effects of the alleged anti-competitive acts do not include effects in the broad retail financial services market, only those in the market for demand deposits or deposits held by FIs. While there is no denying that the Director has placed access to Interac by the intervenors in issue, he has done so in a limited fashion. In our view, he has placed direct card issuance by non-FIs outside the scope of the application.

We reiterate, however, that there is no doubt that access to Interac by the intervenors, in order to provide their clients with electronic access to the funds held on their behalf by the intervenors, is squarely in issue in the application because of the DCO provision relating to sweep accounts.

B. PROVISIONS OF THE DCO

(1) Membership of FIs/Governance

With respect to those provisions of the DCO dealing with membership requirements and the related issue of service access fees, there is no doubt, in our view, that the proposed amendments to the by-laws will allow other FIs to become members of Interac on virtually the same terms as the respondents.

We know from the SGMF that there have been a number of FIs who wanted to be able to offer shared network services, as evidenced by their attempt, albeit unsuccessful, to start their own network.[36] Most of the FIs implicated in the attempt are currently or were sponsored members of Interac. After the DCO, the principal advantages conferred on chartered members and not on sponsored members, including the right to connect directly and voting rights, will be eliminated.

In the case of the Amex Bank, one of the sponsored members, the extent to which it could issue cards was severely restricted by the service access fees imposed by Interac. This will no longer be the case with the DCO in place. The comments of the Amex Bank endorse the changes proposed in the DCO, in particular those related to eligibility criteria for membership and the elimination of service access fees. They express some concern about the calculation of the switch fee. The reply by the Director to the Amex Bank comments on this point is comprehensive and provides a reasonable justification for the manner in which the switch fee is to be calculated.

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[36] In 1991, Amex, Central Guaranty Trust, Hong Kong Bank, Montreal Trust, National Trust and Royal Trust tried to start a network called "Sunrise". It was abandoned when it became clear it could not directly connect to Interac.

The Director anticipates significant *new* membership by FIs in Interac once the DCO is issued. While there are over 100 other FIs in existence who meet the criteria for membership, there is no indication in the material filed or the evidence that these other FIs will be eager to join. The most that can be said is that the opportunity will be open to them.

With respect to the changes in representation on the board of Interac resulting from the provisions of the DCO relating to governance, even the parties claim very modest improvements from the changes. As counsel for the respondents said in opening, the DCO will not remove the respondents' control over the voting of the new board.[37] While he maintained that the DCO creates a *possible* shift in control from the nine respondents, he conceded that it is clear that they are likely to have a dominant or substantial majority of the votes on the board for the foreseeable future. He explained that the DCO does not seek to eliminate the ability of the nine charter members to control the affairs of Interac but rather seeks to provide guaranteed representation on the board to other FIs and non-FIs and thus prevent abuse by the respondents by promoting heterogeneity. The DCO clearly achieves this limited purpose.

(2)New Services

The mechanism for introducing new services to the network which is provided in the DCO (paragraphs 4(f) and 4(g)) could yield significant benefits if it succeeds in accelerating the

[37] The Amex Bank comments suggest that the definition of fundamental change be expanded to submit additional matters to a two-thirds majority vote because the charter members will continue to have a majority position on the board. This would seem to have the opposite effect from the desired one of loosening the control of the charter members over Interac.

introduction of new services. While the proposed change offers an improvement in principle, there is nothing in the SGMF or evidence that indicates that the present by-laws have had a material effect in impeding innovation with respect to *shared* (as opposed to bilateral/multilateral services) services. It is true that, as the Director points out, services such as deposits, balance inquiries and bill payment are available on other shared networks and proprietary networks while no new ABM service has been introduced in Interac since 1986. The Director does not state, and there is no reason to believe, that it would not be in the respondents' interest to offer these services on a shared basis if they perceived a demand for them. There is nothing in the information supplied that explains why the respondents' interest in using the available infrastructure more intensively would not extend to other services. On the other hand, a plausible reason why other shared services have not been introduced is that there is insufficient demand to justify the additional costs of providing them.

The most likely source of improvement from the DCO in this area is from the introduction of bilateral/multilateral services which might provide a competitive advantage to the FIs participating in the service. The charter members have had an incentive to discourage these types of offerings in order not to have to compete with each other or the sponsored members.

TelPay was granted leave to intervene for the sole purpose of making representations in the form of argument on the process for approval of a new service set out in the DCO. TelPay currently provides a telephone bill payment service for about 40 smaller FIs, mainly credit

unions. The banks provide a similar service to their own customers. TelPay would like to offer its bill payment service through Interac.

Unfortunately, the TelPay submissions were largely unhelpful on the particular question regarding which the intervention was permitted. Much of its argument was directed at the general difficulties that TelPay faces in offering its service in the current electronic financial services environment, rather than focusing on the DCO before us. With respect to the DCO, TelPay's principal objection appeared to be directed at the assumption, which underlies the entire application, that any new Interac service would be based on "plastic card and terminal-based" technology. The TelPay system, in contrast, uses the telephone. The application clearly does not take issue with the technology used by Interac and nothing in TelPay's arguments provided us with any basis whatsoever to conclude that the Director should have expanded the application to force Interac to change its technology. The TelPay submissions shed little light on the issues before us as they were, by and large, directed at matters well beyond the scope of the application.

The Amex Bank also commented on paragraph 4(f). While its suggestions likely represent an improvement, we could not conclude that they were necessary for us to approve the DCO.

(3) Pricing

The DCO will allow deployers of terminals to impose surcharges on a non-discriminatory basis. While it is possible that this ability could lead to the placement of additional ABMs, as claimed by the Director, the evidence before us was that, on balance, it is unlikely.

The parties' witness, Scott Engle, testified that in the United States the experience has been that consumers will pay for the added convenience of having an ABM at hand when and where they want it. The intervenors' witness, Kenneth Morrison, provided a number of factors based on his experience in the Canadian marketplace that cast doubt on the existence of a significant unmet need for more ABMs in this country. Canada is already well endowed with ABMs. In fact, it has the highest number of ABMs per capita of any country in the world besides Japan. Alternative sources of funds are becoming increasingly available and popular and, in a related development, the growth in SCD transactions is levelling off. Foremost among the alternatives are POS terminals which are used in lieu of cash and the growing trend among retailers to give "cash back" in conjunction with an POS transaction.[38] Proprietary networks are expanding and offer a wider variety of transactions and, given the extended hours now available, the branch banking system may also offer an alternative.

In addition, only thirty percent of cash dispensing transactions in Canada are shared, as opposed to forty percent in the United States. It is certainly a consideration to be taken into account that relatively fewer consumers in Canada need to or appear to be willing to pay the existing fee (to which the surcharge would be added) to use a non-proprietary ABM. There is also a possible downside to consumers to permitting surcharges, as deployers of ABMs may impose the surcharge in prime locations where there is currently an ABM.

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[38] The consumer requests that an amount larger than the total of the purchase be debited from his or her account and the retailer provides the excess in cash.

The DCO (paragraph 4(d)) would also require that the IMN software be able to accommodate rebates to consumers. The current by-laws do not prohibit rebates. If rebates were to become common, this would obviously benefit consumers. It is difficult to see how, if rebates were offered at some ABMs and not others, this fact could be easily advertised and, without this ability, how the deployer would benefit from offering them. It is also interesting that the premise behind allowing surcharges, that consumers do not wish to shop around for an ABM and will pay a premium for extra convenience, argues against the plausibility of offering rebates.

On the whole, the provisions of the DCO relating to individualized pricing of services to consumers at the terminal level appear to offer minimal, if any, benefit to consumers.

(4) New Members: Non-FIs as Acquirers Only

The evidence with respect to the likely effect of the provision of the DCO allowing membership in Interac for acquirers only is largely inconclusive. The intervenors, in particular the RCC, took the position that entry as an acquirer only would not be commercially viable. The parties, again relying on the evidence of Mr. Engle regarding the U.S. experience, were of the view that it would be viable. Neither side studied the Canadian market in detail, including examining possible consumer reaction to various levels of surcharges. There is no doubt, however, that Mr. Morrison, the intervenors' witness, is much more knowledgeable about the Canadian scene.

To the extent Mr. Morrison based his conclusions about the viability of entry on an assumption of entry to acquire transactions in Interac *only*, as opposed to acting as a more general service provider, we agree with the parties that the assumption is unduly narrow. Even accepting the parties' view that acquiring would be one part of the business of a third-party service provider or transaction processor, the evidence with respect to the scope for placing additional ABMs in Canada is not encouraging. Mr. Engle, as already noted, based his opinion on the United States where such service providers are a significant presence. The second and third largest ABM owners in the United States are third-party transaction processors. Retailers are also a presence in ABM deployment. As reviewed above, the testimony of Mr. Morrison in this respect provided a number of cogent reasons why there is little scope for placing additional ABMs in Canada.

In addition to those reasons, it should be noted that there are significant differences in the general structure and history of the banking industry in the two countries which may impact on the transferability of the U.S. experience with third-party service providers. Canadian banks tend to be larger and less numerous than U.S. banks and may be less likely to use a third-party service provider. Of relevance is Mr. Carmody's evidence to the effect that the U.S. banks offering sweep arrangements tend to be large because the *larger* banks typically do their processing *internally* and can leverage their costs by offering that service.

With respect to the potential for retailers to set up ABMs in their retail locations, Mr. Morrison testified that there are not many retail locations in Canada that do not already have ABMs. He explained that while in the early days retailers used to pay FIs to place ABMs at their

retail locations, now FIs bid vigorously to place ABMs in prime retail locations. In other words, there is no lack of existing competition in this particular aspect of acquiring.

The comments of the RCC did indicate that there is perhaps a lack of competition in the deployment of POS terminals, since they express concern that the current cost of IDP service to retailers is "far too high", especially for small retailers who do not have sufficient transaction volumes to enhance their bargaining position with the FIs. Mr. Engle testified that with the advent of POS transactions in the United States, "many large merchants" directly connected to the shared networks at the outset. In 1994, 47 percent of POS terminals were operated by directly connected retailers. Mr. Morrison was not hopeful about the possibility of non-FIs entering the IDP business in Canada as, for one thing, they cannot handle the entire transaction; they must enter into an additional agreement with an FI to process and settle each credit to retailers' accounts.

More importantly, FIs, and in particular members of Interac, have a significant head start in both the ABM and the IDP business. With respect to IDP, Interac members have more than 170,000 terminals installed in more than 140,000 retail locations. All of the 17,000 ABMs in Canada are owned by FIs and approximately 98 percent of those are connected to Interac. Even Mr. Engle acknowledged that the head start that Canadian FIs have because they have been to date the only acquirers gives them a clear advantage in acting as acquirers over non-FIs. The banks' established market position creates a disadvantage for new entrants. In the United States,

there was never a prohibition on non-deposit-taking institutions participating in the acquiring business.

Counsel for the Director confirmed that this provision of the DCO was not prompted by a specific request by, or even an expression of interest on the part of, an entity wishing to enter the acquiring business. The parties' position is that if the opportunity is offered, there is no reason to believe that third-party service providers will not enter as they have done in the United States. We have already canvassed the problems in transferring the U.S. experience to Canada. The corollary of the fact that no one appears to have been particularly prejudiced by the Interac prohibition is that curing it cannot be seen as a strong point in support of the DCO. In the end, while removing the prohibition does no harm and may, although we are not convinced that it is likely, do some good, it is hardly an essential part of the order.

(5) Indirect Access by Non-FIs: Sweeps etc.

While sweep accounts and the like are clearly in issue in the application, unfortunately the nature of the application means that there is little the Tribunal can do to guarantee that the intervenors' concerns will be met. However, at least potentially, the provision regarding sweeps is one of the more important elements of the DCO.

As became apparent from the evidence called by both the parties and the three intervenors concerned about indirect access, there is a wide range of possible arrangements

between FIs and non-FIs. The parties called evidence with respect to the situation in the United States and one arrangement in Canada; the intervenors called evidence which focused more on the Canadian experience. These arrangements are described briefly below. In summary, indirect access arrangements work best, from the point of view of the non-FI, when the FI is largely "invisible" in the arrangement. That is, the customer of the non-FI effectively deals only with the non-FI rather than with both the FI and the non-FI or even primarily with the FI.

(a) United States

By entering into an arrangement with an FI, non-FIs in the United States, primarily brokerage firms, are able to offer their clients a financial product called an "asset management account" which integrates brokerage services with banking services. Mr. Carmody describes these accounts as follows:

> [A] sweep feature automatically transfers interest and dividends from securities and the proceeds of the sale of securities into an interest bearing money market fund. Prior to this, the brokerage firm would either mail a check to the customer or deposit the funds in a non-interest bearing cash account. Transaction access allows brokerage customers flexible and convenient access (by check or debit card) not only to the funds in the money market fund but also to marginable securities.[39]

[39] Expert Affidavit of L.J. Carmody (27 March 1996): Exhibit A-26 at para. 12.

The originator of this product was Merrill Lynch. Today, over forty brokerage firms in the United States offer a service similar to that initially offered by Merrill Lynch; over two million consumer investors make use of the accounts. About 90 percent of the money market funds in the United States also offer chequing and debit card access to the investor's funds. American mutual funds, on the other hand, rarely provide debit card access although chequing access is generally available. Neither U.S. retailers nor insurance companies have pursued offering debit card services.

The role of the FI in these arrangements is twofold, first, to provide access to the VISA or MasterCard transaction clearing and settlement infrastructure and second, to authorize transactions. The VISA and MasterCard rules require that principal members in the network be regulated deposit-taking institutions. By accepting membership in VISA or MasterCard, the bank agrees to guarantee payment on all transactions properly accepted by retailers and acquirers and authorized by the bank. When the brokerage customers use their VISA or MasterCard debit cards at ABMs or POS terminals, the transaction is routed back to the brokerage firm's bank for authorization. The bank clears the brokerage customers' transactions for settlement.

While nominally it is the bank that authorizes the transaction, effectively control rests with the brokerage firm. The brokerage firm provides instructions to the bank as to account limits and other criteria that the bank uses to authorize the transactions. The bank has recourse against the brokerage firm if the transaction is authorized but funds are not available.

In none of the U.S. arrangements described by Mr. Carmody is the customer of the brokerage firm required to have an operating account with the FI. While the FI may have a file of account names and numbers, there are no individual customer funds resident with the FI. The customer's funds are in the asset management account with the brokerage firm. The brokerage firm controls the customer relationship, both when the account is opened and during its ongoing administration. As Mr. Carmody put it, the FI in these relationships is "almost invisible" from the customer's perspective.[40]

Generally speaking, Mr. Carmody's evidence was that these arrangements in the United States are extremely innovative, have resulted in popular products and have been operationally efficient, particularly for non-FIs.

(b) Canada

(i) Midland Walwyn - Laurentian Bank

The intervenors called evidence with respect to an arrangement between Midland Walwyn, a full-service Canadian investment dealer, and the Laurentian Bank, a sponsored member of Interac, which has been in place since 1994. Bradley Doney, Senior Vice President, General Counsel and Director of Risk Management for Midland Walwyn testified that, since the early 1990s, Midland Walwyn has offered its clients a service called Preferred Client Service

[40] *Ibid.* at para. 22.

("PCS"). The service was originally offered in conjunction with an arrangement with Royal Trust; that agreement was terminated upon the acquisition of Royal Trust by the Royal Bank.

PCS offers Midland Walwyn clients chequing and card privileges, preferential interest rates on credit and debit balances, and comprehensive monthly statements. According to the brochure, it consists of three elements, an asset management account at Midland Walwyn, a Laurentian Bank savings account with an "Oscar" card issued by the bank and a Midland Walwyn/Laurentian Bank VISA Gold card.[41] The Midland Walwyn client has chequing and Interac (ABM and POS terminal) privileges through the account at the Laurentian Bank. The Oscar card is the debit card that provides access to Interac.

Although the PCS service was modelled after the Merrill Lynch arrangement in the United States, the FI is more visible in this arrangement than in the corresponding U.S. arrangements described by Mr. Carmody. While nothing in Mr. Doney's testimony indicates that the Midland Walwyn clients are required to visit the Laurentian Bank in person for purposes of opening the bank account, picking up the Oscar card or selecting a PIN, in effect the Midland Walwyn client must have two separate *active* accounts, one at the Laurentian Bank and one at Midland Walwyn. Mr. Doney testified that to gain access to the funds in the account at Midland Walwyn using the Oscar card and Interac, the Midland Walwyn client must either transfer money from the account at Midland Walwyn to the account at the Laurentian Bank using a telephone banking facility or take advantage of a $5,000 overdraft protection available, with

[41] The VISA card has nothing to do with accessing the funds of the investor at Midland Walwyn.

interest, on the Laurentian Bank account. This occurs despite the fact that when a Midland Walwyn client uses the Oscar card, the authorization decision is made by the Laurentian Bank on the basis of information which is provided daily by Midland Walwyn on computer tape. The tape indicates the funds available at Midland Walwyn for each PCS client which can be used to meet payment obligations incurred by the Laurentian Bank by cheque or through Interac.

Mr. Doney's evidence was that from the point of view of Midland Walwyn, the PCS account has not been a successful product. While there are currently 6,500 accounts, representing approximately $1.3 billion, Midland Walwyn initially projected 10,000 accounts by the end of 1992 but has continually failed to meet this objective. In addition, likely because of the pervasive role of the FI in the arrangement, any transition from one FI to another causes considerable upheaval. When its agreement with Royal Trust was terminated and the PCS service was switched to the Laurentian Bank, Midland Walwyn lost 25 percent of its accounts. It was Mr. Doney's evidence that the program would likely not survive another similar change.

(ii) London Life - Royal Trust

The intervenors also called evidence regarding an arrangement between London Life, a federally-incorporated life and health insurance company with about $15 billion in assets, and Royal Trust. Donald McMullin, Manager of Banking and Custody Operations for London Life testified that, from 1989 to 1994, London Life offered an "estate account" to beneficiaries of its

life insurance policies. The arrangement was terminated when Royal Trust was acquired by the Royal Bank as the Royal Bank did not want to continue it.

Instead of paying out all the proceeds of a life insurance policy immediately, London Life offered the beneficiary the option of placing the funds in an estate account with chequing privileges. There was no electronic access to the funds.

Again, the FI had a significant presence in this arrangement. The estate account required that the beneficiary have two separate accounts, one with London Life and one with Royal Trust, although at all times the funds remained in the London Life account. The Royal Trust account was a "nominal" account in the amount of the claim. London Life handled all the details of opening the Royal Trust account but Royal Trust operated the account once open and, at any given time, only Royal Trust had accurate, up-to-date information on the balance in account. London Life, on the other hand, received a statement at the end of each month detailing the transactions on the account during that month and providing a balance.[42] When a beneficiary wrote a cheque against the estate account, Royal Trust made the decision of whether or not to honour the cheque on the basis of the balance remaining, as though there were actual funds in the account.

Mr. McMullin testified that London Life did not consider the estate account program to be a success. Over the approximately five year period that the product was offered, a total of only 1,000 accounts were opened. The number of estate accounts never totalled more than 200-300 at

[42] There was an "800" number resident at Royal Trust available to both the beneficiary and London Life representatives to make balance inquiries.

any given time. During this same time period, London Life paid out about 50,000 death claims for almost a billion dollars.

(iii) General Motors Acceptance Corporation - Royal Trust

The parties called evidence that, between the spring of 1990 and September of 1994, General Motors Acceptance Corporation ("GMAC") offered a "demand note" program through Royal Trust to its employees and their families as a convenient way to invest money. The principal amount of a particular demand note varied depending on the amounts withdrawn or deposited by the employee. The notes had no stated maturity date and were redeemable at any time. The interest rate was variable; GMAC set the interest rate for the notes on a weekly basis. The arrangement with Royal Trust was again terminated consequent upon the acquisition of Royal Trust by the Royal Bank. As of September 1994, GMAC made an arrangement with another FI.

In this program, the participating GMAC employee opened a demand note account with Royal Trust. The employee could make withdrawals from the account by writing a cheque, attending in person at a Royal Trust branch or by using a Royal Trust debit card at a Royal Trust ABM. To redeem the demand note, the employee would send a letter to that effect to either GMAC or Royal Trust. To make deposits into the demand note account, the investor could mail a cheque to GMAC, which would forward it to Royal Trust, mail a cheque to Royal Trust

directly, make deposits in person at Royal Trust, make deposits at a Royal Trust ABM or arrange for direct deposit by way of payroll deduction.

At the outset of the agreement between Royal Trust and GMAC, the employee had access to Interac for the purpose of making withdrawals from the demand note account from non-Royal Trust ABMs. By September 1991, access to Interac was no longer available to GMAC employees through Royal Trust because of action taken by Interac to enforce the Interac prohibition on sweep accounts enacted in 1989.

A GMAC employee who was interested in enrolling in the program received an information package from GMAC, opened the account and dealt virtually exclusively with GMAC. When a request for payment against a GMAC employee's demand note account arrived at Royal Trust, Royal Trust made the decision whether to honour the request, however made. When a request for a withdrawal was received from an ABM, in the normal course of events Royal Trust would check the card number and PIN, verify the account balance and then authorize the transaction if funds were available.[43]

This arrangement is unique in that its intent was to provide an investment vehicle for employees rather than to provide access to pre-existing funds already resident with a non-FI like

[43] If for some reason the Royal Trust account verification system was not operational and Royal Trust could not verify the actual account balance, it would check the card number and PIN and then authorize the transaction on the basis of permitted daily and weekly withdrawal limits established by GMAC.

an insurance company or a brokerage firm. Under this arrangement only one account existed, the Royal Trust account; there were no funds and no "account" with GMAC itself.

Noreen Devine, who was responsible for overseeing the daily operation of the GMAC program at Royal Trust's national office, described Royal Trust's role in the program as that of "processing agent", which meant Royal Trust maintained various records and acted as a "vehicle" through which GMAC could offer the program. Royal Trust kept records of the names, addresses and social insurance numbers of all participants, the individual account numbers, deposits and withdrawals processed through the accounts and provided monthly statements and tax forms to the investors and special reports on demand to GMAC. Perhaps because of its unique features, this arrangement appears to have been relatively successful.

(c) Conclusion

It was clear from the evidence placed before us that possible indirect access arrangements fall along a spectrum which ranges from those in which the presence of the FI is evident to those in which the FI is almost invisible. In our opinion, the Canadian arrangements, leaving aside the GMAC demand note program which we regard as anomalous, feature a significant FI presence and are a long way from the virtually "seamless" arrangements found in the United States. While the FI may not need to be effectively "invisible" for a sweep arrangement to be a viable substitute for direct access to the Interac network, it is our view that one would have to go considerably beyond the Midland Walwyn and London Life arrangements to consider such an

arrangement a satisfactory substitute. The London Life arrangement, of course, did not even include electronic access. We do not accept the Director's argument that an arrangement like the Midland Walwyn one is adequate. We agree with the intervenors that more flexibility is required for effective operation of indirect access arrangements.

We note that the terms of the DCO itself are extremely liberal. It prohibits Interac from interfering with the arrangements entered into by a member FI and another entity regarding the FI's accounts. Nothing in the remainder of the DCO, the draft by-laws or any of the documentation filed by the Director in support of the application deals specifically with the precise types of arrangements which are envisaged. According to Joanne De Laurentiis, President of Interac Inc. and the Interac Association, Interac itself has no concrete working definition for sweep accounts. In final argument, counsel for the respondents confirmed that the only limiting factor on these arrangements is that the payment item that results must be eligible for clearing under the CPA rules in force at the time.

What the CPA may or may not do is not entirely certain. A working paper produced by five members of the CPA board of directors, one representing each class of member, was entered into evidence by the parties. In October 1994 Interac approached the CPA with information on a proposal that it had made to the Bureau of Competition for a consent order and asked for a written opinion that nothing contemplated in the proposal contravened the CPA Act, rules, by-laws or standards. This request led to a review of "sweep accounts" by the CPA which resulted in the working paper. The paper does no more than report on the policy issues identified in the

review and suggest possible actions to deal with them. Mr. Hammond confirmed that the full CPA board has yet to take a position on the matter, that it is still being discussed.

The paper describes two kinds of sweep arrangements which are referred to as "Type 1" and "Type 2". Note that these definitions are in general terms which go beyond the electronic transactions with which Interac is involved. A Type 1 arrangement is described as follows:

> Investor has account relationship with CPA member and a corporate entity offering an investment program; the investor's account with CPA member provides chequing privileges and is supported by signing documentation and an overdraft facility; the CPA member makes the pay/no pay decision; on a daily basis, the balance in the customer's chequing account, positive or negative, is swept into investment account at the corporate entity.[44]

The following description is provided for a Type 2 arrangement:

> A corporate entity offering an investment program has an account relationship with a CPA member; investors do not have an individual account relationship with the CPA member but may redeem all or part of their investment by a "redemption order evidenced by a cheque" drawn on the CPA member institution; the corporate entity makes the pay/no pay decision.[45]

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[44] Exhibit R-15, *supra*, note 10, Appendix Y at i.

[45] *Ibid.*

The working group concluded that while Type 1 is properly termed a sweep account, Type 2 is actually a "payable through account with a payable through draft facility". A Type 1 arrangement involves a high degree of FI presence while a Type 2 arrangement apparently does not. It is impossible to be more specific than that; the paper does not reveal which were the characteristics out of those listed which effectively distinguished the two types of arrangements in the eyes of the working group or, indeed, what precisely was meant by terms like "individual account relationship" and "the pay/no pay decision".[46]

Other evidence entered by the parties raised at least a possibility that Type 1 arrangements are permissible under the existing CPA rules. Mr. Hammond said that in his view the working group had concluded they were. He agreed with that conclusion and noted that if the board had been of a different opinion, it would not have approved the paper for release. Mr. Crawford, on the other hand, expressed some doubt about whether payment items arising from sweeps would be eligible as the rules do not explicitly provide for them.

The paper then proceeds to discuss the "policy concerns" identified by the working group with respect to these arrangements. There are three: consumer confusion risk regarding which assets are covered by deposit insurance, asset risk arising if paper and electronic payments are backed by assets of non-CPA members and payable through draft risk.

[46] In particular, the reference to the "pay/no pay" decision being made by the non-FI in a Type 2 arrangement is puzzling. Even in the U.S. arrangements, the authorization decision is made by the FI, although it is generally acting on instructions from the non-FI.

The working group concludes that the special features of Type 1 arrangements (involvement of the CPA member) offset any concern about asset risk. With respect to consumer confusion, they state only that regulators and deposit insurance agencies should ensure that documentation relating to sweep arrangements clearly states that funds swept out of the account at the CPA member and into the investment account are not insured. The third risk is obviously not relevant for arrangements within Interac.

The working group concludes that Type 2 arrangements would introduce additional risk to the payments system, the extent depending on the type of assets involved in the investment program and the parameters put in place regarding the use of payable through drafts. Thus, they conclude that they should not be "encouraged" until CPA members and regulatory authorities further consider the ramifications and possible parameters. According to Mr. Crawford "not encouraged" in the parlance of bankers means prohibited. Mr. Hammond indicated there would likely be some accommodation of arrangements that go beyond Type 1 subject to unknown conditions to meet the policy concerns of the working group.

The detailed discussion of the policy concerns regarding Type 2 accounts provides further insight. With respect to consumer confusion, the issue and the conclusion is the same as for Type 1 arrangements -- adequate investor disclosure. Regarding asset risk, the working group concluded that it could be significant because the assets of mutual funds might be subject to a sudden, sharp decrease in value and because life insurance companies and other corporate entities are not subject to the same regulatory restrictions as FIs. The remaining concern relating

to payable through drafts would not impact on Interac's operations as it deals with non-electronic transactions.

We recognize that because of the nature of this application the decision as to what arrangements will and will not be permitted lies in the hands of the CPA. Nonetheless, we can at least comment that none of the evidence presented to us (including by the respondents who are, after all, important CPA members) indicated that the concerns about asset risk raised by the working group with respect to Type 2 arrangements cannot be dealt with in a way which allows such arrangements to operate effectively. The parties held up the situation in the United States as a model. There is apparently no regulatory bar in that country to the operation of arrangements which are clearly Type 2 in nature.[47] Mr. Carmody's testimony provides some insight into the risk question. He confirmed that "[t]he bank is going to make a credit decision on the quality and integrity and solvency of the brokerage firm" and that the risk to the bank is not great because what is at risk is "24 hours of ABM transactions. It is just simply not a big risk."[48] Another one of the parties' expert witnesses, Jack Carr, also stated that the risks to FIs associated with these arrangements can be compensated for in the terms of the agreement between the FI and the non-FI through a guarantee or the deposit of funds with the FI by the non-FI, as in the United States. FIs are not passive recipients of customers for these arrangements; they will only enter into them if they have made due allowance for the risks involved and are adequately compensated for incurring those risks.

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[47] When the working group discussed "payable through" arrangements with the Federal Reserve, the only specific concern emanating from that source related to their use by foreign banks whose customers the domestic bank does not know, raising the possibility of money laundering and other undesirable uses of the domestic system.

[48] Transcript at 5:843-44 (16 April 1996).

Unfortunately, the scope of this application does not allow us to do anything more to assist the intervenors with their valid concerns. Until the CPA acts, non-FIs and FIs alike will be unlikely to commit to any indirect access arrangement given the costs of disrupting the arrangement. The CPA may choose never to act. Or it may impose restrictions that limit permissible sweeps to Type 1. In either case, the DCO provision removing the prohibition against sweeps from Interac will have no effect. Consumers would thus reap little benefit from the DCO.

Nonetheless, as we have concluded that the actions of the CPA in this matter are beyond the scope of this application there is little more that can be done in this forum. Despite the possibility that the sweep provision of our order will never be effective and recognizing that it is an important element of the DCO, we must nevertheless issue the DCO as it accomplishes what can be accomplished at this juncture. In the event that the CPA takes a liberal approach to sweeps, the removal of the Interac prohibition, in conjunction with the other provisions of the DCO which open up FI membership in Interac and place all FI members on equal footing, will be of considerable benefit to non-FIs seeking to enter into indirect access arrangements. The more FI Interac members there are who might want to offer such an arrangement, the more likely that the non-FIs can negotiate an arrangement which best meets their needs and those of their customers.

VIII. REASONS OF MCKEOWN J. (concurring in result)

I am in general agreement with my colleagues as to the disposition of this application and the reasons for that disposition. I agree that the Tribunal can only ask whether the Director has effectively acted insofar as he could in proposing the DCO for approval and that he has done so.

While I agree that the application should not be rejected as premature, there is no evidence that the Director would have had to wait indefinitely for the CPA to act.

My concern is that it is impossible for me to examine the validity of the regulatory policy of the CPA in light of the fact that this application was brought prior to the CPA making any amendments to its rules to allow sweep accounts to generate eligible payment items.

Although between the two options set out in the reasons of the majority, forcing Interac outside the CPA for clearing and settlement and allowing Interac to continue to use the CPA system, the Director's decision was not inappropriate, I would have preferred if the Director had satisfied me as to why the third option was not available in the circumstances. I am concerned about the Director's failure to explain, in my view, why serious consideration was not given to waiting until the CPA acted. The majority has stated: "We recognize that because of the nature of this application the decision as to what arrangements will and will not be permitted lies in the hands of the CPA." By bringing the application when he did, the Director deprived the Tribunal of its ability to determine whether the CPA rules on sweeps would *in fact* permit the effective operation of these accounts and whether the rules deal with these accounts in a manner which is the least restrictive of competition.

DATED at Ottawa, this 20th day of June, 1996.

SIGNED on behalf of the Tribunal by the presiding judicial member.

(s) W.P. McKeown
W.P. McKeown