Kluwer Competition Law Blog

Credit Cards in Canada: What Role for Competition Law?

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1. Introduction

The growing popularity of credit and other payment cards among consumers has been accompanied by an increase in the regulatory and legal scrutiny of the terms governing the availability and use of these cards.

One focus of concern has been on whether “interchange fees” are set and administered by operators of card networks in an anticompetitive fashion that operates to the detriment of retailers (merchants) and consumers.

Interchange fees (also known as “swipe” fees) are one of the fees charged for sales transactions made at a merchant’s outlet involving a payment card. The interchange fee is typically set by the network operator (such as Visa or MasterCard) and can be a flat fee, a percentage of the transaction value or some combination of the two. Interchange fees typically form part of the fees ultimately paid by merchants for each sales transaction involving a payment card.

Although interchange fees may not seem significant when looked at in isolation, they add up. According to one U.S. business association, interchange fees paid by merchants in the United States amount to $48 billion annually and represent the largest non-labor cost for many businesses. Apart from their impact on merchants, the concern is that interchange fees are then passed along in the form of higher costs for products and services, affecting all consumers regardless of whether they use a payment card, cash or another method of payment.

Related issues also have been raised about various restrictions imposed by network operators on merchants (“merchant acceptance rules”). For example, merchants may be (i) prohibited from applying surcharges when payment cards are used or, similarly, from offering discounts for payments by cash (the “no surcharge rule”), (ii) prevented from knowing what fees are being applied to which payment card specifically (the “blended rates” rule), (iii) obliged to accept all payment cards of a particular network (the “honor all cards” rule), and/or (iv) prohibited from discriminating between cards of different networks (the “no discrimination” rule). The alleged effect of these rules is to deprive merchants of the ability to identify and encourage the use of lower cost payments methods, and to deprive consumers of the ability to make informed choices about their payment methods since they are unaware of the costs involved.

The issues surrounding interchange fees and merchant application rules have been investigated by antitrust enforcement agencies in several jurisdictions, such as the United States, the European

Union, Australia, New Zealand and the United Kingdom. In some cases (such as in the United States and New Zealand), the authorities settled cases brought against credit card network operators. In other instances, antitrust investigations ultimately led (or are intended to lead) to regulatory solutions (such as in Australia and the U.K.).

Canada has also demonstrated a mix of approaches to credit card issues. In 2010, the federal government engineered the adoption of a "voluntary" code of conduct for the credit and debit card industry in Canada. In that same year, Canada's Competition Bureau (the Bureau), headed at the time by former Commissioner of Competition Melanie Aitken, commenced an application against Visa Canada Corporation (Visa) and MasterCard International Corporation (MasterCard) under the price maintenance provision of the Competition Act (the Act).

The application was heard by the Competition Tribunal (the "Tribunal"), a specialized administrative body consisting of a combination of judges and lay members. The Tribunal issued a summary of its decision in the matter on July 23, 2013. Public versions were released subsequently on September 9, 2013. As discussed in more detail below, the Tribunal dismissed the Bureau's application on the grounds that it did not satisfy the elements of the Act's price maintenance provision. However, in comments delivered in obiter, the Tribunal observed that even if it had decided differently, it would not have exercised its discretion to issue an order against the respondents. That is because, in the Tribunal's view, it is "clear" that these issues should be resolved within a "regulatory framework."

The Tribunal's decision has effectively placed the dispute between merchants and the credit card networks in Canada back into the lap of the federal government. As will be discussed, however, that does not necessarily mean that competition law concerns are now irrelevant. Rather, it means that the vehicle for competition law intervention may have simply shifted from one based on litigation to one based on advocacy.

2. The Canadian Experience with Credit Cards

The Controversy in Canada

As elsewhere in the world, credit and debit card transactions are an important part of retail purchasing in Canada. According to recent data (for 2007), almost 50% of all retail transactions in Canada are paid for with credit or debit cards.

Interchange fees and merchant application rules became contentious issues in Canada after both Visa and MasterCard changed their fee structures for credit cards in 2008.

Visa led the way, introducing the first significant changes to its credit card interchange fee structure in more than 30 years. It moved from two formulae for calculating these fees to 21 different formulae based on sector (e.g., gasoline sector, grocery sector, etc.), nature of transaction (online versus in-person), type of card used (standard, gold, platinum or premium) and type of use (business or consumer). Visa also changed its methodology for calculating the interchange fee, from one based on a percentage of the transaction value with a minimum fee, to one based solely on a percentage of the transaction value, with no minimum fee. Finally, Visa also introduced a new premium card (Visa Infinite), with a higher interchange fee than its other cards.

MasterCard followed suit, moving from three formulae for calculating interchange fees to 19 different formulae. It also introduced enhanced features on its existing gold and platinum cards.

Many merchants in Canada objected to these changes. They complained that the new interchange fee formulae, combined with the introduction of premium cards, made it more difficult for them to control and predict the level of merchant fees that they would face at the end of each month. Even more disturbing, the net result was to introduce significantly higher fees. Some merchants said that their fees had gone up by 30%.

Complaints were also raised about certain of the operating networks' merchant acceptance rules, in particular the "no surcharge" rule and the "honor all card" rule. Merchants alleged that these rules limited their ability to control their payment costs and to direct consumers to lower-cost payment methods.

Senate Committee Hearings and Report

In response to the chorus of complaints from merchant and consumer groups, the Canadian Senate voted in March 2009 to "examine and report on the credit and debit card systems in Canada and their relative rates and fees, in particular for businesses and consumers." The hearings were convened by the Senate's Standing Committee on Banking, Trade and Commerce (the "Senate Committee"). The Senate Committee issued its report in June 2009 (the "Senate Report").

On the issue of interchange fees for credit cards, the Committee found that the Canadian credit card market is characterized by unequal bargaining power as between merchants and the credit card companies. The Committee was struck by how many merchants claimed that they had to continue accepting credit cards to avoid losing customers and sales, which left them with no leverage to resist rising fees and negotiate more favorable payment arrangements.

The Senate Committee also noted an unusual aspect of the credit card market, namely that competition between network operators can actually lead to higher fees for merchants and thus increased prices for consumers. The Senate Committee attributed this counter-intuitive result to the fact that credit card companies compete to add card issuers to their networks by offering higher interchange fees, a source of revenue for these issuers, and compete to add cardholders by offering "premium" credit card features, which have higher interchange fees attached to them. The end result is higher costs for merchants and higher retail prices for all consumers, regardless of whether they use premium cards, or credit cards at all.

Although it recognized problems with the current system, the Senate Committee was not prepared to recommend regulation of interchange fees along the lines adopted in Australia. Instead, it recommended that the federal government appoint an oversight board with the mandate of determining ways that merchants could be empowered by improving the quality and range of information available to them. The Senate Committee also recommended that the board develop a "code of conduct" to govern practices for setting fees and rates. The Senate Committee also recommended that merchants be permitted to bargain collectively when negotiating payment card conditions and fees, and that this form of cooperation should be exempt from the provisions of the Competition Act.

On the issue of merchant application rules, the Senate Committee recommended that merchants be permitted to impose surcharges or offer discounts for different payment methods (although it expressed a preference for surcharges). Merchants would be able to inform customers about lower-cost payment methods and would be obliged to display, at the point-of-purchase, the amount of any applicable surcharge or discount.

The Senate Committee also expressed its strong belief that networks should not be able to impose "honor all card" rules, whether to require acceptance of all credit cards, including the premium cards with higher interchange fees, or to require acceptance of both credit cards and debit cards.

Response of the Canadian Government – The "Voluntary" Code of Conduct

The Canadian government responded to the Committee's report in remarkably rapid fashion. It agreed that the most appropriate route was to adopt a code of conduct for the payment card system in Canada rather than regulate interchange fees directly. To that end, the government released for consultation a proposed "Code of Conduct for the Debit and Credit Card Industry in Canada" (the "Code") in November 2009. Following a brief (60 day) consultation period, a final version of the Code was released in April 2010.

The object of the Code is to:
• ensure that merchants are fully aware of the costs associated with accepting credit and debit card payments;
• provide merchants with increased pricing flexibility to encourage consumers to choose the lowest-cost payment option; and
• allow merchants to freely choose which payment options they will accept.

Rather than setting out detailed provisions, the Code establishes 10 "policy elements" that are to be followed by participants and that are to be incorporated into the contracts, rules and regulations governing credit and debit card networks in Canada. The Code's prescribed "policy elements" are as follows:
(a) Increased transparency and disclosure by payment card networks to merchants, e.g.
(i) monthly statements to include a sufficient level of detail on fees and rates and in an easily understood manner;
(ii) all applicable interchange rates to be available on payment card network websites;
(iii) changes to fees must be posted in advance.
(b) Merchants will receive a minimum of 90 days' notice of any fee increases or the introduction of new fees related to any credit or debit card transactions.
(c) Merchants will be allowed to cancel their contracts without penalty within 90 days after being notified of a fee increase or the introduction of a new fee.
(d) Merchants who accept credit card payments for a particular network will not be obliged to accept debit card payments from that same network, and vice versa.
(e) Merchants will be allowed to provide discounts for different methods of payment. Merchants will also be allowed to provide differential discounts among different card networks. Any discounts must be clearly noted at the point-of-sale.
(f) Competing applications from different networks cannot be offered on the same debit card, although a number of different debit applications from different networks can be offered (e.g., those used for domestic point-of-sale, international point-of-sale, Internet, telephone and ATM transactions).
(g) Co-badged debit cards must be equally branded, i.e., brand logos must be the same size, located on the same side of the card, and both logos must be either in color or black and white.
(h) The same card cannot be used for both credit and debit functions.
(i) Premium credit and debit cards can only be offered to a well-defined class of consumers who specifically apply for or consent to receive such cards.
(j) Merchants cannot be obliged to accept new products or services introduced by payment card networks. They must actively agree to accept in writing.

Although the Code is characterized as “voluntary” in nature, the Government made it clear that it would not hesitate to legislate the changes it considered necessary if the industry failed to adopt the Code. In that regard, the government introduced legislation to give the Minister of Finance the power to regulate the conduct of the Canadian payment card system – if necessary. The legislation also expanded the mandate of the Financial Consumer Agency of Canada (the “Agency”) to supervise payment card network operators to monitor their compliance with the Code. Payment card network operators are obliged to pay for the fees associated with monitoring compliance under the Code, as determined by the Agency, and are subject to fines for failure to provide the Agency with access to relevant records.

The Competition Bureau Takes Action

During the Senate Committee hearings on credit and debit cards, a representative of the Bureau testified that it was investigating the interchange fee issue to determine if the credit card companies were in violation of section 79 of the Competition Act, which prohibits “dominant” parties from engaging in “anti-competitive acts” that result in a “substantial lessening or prevention of competition.” The Bureau confirmed that this investigation remained ongoing at a separate hearing into credit and debit card issues conducted by the House of Commons Standing Committee on Industry, Science and Technology in November 2009.

Ultimately, however, the Bureau decided to bring its application under section 76 of the Act, which provides that the Tribunal may make an order if it finds that, among other things (i) a person who is engaged in the business of producing or supplying a product or who is engaged in a business that relates to credit cards, (ii) has, by agreement, threat, promise or any like means, influenced upwards or discouraged the reduction of the price at which the person’s customer, or any other person to whom the product comes for resale, supplies or offers to supply or advertises a product within Canada, and (iii) that this conduct has had, is having or is likely to have an “adverse effect on competition in a market”.

Where the Tribunal determines that the elements of section 76 are established, it may make an order prohibiting the person from continuing to engage in the impugned conduct.

Section 76 was enacted as part of a series of amendments to the Act passed in 2009. Prior to 2009, price maintenance was a per se criminal offence. The 2009 amendments repealed the criminal prohibition against price maintenance and, with the enactment of section 76, made this practice a civil matter subject to review by the Tribunal. Importantly, the amendments also introduced a market impact element (adverse effect in a market) in place of the former per se standard.

The Bureau’s application against Visa and MasterCard represented the first case brought under the new price maintenance provision in section 76. The Bureau’s case focused on the impact of three types of merchant application rules: the “no surcharge” rule, the “honor all cards” rule and the “no discrimination” rule (the latter only imposed by MasterCard). The Bureau alleged that these rules (collectively, the “Merchant Rules”) constrain merchants from encouraging customers to use lower-cost methods of payment, thereby limiting the ability of merchants to negotiate lower interchange and other fees that they must pay for use of credit cards. These fees (referred to collectively as Card Acceptance Fess) are paid by merchants to entities known as Acquirers, who provide the services required by merchants to accept credit cards as a form of payment. Since the Merchant Rules are established by Visa and MasterCard in their own respective agreements with Acquirers, the Bureau alleged that Visa and MasterCard’s conduct had the effect of “influencing

upward or discouraging the reduction of" the Card Acceptance Fees contrary to section 76. The Bureau further alleged that this conduct reduced competition by preventing merchants from playing one credit card network against the other in order to negotiate reduced Card Acceptance Fees and by otherwise reducing the incentive of the two networks to compete against each other by lowering their fees.

The Competition Tribunal's Decision

The Tribunal heard the case in May and June of 2012. Thirty-one individuals testified, including 11 experts. In the end, however, the Bureau held that section 76 did not apply. The Tribunal decided that section 76 requires that there be a "re-sale" of a product and that there was no such re-sale in this case. According to the Tribunal, Visa and MasterCard operate networks by which credit card transactions are authorized and paid. In that context, they supply "Credit Card Network Services" to Acquirers, consisting of authorization, clearance and settlement of transactions services. The Acquirers, in turn, provide "Credit Card Acceptance" services to merchants to enable them to accept credit cards. These "Credit Card Acceptance" services are different from the "Credit Card Network" services provided by Visa and MasterCard to the Acquirers. As such, the Acquirers do not re-sell to merchants any services that they receive from Visa and MasterCard.

The Tribunal commented that the Bureau's concerns appeared to "be more directed to abuse of dominance by the two credit card companies." However, the Tribunal also recognized that, pursuant to existing Canadian jurisprudence, the Act's abuse of dominance provision is limited to conduct the purpose of which is to exercise a predatory, exclusionary or disciplinary negative effect on a competitor, which would not have fit the circumstances here.

Having dismissed the Bureau's application on the grounds that section 76 did not apply, the Tribunal then went on to consider the substantive merits of the case in the event that it was wrong in its conclusions. The Tribunal also recognized that the Bureau had raised novel issues that were worthy of discussion. The Tribunal's comments in this regard are thus obiter but interesting nonetheless:

• The Tribunal held that Visa and MasterCard each independently exercised "market power" in the relevant market, which it defined as the market for "Credit Card Network Services sold to Acquirers" in Canada. While Visa's share of this market is approximately 66%, MasterCard has only an approximately 1/3 share, which would typically not be sufficient for unilateral market power under Canadian law and enforcement practice. Nonetheless, in the circumstances (including high barriers to entry), the Tribunal concluded that MasterCard also had market power in the relevant market.
• The Tribunal also concluded that the respondents' respective "no surcharge" rules have indirectly influenced upward the Card Acceptance Fees paid by merchants to Acquirers. The Tribunal held that, in the absence of these rules, either surcharging or the threat of it would steer or threaten to steer credit card transaction volume to other means of payment and this would either constrain the fees charged to merchants or bring about the reduction of fees charged to Acquirers that are then passed on to merchants, such as interchange fees.
• Similarly, the Tribunal concluded that the "no surcharge" rules suppress price competition between Visa and MasterCard in the market for Credit Card Network Services sold to Acquirers. Again, this is based on the finding that the "no surcharge" rule eliminates the prospect of an actual or threatened loss of transaction volume that otherwise could be brought about by actual or threatened surcharging. As such, the Tribunal concluded that the "no surcharge" rule has had, is

having and is likely to have an adverse effect on competition.
• As to the other Merchant Rules challenged by the Bureau, the Tribunal concluded that there was insufficient evidence to support the allegation that the "honor all cards" rule and the "no discrimination" rule influenced Card Acceptance Fees upwards.

Having concluded its substantive analysis, the Tribunal then turned to the issue of exercise of discretion. As noted above, section 76 of the Act only provides that the Tribunal may issue an order where all of the elements of the provision are satisfied, not that it is obliged to do so. In that respect, section 76 is similar to the other reviewable practices provisions in the Act (such as abuse of dominance).

In this case, the Tribunal members were unanimously of the view that, even if they had found a violation of section 76, they would not have granted relief. The Tribunal acknowledged that this type of result is exceptional, but it was satisfied on the evidence that "the proper solution to the legitimate concerns raised by the Commissioner of Competition is going to require a regulatory framework." Based on evidence of the experiences in Australia and the United Kingdom, the Tribunal believed that there would be a need for "ongoing adjustment and stakeholder consultation" which is more readily accomplished under a regulatory scheme and for which the "blunt instrument" of a Tribunal order is not suitable. The Tribunal also acknowledged, however, that this was a case which should have been brought and that anticompetitive effects had been identified, even if the Tribunal held that the Competition Act may not be the appropriate tool to remedy these effects.

3. Conclusion

The Bureau announced on September 30, 2013 that it would not appeal the Tribunal's decision. Commissioner of Competition John Pecman stated that the Bureau would focus its efforts on alternate means of addressing competition issues in the supply of credit card services in Canada, including working with the federal government and stakeholders to advocate for appropriate changes.

This effort dovetails with the Bureau's renewed commitment to making greater use of its advocacy powers to address competition issues in the Canadian economy, particularly in regulated sectors. Mr. Pecman first raised this prospect in speeches delivered earlier this year, when he was still Interim Commissioner. More recently, the Bureau issued a call on September 10, 2013 for public input into which areas of the economy could benefit from targeted advocacy from the Bureau for increased competition.

Thus, competition policy likely will continue to have an important role in addressing claims of anti-competitive behavior in credit card markets in Canada. It is simply that the battlefield will have changed.

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Source: OECD">Consumer welfare
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