

CT-95102

COMPETITION TRIBUNAL TRIBUNAL DE LA CONCURRENCE		P R O D U I T
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REGISTRAR - REGISTRAIRE		
OTTAWA, ONT. <i>*20161</i>		

SCHEDULE "C"

THE COMPETITION TRIBUNAL

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, as amended;

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.

BETWEEN:

**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 and INTERAC INC.**

Respondents

CONSENT ORDER IMPACT STATEMENT

1. This Statement is filed by the Director of Investigation and Research (the "Director") pursuant to section 43 of the *Competition Tribunal Rules*. It describes the circumstances surrounding, and anticipated effect on competition of, the Draft Consent Order attached to the Notice of Application as Schedule "B" and submitted by agreement of the Parties to this proceeding. Unless otherwise expressly defined herein, terms used in this Statement incorporate the meaning ascribed to them in the Draft Consent Order.

I. INTRODUCTION

2. By 1986, the nine largest Financial Institutions ("FIs") in Canada had joined the network of the Interac Association ("Interac") making it the dominant shared network in Canada. Interac eventually provided consumers with two services: (i) Shared Cash Dispensing (SCD) -- the ability to access Demand Accounts through ABMs of other member institutions; and (ii) Interac Direct Payment (IDP) -- the ability to access Demand Accounts for the purpose of making payments to a retailer at the point of sale.

3. The Respondents jointly have substantial or complete control of a class or species of business: the supply of shared electronic network services ("Shared Electronic Network Services") that enable network participants to provide consumer-initiated shared electronic financial services ("Shared Electronic Financial Services"). The Respondents have engaged in a practice of anti-competitive acts which has had, is having, and, unless restrained, is likely to continue having the effect of preventing or lessening competition substantially in the intermediate market for Shared Electronic Network Services and in the retail market for Shared Electronic Financial Services. Through their control over the governance of Interac and Interac Inc., the Respondents have restricted other interested parties from connecting directly and indirectly to the Interac network through narrow eligibility requirements, or have created financial disincentives or barriers which have achieved that result. As a consequence, the Respondents have limited the number of Direct Connectors who are suppliers in the intermediate market for Shared Electronic Network Services and the number of Indirect

Connectors who are purchasers of Shared Electronic Network Services. Furthermore, through their control of Interac and Interac Inc., the Respondents restricted the output of Shared Electronic Network Services by limiting the introduction of New Shared Services and by preventing bilateral/multilateral arrangements using the network, both of which were critical inputs to the provision of innovative services in the retail market for Shared Electronic Financial Services.

4. At the same time, through the Association, the Respondents collectively established fees for access to the Shared Services and raised the cost of Shared Electronic Network Services for most Indirect Connectors, thereby disadvantaging those competitors in the retail market. In addition, the Respondents curtailed competition between themselves for Terminal deployment in the retail market by prohibiting Acquirers from varying prices for Terminal use. Finally, by restricting the accounts eligible to be accessed through the Interac network, the Respondents further limited the range of Shared Services offered in the retail market.

5. For these reasons, the Director seeks an order to restore competition in both the intermediate market for the supply of Shared Electronic Network Services to competitors and in the retail market for the provision of Shared Electronic Financial Services to consumers. The main thrust of the Director's remedy in this case is to introduce appropriate competitive discipline to 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. In doing so, the Director acknowledges that in many respects the Interac network creates efficiencies that could not be realized without certain standardized rules or some degree of coordination among Members. The Director further acknowledges the need to maintain and preserve the level of security currently afforded to the consumer, and recognizes the responsibility of Financial Institutions to protect their Demand Accounts. In this regard,

the proposed Order will not adversely affect either the security and integrity of the network, or the universality of the services provided and the resulting consumer convenience.

II. NATURE AND PURPOSE OF THE PROCEEDING

6. The Director files with this Statement a Statement of Grounds and Material Facts, attached to the Notice of Application as Schedule "A," pursuant to sections 79 and 105 of the *Competition Act* (the "Act"). The Director's investigation has demonstrated that:

- (a) the Respondents substantially or completely control the supply of Shared Electronic Network Services that enable financial institutions to provide consumer-initiated Shared Electronic Financial Services in the geographic market of Canada;
- (b) the Respondents have jointly engaged in and are engaging in a practice of anti-competitive acts as outlined in paragraphs 61 and 62 of the Statement of Grounds and Material Facts; and
- (c) in so doing, the Respondents have substantially prevented or lessened competition in both the market for Shared Electronic Network Services and the market for Shared Electronic Financial Services in Canada.

7. The Applicant has also filed as the covering document to this Schedule "C," and to accompanying Schedules "A" and "B", a Notice of Application which states that the Director and the Respondents have reached a proposed settlement, which is designed to eliminate the alleged anti-competitive effects of the Respondents' acts. The Director requests the Competition Tribunal's approval of the Draft Consent Order pursuant to section 105 of the Act to effect this settlement.

8. The Applicant has undertaken, since 1990, an extensive study of Interac and the industry in which it participates. Over the course of this examination, the Director consulted with industry participants in Canada, the United States, Britain and Australia. The discussions with network owners, operators and Members; economic, industry and technical experts; and numerous government officials and regulatory bodies provided the Director with the necessary background on the industry and supporting arguments for his position.

III. SUMMARY DESCRIPTION OF THE PROPOSED SETTLEMENT

9. The proposed settlement, in the form of the Draft Consent Order (the "Order"), contains relief measures that can be grouped into two categories and which are designed, in their totality, to remedy the practice of anti-competitive acts of the Respondents. These categories relate to:

- (a) Interac: Amendments to the Interac Memorandum of Association and Interac's By-laws; and
- (b) Interac Inc.: Amendments to the Interac Inc. By-laws and Shareholders' Agreement.

10. The following provides a summary description of the proposed relief measures in the Order under these two categories:

- (a) Interac Association:

The Memorandum of Association and By-laws of Interac shall be amended to reflect the following:

(i) Re: Access to the Network

- (1) Specified provisions of the Interac By-laws which restrict admission to Interac shall be revoked;
- (2) The Board of Interac may adopt reasonable financial eligibility criteria, operating regulations and standards to ensure the current level of security and integrity of the network.

(ii) Re: Governance of Interac

- (1) The Respondents shall be required to amend the By-laws to provide greater representation of non-Charter Members on the Board of Directors of Interac and, in particular, to afford all classes of Membership in the Interac Shared Services effective voting representation on the Board;
- (2) The Board shall be provided with sole responsibility for making all decisions relating to the administration and operation of the Shared Services;
- (3) Decisions of the Board shall be decided by a simple majority vote, except for matters of Fundamental Change, which shall be decided by a two-thirds majority vote; and
- (4) Members who participate in Bilateral/Multilateral Services will govern and manage any such service, although they may be required to meet such security and technical requirements as the Interac Board reasonably deems necessary to safeguard the IMN and the Services utilizing it.

(iii) Re: Innovation

- (1) The Respondents shall be required to amend the By-laws to provide that proposals for any New Shared Service or Shared Service Enhancement can be adopted by a majority vote of the Board; and
- (2) The Respondents shall be required to revoke the By-law provision that restricts access through a Shared Service to any account which involves a "sweep", "pass-through" or "zero-balance" feature or option.

(iv) Re: Fees and Pricing

- (1) The Respondents shall be prohibited from maintaining or enacting By-laws that:
 - (a) establish an initiation or entry fee in excess of the direct administrative and certification costs associated with the admission of that new Member;
 - (b) prevent Members from unilaterally pricing their services to Cardholders of other Members; and
- (2) The Respondents shall be required to amend the By-laws to prevent Members from charging any discriminatory fees to Cardholders in conjunction with the use of any of the Shared Services, based on the identity of the other Member who is party to the Shared Service transaction.

(b) Interac Inc.:

Interac Inc. and the Respondents shall be required to:

- (i) maintain Interac Inc. as a business corporation operating on a not-for-profit basis;
- (ii) grant commercially reasonable software licenses, without fee or charge, to a Member to permit direct connection to any Interac Shared Service or Bilateral/Multilateral Service which utilizes the IMN, subject to the Members' ability to satisfy certain reasonable access criteria;
- (iii) grant commercially reasonable trade-mark licenses, without charge, to any Member participating in the Interac Shared Services that use the Interac Trade-marks;
- (iv) undertake improvements to the IMN to facilitate full compliance with the Order;
- (v) require the senior management of Interac Inc. to follow certain criteria established by the Order in determining whether to accept as qualified a proposed Bilateral/Multilateral Service or a new Shared Service, and introduce a procedure for arbitral review of such a decision; and
- (vi) eliminate a specific barrier to exit identified in Interac Inc.'s Shareholders' Agreement.

IV. ANTICIPATED IMPACT OF THE PROPOSED REMEDIES

11. The provisions of the Order being sought have been designed to achieve the following four objectives:

- (a) to ensure access to the Shared Electronic Network Services by new participants on a nondiscriminatory basis;
- (b) to revise the governance structure of Interac to enhance representation of interests other than the Respondents and to create an environment within Interac conducive to innovation;
- (c) to strengthen individual Members' incentives for product and service innovation through Bilateral/Multilateral Services; and
- (d) to remove prohibitive fees and other constraints on competitive pricing in the intermediate and retail markets.

The measures in the Order were included to address the above four objectives as set out more specifically below.

(a) Access to the Network:

12. The broad effect of remedial measures 3(a) to (e), (r), (s), (t), 4(c) and (e) of the Order will be to make access to the Interac network widely available to any commercial entity that is capable of providing a Shared Service, or of facilitating the provision of a Shared Service. A more openly accessible network provides the potential for significant entry of new Members who may connect either directly or indirectly, and as Acquirers or Issuers. In particular, it is anticipated that the Order will lead to a significant increase in the number

of Direct Connectors competing to supply access to the Shared Electronic Network Services and an increase in the number of Indirect Connectors able to purchase access to the network through Direct Connectors. Moreover, with the greater diversity of interests represented by the new Members, it is likely that, in conjunction with other remedial measures addressing the governance of Interac, there will be a greater range of shared services in the retail market for Shared Electronic Financial Services.

13. More specifically, relief measures 3(a) and (e) of the Draft Consent Order broaden the opportunities for Interac membership by eliminating strict Interac by-laws that limit the eligibility of candidates for membership. Whereas Membership is currently restricted to members of the CPA, 3(a) opens Membership for acquiring transactions to all commercial entities. Similarly, 3(e) opens Membership to commercial entities and Financial Institutions that choose to participate only as an Acquirer or an Issuer, in contrast to the current situation in which Members have to participate as both. These remedial measures not only open membership to those commercial entities and FIs that wish to connect directly, but also to those who wish to connect indirectly.

14. 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.

15. Relief measure 3(d) of the Draft Consent Order expands a Member's options for connecting to the Interac Shared Services by eliminating the requirement that a Direct Connector be a Direct Clearer in the CPA. Under 3(d), any Member can become a Direct Connector.

16. Opening up membership of Interac to all commercial entities effectively eliminates a number of other financial barriers to entry to the Shared Electronic Network Services market:

- (a) the requirement that Charter Members be equal shareholders of Interac Inc., at an estimated cost in 1992 of between \$15,000,000 and \$20,000,000; and
- (b) the requirement that each Charter Member participate as a Direct Connector in all Shared Services offered by Interac as well as contribute on an equal basis to the common assets required for New Shared Services.

In addition, relief measure 4(c) requires the Respondents to remove the provision of the Interac Inc. Shareholders' Agreement which requires that, upon the loss of Charter Member status, a shareholder must surrender its shares in Interac Inc. in exchange for \$1.00.

Eliminating this requirement removes an unnecessary restraint on exit, and therefore, on entry as a Member of Interac.

17. Relief measure 4(e) requires Interac Inc. to provide a commercially reasonable trademark license, without charge, to all requesting Members participating in the Shared Services that use the Trademark. This ensures that Members accessing the Shared Services are recognized by consumers as full participants in Interac, thereby increasing the value of network access to each potential Member.

18. Finally, recognizing that completely free and unconditional access to the Interac network could compromise the security and integrity of Interac, certain safeguards were provided for in the Order. In particular, relief measures 3(b) and (c) of the Order allow the Interac Board to adopt reasonable criteria and regulations regarding Members' connection to and participation in a Service. Additionally, relief measures 3(r) and (s) require Interac to provide potential Direct Connectors with the technical specifications and related information

necessary for determining their ability and willingness to become directly connected Members and for achieving connection, subject to the applicant's ability to satisfy certain eligibility criteria.

(b) Enhanced Representation on the Board to Foster Competitive Pricing, Improved Service Offerings and Innovation:

19. The broad intent of relief measures 3(f) to (l), and 4(a) of the Order is to transfer the decision-making powers over the Shared Services from the former Charter Members to the Board, and to ensure that all Members have reasonable representation in the decision making process. The expanded representation of Members, along with the likely broader range of interests among new Members stemming from the relief measures identified in 10(a) above, will provide for a more competitive environment within Interac. This increased rivalry is likely to lead to a fuller gamut of services being offered over the network and an enhanced incentive for innovation within Interac.

20. More specifically, relief measure 3(g) provides the Board with the sole responsibility for making all decisions relating to the administration and operation of the Interac Shared Services. Additionally, relief measure 4(a) requires Interac Inc., which is wholly owned by the Charter Members, to operate as a non-profit organization in the management of the IMN for Interac. These measures prevent the former Charter Members from exercising market power through their control of the IMN, the primary input in the provision of Shared Services.

21. Relief measures 3(f) to (l) increase the scale and diversity of representation on the Board. In particular, the influence of the former Charter Members will be diluted by guaranteeing new Members at least 5 seats on the Board. The effect of this change is likely to create more voting support for New Shared Services and Shared Service Enhancements favoured by these Members. In particular, relief measures 3(f) and (i) create three distinct

classes of Members of the Shared Services within Interac for the purpose of appointing directors to the Board, including distinct classes for both the Direct Connected Non-Financial Institutions and the Indirect Connectors in the Shared Services. 3(j) and (k) specify how rights to appoint directors are allocated among the Members of each class. Finally, 3(l) specifies that each director shall have one vote and that all decisions of the Board regarding Shared Service Enhancements and New Shared Services shall be decided by simple majority vote, in contrast to the current requirement of a two-thirds majority. In this way, the initially overwhelming volume of transactions being processed by the former Charter Members, and hence votes of the former Charter Members, will not prevent the interests of new Members from being recognized.

(c) Bilateral/Multilateral Agreements Outside Interac to Facilitate New Service Offerings:

22. The intent of relief measures 3(h), 4(b) and 4(f) to (h) is to create an additional incentive for the introduction of new shared electronic financial services, by requiring Interac Inc. to make the IMN readily available to commercial entities wishing to introduce these services on a bilateral or multilateral basis.

23. In particular, relief measure 4(b) requires Interac Inc. to provide Members with a commercially reasonable software license, without fee or charge, authorizing Members to use the IMN to directly connect to a service and to allow the Members to connect Indirect Connectors for the provision of a service. To ensure that the IMN is an available input for the provision of a Bilateral or Multilateral Service and that its use by the proponents of such a service will not compromise the integrity or security of the existing services, qualification as a Bilateral/Multilateral Service is subject to the conditions set out in 4(f) which are: (i) that the proposed service requires access to Canadian Demand Accounts; (ii) that the proposed service is not a Shared Service offered by Interac at that time; and (iii) that the proposed service will not negatively impact in a material technical sense on any existing Service which utilizes the

IMN. Facilitating Bilateral/Multilateral Services will create a stimulus for innovative uses of the IMN and will afford Members of such services a competitive advantage over other Members which they can exploit both in the market for Shared Electronic Network Services and in the Shared Electronic Financial Services market.

24. Relief measures 3(h), 4(g) and 4(h) establish a process and a set of further requirements to ensure the incentives created through 4(b) and (f) can be realized. In particular, 3(h) ensures that Members of the Bilateral/Multilateral Service shall govern and manage that service independently from the Interac Board.

(d) Restoring Competitive Pricing:

25. The intent of remedial orders 3(m), (n), (o), (p), (q) and 4(d) is to eliminate all constraints on competitive pricing of Services in both the intermediate and retail markets.

26. In particular, relief measures 3(m) and (n) prevent Interac from establishing and collectively sharing among the Charter Members any access fees which exceed the actual direct administrative and certification costs associated with each new Member. The Respondents are limited to recovering only the direct and identifiable costs incurred during the course of admitting a new Member into the Services. The effect of these measures is to limit the Respondents' collective ability to set access fees at a prohibitive level. Further, it is required that Interac derive all of its other revenue through a cost-based switch fee. These measures reduce the barriers to entry, particularly among the very large card-issuing Financial Institutions which currently pay a card-based fee, and extremely small Financial Institutions which are currently subject to minimum entry fees. In addition, with the elimination of the sharing of entry fees, competition will be promoted among the Direct Connectors in the business of supplying Shared Electronic Network Services to Indirect Connectors.

27. Relief measure 3(o) requires Interac to abolish the By-law provision that prevents Members from unilaterally pricing their Shared Services to Cardholders of other Members. This will have the effect of: (i) allowing more competitive pricing of Shared Services to consumers at the Terminal; (ii) promoting an optimal allocation of Terminals in the market; and (iii) creating an incentive for the development of new products and process technologies. Additionally, relief measure 4(d) requires Interac Inc. to ensure that the IMN is fully capable of supporting individual pricing of the Shared Services at the Terminal level.

28. Relief measures 3(p) and (q) prohibit Members from engaging in discriminatory pricing aimed at disadvantaging a Cardholder of another Member based on the identity of that other Member. These explicitly prohibit a form of anti-competitive pricing, that is, attempts by a group of Members to disadvantage one particular Member.

Overall Anticipated Effects of the Proposed Order:

29. The relief measures provided in the Order will promote competition in the markets for the intermediate supply of Shared Electronic Network Services and in the supply of Shared Electronic Financial Services to consumers in three principal ways. First, the Order eliminates existing barriers which prevent or limit access to Interac. This will lead to significant new entry into these markets by Members with diverse interests, enhancing competition among the Members and increasing the volume of transactions and types of Services offered over the network. Second, the Order removes barriers to, and improves the incentives for, innovation within Interac, by providing non-Charter Members with an increased ability to influence the decisions of the Board. The Order also facilitates and improves the incentives for innovation outside of Interac by providing parties interested in offering Bilateral/Multilateral Services with access to the IMN. Thirdly, the Order eliminates existing constraints on competitive pricing at both the intermediate and consumer level. Further, since the Order sufficiently restores competition in the intermediate market by

removing entry barriers for other potential suppliers, the rules of the Plus Network will not present an obstacle to competition.

30. Overall, the Order will provide for a greater diversity in Service offerings and more competitive pricing of Services in both the intermediate and retail markets. Furthermore, by creating an environment more conducive to innovation, there will be a proliferation of new Services and service enhancements.

31. Finally, as stated in the Introduction to this Statement, the Director recognizes that, in many respects, the Interac network creates efficiencies that could not otherwise have been achieved in the absence of certain standardized rules and coordination in the provision of shared electronic network services and shared electronic financial services. In this regard, the Order is not expected to interfere with certain key inputs that Interac has continually provided, including the security and integrity of the network, and the universality of the services with the resulting consumer convenience.

V. **ALTERNATIVE RELIEF CONSIDERED:**

32. As an alternative to the settlement proposed, the Director considered litigation seeking structural relief, including a proposal to split the Interac network into competing networks. The Director decided against divestiture for three reasons. First, in his view, the proposed settlement described above will effectively correct for the effects of the anti-competitive practices. Second, the Director recognized the benefits of having a national network that can provide consumers with universal and ubiquitous access. Finally, the divestiture of Interac was likely to involve the Tribunal and the parties in a complex and time-consuming process of reorganizing the network.

VI. CONCLUSION:

33. For the reasons presented herein, the Director recommends the settlement and asks the Competition Tribunal to approve the Draft Consent Order.