

OPUS 2

INTERNATIONAL

Sainsbury's Supermarkets Ltd v. (1) MasterCard Inc, (2) MasterCard International Inc, (3) MasterCard Europe S.P.R.L.

Day 13 Redacted

February 19, 2016

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1 Friday, 19th February 2016
 2 (10.30 am)
 3 (Open session)
 4 MR JUSTICE BARLING: Good morning.
 5 MR HOSKINS: Morning, sir.
 6 MR JUSTICE BARLING: Good morning, Mr von Hinten-Reed.
 7 A. Good morning.
 8 MR HOSKINS: Can I just mention confidentiality before we
 9 start because there are going to be some confidential
 10 passages today --
 11 MR JUSTICE BARLING: Right.
 12 MR HOSKINS: -- where I will need for us to go in camera, if
 13 we get to pass through on Monday, which we hopefully
 14 will, that is all going to be in camera, because that's
 15 all Sainsbury's protected information.
 16 MR JUSTICE BARLING: You expect that to be on Monday?
 17 MR HOSKINS: I expect it to be on Monday, you asked me to
 18 let people know, so I flagged that up.
 19 MR JUSTICE BARLING: I am sure that has been noted then, by
 20 those here, that Monday looks as though it is going to
 21 be highly likely that the court will have to sit in
 22 camera and now you are going to say that some of today.
 23 MR HOSKINS: Some of today, but most of today will be open,
 24 it is just certain bits.
 25 MR JUSTICE BARLING: That you don't feel you will be able to

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1 deal with sufficiently cryptically, as it were, so you
 2 will let us know when you get there?
 3 MR HOSKINS: I will.
 4 MR NILS VON HINTEN-REED (continued)
 5 Examination-in-chief by MR HOSKINS (continued)
 6 MR HOSKINS: Good morning Mr von Hinten-Reed.
 7 A. Good morning, Mr Hoskins.
 8 Q. Could you go to bundle D2.1 please at tab 3, which is
 9 your second report, page 466. It is paragraph 236.
 10 This is where you are dealing with your counterfactual
 11 and you say in the last sentence:
 12 "There would be no commercial rationale in
 13 maintaining the Visa UK MIF above the established lawful
 14 level as any revenue gained from attracting MasterCard
 15 issuers would be lost in damages."
 16 That assumption is only correct if one assumes that
 17 every single merchant able to bring a claim does bring
 18 a claim and succeeds, isn't it?
 19 A. We are in the section -- 236 is in the section which is
 20 to do with damages and there we are assuming that the
 21 MasterCard UK MIF was deemed to be unlawful.
 22 So the argument in the last sentence of 236 is that
 23 a sufficient number, it doesn't have to be everyone,
 24 would bring a damages action, such that Visa would
 25 determine that it would be in their interest to reduce

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1 their MIF to zero.
 2 Q. So the words "there would be no commercial rationale" is
 3 actually too absolute: it depends on the number of
 4 people who would actually sue and it depends how many
 5 people Visa would think might actually sue?
 6 A. I think that is correct.
 7 Q. If Visa maintained a high MIF for a number of years
 8 whilst MasterCard had a zero or a low MIF, Visa would
 9 attract issuers to itself, we established that
 10 yesterday. If the Visa MIF was then reduced to the
 11 level of MasterCard after a period of years, it cannot
 12 be assumed that all issuers who switched to Visa would
 13 then switch back in any short timeframe to MasterCard,
 14 correct?
 15 A. If you make the assumption that it is sticky on the way
 16 out, it must also be sticky on the way in.
 17 Q. So I think the answer is yes?
 18 A. Yes, I'm trying to explain that. Yes.
 19 Q. Can we go to D2, tab 2 please. This is your first
 20 report. At paragraphs 440 and 441 you deal with the
 21 threat from Amex. So it is page 211 of the bundle,
 22 paragraphs 440 to 441. You see at the beginning of 441
 23 you say:
 24 "I have estimated, based on UK evidence mainly from
 25 MasterCard disclosure, that MasterCard would lose around

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1 5% of its market as measured by the value of credit card
 2 transactions to Amex in a zero or low interchange fee
 3 environment."
 4 In 440, just above, you say:
 5 "Since the Duo card carries a fee, it is only fee
 6 paying elements of MasterCard's business that would be
 7 at risk."
 8 Are you aware that Amex currently offers at least
 9 three different rewards based consumer credit cards
 10 without an annual card fee?
 11 A. Yes.
 12 Q. Are you aware that Amex currently offers two high
 13 rewarding consumer credit and/or charge cards without
 14 an annual fee in the first year?
 15 A. I wasn't aware of that.
 16 Q. If it is clear therefore that Amex does also compete
 17 with MasterCard's non-fee paying credit cards, is it
 18 not?
 19 A. A portion.
 20 Q. Equally, in the last sentence of 440, you say, since the
 21 Duo card carries a fee:
 22 "Whilst all Lloyds Duo cards do now carry a fee ..."
 23 Are you aware that that was not always the case?
 24 A. No.
 25 Q. Because for most of its existence the standard Lloyds

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1 Duo card did not have a fee. If you can go to E3.14, at
 2 tab 272 you will see this is a Lloyds TSB press release
 3 dated Wednesday, 23rd November 2011. The first
 4 paragraph below the italics:
 5 "Lloyds TSB is relaunching its reward credit cards
 6 and turning everyday spending into travel rewards.
 7 A unique feature of the Duo Avios credit card account is
 8 that customers are supplied with both an American
 9 Express and a MasterCard."
 10 If you turn over the page you will see the editor's
 11 notes on page 2:
 12 "Lloyds TSB premier Duo Avios ..."
 13 Second bullet:
 14 "... representative APR of 21.9% variable inclusive
 15 of annual fee."
 16 Then the next one:
 17 "Lloyds TSB Duo AVIOS, representative APR of 15.9%
 18 variable and no annual fee."
 19 A. Mmm. So, Mr Hoskins, can I just ask -- I don't want to
 20 ask a clarificatory question, this press release, if
 21 I read it right, is the relaunching of its reward credit
 22 card, so they had the Duo before but apparently it
 23 wasn't that successful. That's how I read it. So we
 24 have two cards, as you say, one which now has an annual
 25 fee and the other one which is variable, without a fee.

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1 Q. So I just clarify the last sentence of 440 of your first
 2 report isn't quite accurate, it says "since the Duo card
 3 carries a fee", but clearly at certain times in its
 4 history it didn't carry a fee, or certain aspects of
 5 certain types of Duo didn't carry a fee?
 6 A. Right. The reason why I looked at the Duo card was in
 7 part because of MasterCard itself. So when I reviewed
 8 some of the documents that I had been provided with,
 9 I understand it was -- I have to be accurate here
 10 because it is MasterCard and its advisers BCG, I believe
 11 Mr Perez said it was the Duo fee paying card that was
 12 the threat. So, you know, that is the basis on which
 13 I have said 440. Now, if actually you see in 2011 that
 14 we have a card which doesn't have a fee, then what
 15 I have said here in the last sentence needs to be
 16 altered slightly.
 17 Q. Are you aware that MBNA offers sole Amex cards under
 18 licence from Amex?
 19 A. I understand that now.
 20 Q. There's no fee for that Amex card; do you know that?
 21 A. That is correct and MBNA, as I think we found yesterday,
 22 has a wish to try to get into less affluent cardholders.
 23 MR HOSKINS: Sir, I'm afraid I have reached one of the
 24 confidential sections, I'm sorry, I'm going to try to
 25 limit it as much as possible but I also need to keep the

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1 flow of my questions.
 2 MR JUSTICE BARLING: Right. You are going to deal with what
 3 aspect now then?
 4 MR HOSKINS: I need to look at various Boston Consulting
 5 Group documents and they are MasterCard confidential and
 6 I need to look at specific figures in them. It is not
 7 going to be effective if I can't ask questions in that
 8 way and the answer can't answer.
 9 MR JUSTICE BARLING: I'm afraid -- probably people here are
 10 used now to this problem. I'm afraid those who haven't
 11 signed undertakings, who are not in the confidentiality
 12 ring we will have to part company with you for a while.
 13 We will let you know as soon as possible by removal of
 14 the notice when we have gone back into public session,
 15 thank you very much.
 16 (10.42 am)
 17 (End of open session)
 18 (In camera)
 19 (11.52 am)
 20 (Beginning of open session)
 21 Cross-examination by MR HOSKINS (continued)
 22 A. May I have a small clarification, sir?
 23 MR JUSTICE BARLING: Be careful because we are in open
 24 session now.
 25 A. I will be very careful. When we talk about competitive

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1 advantage in -- vis-a-vis American Express, whether it
 2 is the -- what you call the three and a half or the
 3 four-party or the three, bear in mind on the merchant's
 4 side part of the problem for Amex has been actually its
 5 acceptance, and that obviously before and after the
 6 regulation, so however this -- the impact of this -- and
 7 let's call it the discount rate for evermore, rather
 8 than confusing MSC, the discount rate has fallen, there
 9 will also be a change in the rewards and also some sort
 10 of impact on acceptance.
 11 Mr Hoskins, sorry.
 12 MR HOSKINS: No, no.
 13 MR JUSTICE BARLING: Okay.
 14 MR HOSKINS: Are you happy for me to?
 15 MR JUSTICE BARLING: Yes, I think we are ready to roll.
 16 MR HOSKINS: Can you go to D2, tab 2, which is your first
 17 report. At page 211, it is something we have looked at.
 18 It is simply paragraph 441, which is where you set out
 19 your estimate of the 5%. You say:
 20 "I have estimated, based on UK evidence mainly from
 21 MasterCard disclosure, that MasterCard would lose around
 22 5% of its market to Amex in a zero or low interchange
 23 environment."
 24 I'm going too fast. Page 211, paragraph 441.
 25 A. Apologies, I lost my page.

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1 Q. No problem at all.
 2 A. Okay, I'm in 441.
 3 Q. It is the first sentence of 441, you say that:
 4 "... MasterCard would lose around 5% of its market
 5 to Amex in a zero or low interchange fee environment."
 6 A. Mr Hoskins, yes.
 7 Q. Can we go to bundle B, tab 11, please? You should have
 8 there one of the information tables that was handed up
 9 to the Tribunal?
 10 A. I do.
 11 Q. Have you seen this before?
 12 A. Not the last version, but I have seen a version of this.
 13 Q. Thank you. If you go to page 3 of this, you see there
 14 is a table that's shaded, top left:
 15 "Percentage share of cards issued, based on 1 above,
 16 2(a) debit; 2(b) credit and charge cards."
 17 Then (i):
 18 "Based on number of cards issued."
 19 (ii):
 20 "Based on value of transactions."
 21 It is that part of the table I would like it look
 22 at. So you will see:
 23 "Based on value of transactions, MasterCard ..."
 24 During the claim period, we see that MasterCard had
 25 a market share of between 40 and 60% of the credit card

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1 market, correct?
 2 A. So between 2006 and 2007 the 40 and the 46?
 3 Q. I'm just reading across that row. So for the period of
 4 the claim from 2006 up to 2014, we see MasterCard's
 5 market share of the credit card market, based on value
 6 of transactions is between 40% and 60%?
 7 A. Yes.
 8 Q. Your evidence is that if MasterCard had applied a zero
 9 or low MIF during the period of the claim and Amex had
 10 maintained its actual level of merchant fees, MasterCard
 11 would have lost around 5% of its market share to Amex;
 12 is that correct? That's what we have just looked at at
 13 441.
 14 A. In 441 we lost 5%, yes.
 15 Q. Of its market share?
 16 A. Yes.
 17 Q. 5% of its market share of 40 to 60% is around 2% to 3%
 18 of MasterCard's market share, that's what it would have
 19 lost?
 20 A. Yes.
 21 Q. 2% to 3% of the whole market?
 22 MR HOSKINS: Exactly, of its share of the whole market.
 23 MR JUSTICE BARLING: Yes.
 24 MR HOSKINS: If we go back to the table and go back to the
 25 same part at the bottom, "Based on value of

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1 transactions", you see an entry:
 2 "Other three party scheme cards."
 3 Which obviously includes Amex and for the UK will be
 4 predominantly Amex, correct?
 5 A. Yes.
 6 Q. We will see that in the period between 2006 and 2009
 7 Amex increased its market share from 8% to 14%, yes?
 8 A. Other three-party scheme cards had that effect, so
 9 I assume most of that is Amex.
 10 Q. Okay. So we see a 6% increase over those four years?
 11 A. Yes.
 12 Q. That's twice the level of increase which you say would
 13 have taken place over the nine year claim period if
 14 MasterCard had operated with zero or low interchange
 15 fees while Amex applied its actual fees. I say that
 16 because I'm comparing the 2 to 3% figure which you say
 17 MasterCard would have lost and I'm just noting that for
 18 those four years, Amex actually gained 6% in any event.
 19 A. That is right. You are talking about the 6%, but what
 20 has actually changed in those figures -- changed during
 21 that period?
 22 Q. Well, that 6% increase in market share for Amex took
 23 place during a period when MasterCard had average
 24 interchange fees of around 0.84%. Does that sound about
 25 right to you in terms of the level, or do you want to

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1 see the figure?
 2 A. No, I think that's broadly right.
 3 Q. That average interchange fee applied by MasterCard in
 4 that period is nearly six times higher than the MIT-MIF
 5 that you are suggesting MasterCard should have applied,
 6 correct?
 7 A. Yes.
 8 Q. Yours is 0.15 and this is 0.84.
 9 A. Roughly six, yes.
 10 Q. If in the period between 2006 and 2009 there had been as
 11 wide a disparity between the MasterCard MIF and the Amex
 12 fees, as you propose, Amex would have gained a much
 13 larger market share at MasterCard's expense than it
 14 actually did, would it not?
 15 A. Controlling for what? That is not controlling for
 16 anything. If over the period, actually, you have more
 17 affluent consumers, then you may see a shift towards
 18 Amex, given the same ratio between Amex and the
 19 MasterCard MIF.
 20 Q. We have actual figures because that's what this table
 21 suggests.
 22 A. These are actual figures but you haven't controlled in
 23 any way in that last statement/question for other
 24 factors.
 25 Q. Do you think that if the MasterCard MIF had been 0.15

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1 instead of 0.84, Amex would have achieved a materially
 2 larger market share at MasterCard's expense or not?
 3 A. The point I'm making is that once you go to a low or
 4 zero MasterCard MIF, that there would be pressure on
 5 Amex to reduce their rates and that's the mechanism that
 6 I saw in the Australian data.
 7 Q. So that depends, again, on Australia?
 8 A. It is something where something has changed and
 9 therefore I can observe an effect. I can't speculate.
 10 Q. Assume you are wrong on Australia, and Amex isn't under
 11 any pressure to lower its merchant fees and doesn't do
 12 so, do you accept that, in that scenario, the
 13 differential of the sort that I have described would
 14 lead to a greater shift in market share from MasterCard
 15 to Amex?
 16 A. Yes.
 17 Q. Can we go to page 5 of the table. You will see in the
 18 top left:
 19 "Merchants accepting payment by card in thousands."
 20 You will see "Number of merchants accepting payments
 21 by MasterCard" in the first row. The figures go up from
 22 811 to 1126, the same for Visa. Then:
 23 "Number of merchants accepting payment by other
 24 cards."
 25 American Express starts at 570 and goes to 1,000.

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1 So what we see is that, whilst Amex had lower acceptance
 2 than MasterCard throughout the period, the gap actually
 3 narrowed considerably over the period of the claim; do
 4 you agree?
 5 A. The gap did narrow, yes.
 6 Q. Given the growth in Amex's market share between 2006 and
 7 2009 that we saw on page 3, consumers obviously viewed
 8 the benefits from Amex, such as higher rewards, as
 9 compensating for its lower levels of acceptance; do you
 10 agree?
 11 A. Merchants felt cardholders benefited, merchants felt
 12 that they -- that there was more acceptance by
 13 cardholders and thought that more of these desirable
 14 affluent people would come into their stores.
 15 Q. Can we go to C2, tab 2. I need to keep the table, so
 16 you probably want to keep that tab. C2, tab 2. If we
 17 go to page 23. You should look at the first page, this
 18 is the witness statement of Mr Douglas.
 19 A. Yes.
 20 Q. That's something you have read, isn't it?
 21 A. I have read Mr Douglas.
 22 Q. If we go to page 32. I think the easiest way is if you
 23 just refresh your memory by reading to yourself
 24 paragraphs 42 to 46, please. (Pause)
 25 The particular passage -- I wanted to give you the

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1 context, but in 44 you will see that Mr Douglas
 2 explains, four lines into 44:
 3 "We could not compete with Amex for these issuers
 4 based on the standard default interchange fee. As such,
 5 we developed and offered our issuing customers
 6 an opportunity to issue MasterCard's World credit card
 7 as an alternative to Amex. This was a premium product
 8 created to compete with Amex in the niche travel and
 9 entertainment space in 2005 to 2006. It required
 10 a specific level of cardholder rewards and had a higher
 11 default interchange rate to cover this. The World card
 12 offered a 50 plus BPS premium over standard default
 13 domestic rates, resulting in a default interchange rate
 14 of between 138 and 150 BPS."
 15 I would like you to see the development in relation
 16 to World by looking at C2, tab 7. It is the same one as
 17 Mr Douglas's statement.
 18 A. Sorry.
 19 Q. That's fine, tab 7. That should be the witness
 20 statement of Mr Willeart?
 21 A. Yes.
 22 Q. Again, is this something you have read?
 23 A. Yes.
 24 Q. If we could go to page 128, paragraphs 48 to 49, you
 25 will see the last sentence of 48:

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1 "I was also involved in the development of
 2 MasterCard product to compete with Amex in the co-brand
 3 space. As regards the former, I was aware that
 4 MasterCard had developed a premium credit card, the
 5 World card in 2005, which had a higher premium fallback
 6 interchange rate that was competitive for those offered
 7 by Amex credit cards."
 8 That's what Mr Douglas described, the creation of
 9 the niche World card in his statement. Mr Willeart goes
 10 on to explain:
 11 "This product was subsequently adapted and used by
 12 MasterCard in 2009/2010 to respond to the competitive
 13 threat that Amex posed more generally in relation to
 14 MasterCard's major issuers, who were seeking to target
 15 affluent cardholders. MasterCard was on the verge of
 16 losing a number of those issuers who were intending to
 17 move their entire credit card portfolios to Amex's
 18 non-proprietary card."
 19 So what we see from this, tell me if you agree or
 20 not, is that MasterCard prevented Amex taking further
 21 market share by developing and offering to issuers in
 22 2009/2010, a premium card called MasterCard World, which
 23 had interchange fees which were roughly 0.5% higher than
 24 MasterCard's standard interchange fees; do you agree?
 25 Do you want me to repeat the question or statement I'm

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1 asking you to agree with?
 2 A. Do not repeat your question, I will say yes. There is
 3 a context, I think, to some of this. But I want you to
 4 ask questions rather than me speak.
 5 Q. Can I go back to the table that we are looking at in
 6 bundle B, tab 11. You can put away the C bundle now.
 7 Do you want to take some time to do so?
 8 A. It is going to create a mountain.
 9 Q. That's what I'm worried about. You are getting
 10 overwhelmed. You need B out at the moment. So we are
 11 back in the table at page 3. If we pick up the story of
 12 Amex's share of the market, so it is the bottom row in
 13 the table. We have looked at the increase from 2006 to
 14 2009, from 8% to 14%.
 15 What we see is that from 2010 onwards, which
 16 coincides with the evidence we have just seen of
 17 MasterCard repositioning its World card as a general
 18 premium product, what we see is Amex's market share
 19 declined, correct?
 20 A. Well, first off, I think we need to explain a bit more
 21 for the panel 2008 onwards, because of that 8%, at that
 22 point, it is the Amex proprietary scheme. If we go to
 23 2007, it is 10%, is proprietary scheme. 13% is the
 24 proprietary scheme. 14 is when we have -- and this is
 25 why I need to go back to the previous one, when Lloyds

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1 GNS came in, that is the four-party equivalent of Amex,
 2 okay?
 3 So if you are going to have competition from other
 4 issuers saying, look, we need to have a four-party Amex
 5 or -- we are going to move to a, four-party Amex because
 6 we have a MasterCard card and you don't offer enough
 7 standard, you would expect that to be around. So the
 8 Amex proposition has gone down, 13 to 11, with the
 9 threat of a new MasterCard World card. Okay?
 10 Q. If you look at footnote 13, it explains:
 11 "In addition to three-party scheme cards, these
 12 cards include the American Express cards issued under
 13 the GNS initiative, which allows financial institutions
 14 such as banks to issue American Express cards."
 15 We have seen from the evidence that it is precisely
 16 because of the GNS threat that MasterCard took the step
 17 of broadening out its World card. So what we see, do we
 18 not, is that with the introduction of the world card,
 19 the effect, even with the launch of GNS, was a reduction
 20 in Amex's market share, correct or not?
 21 A. I think that needs further clarification because you
 22 need to bear in mind that what I'm saying to you is, of
 23 that 13%, the GNS accounts for some 2.73. So if we are
 24 saying that the World card has competition with GNS and
 25 that is your major substitution, then the reduction

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1 is -- and basically that's Lloyds at that point, which
 2 wasn't working very well -- then that's the -- possibly
 3 the drop from 13 to 11. I hope that helps you.
 4 Q. I think we are agreeing, because my question is not
 5 a particularly difficult one. Amex's market share
 6 dropped after the introduction of the World card, just
 7 as a fact. Let's forget for a moment the whys and
 8 wherefores, that is observable from this, isn't it?
 9 A. We don't know part of it. The point here I'm making is
 10 that the part which is competing between the -- is the
 11 GNS and your new MasterCard World card. It is not the
 12 proprietary three-party scheme.
 13 Q. Footnote 12 tells us that the figures in this table
 14 include both three party Amex cards, the proprietary
 15 cards and Amex GNS cards, correct?
 16 A. That is right, Mr Hoskins. I'm not going to argue on
 17 that point. I'm merely making a factual point that the
 18 GNS card, the Lloyds card, did not come in in 2006. It
 19 came in -- and correct me if I'm wrong -- on -- I'm
 20 going back to Mr Douglas' -- I think it came in in 2008,
 21 not to hold up the Tribunal.
 22 Q. But the question I'm asking is a really simple one which
 23 is the total number of Amex cards in the market
 24 decreased after 2009, correct?
 25 A. The value decreased after 2009, the total number of

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1 cards increased. You can see that from number 1, which
 2 is the number, and the value is the second bit at the
 3 bottom, which you are referring me to.
 4 Q. Yes, in a growing market, Amex's share by value of
 5 transactions decreased after 2009?
 6 MR JUSTICE BARLING: Sorry, you are saying the number of
 7 cards increased for Amex but the value of the
 8 transactions decreased after 2008?
 9 A. And that is right.
 10 MR JUSTICE BARLING: Is that what these show. I'm sorry,
 11 I haven't followed it through. I don't know where you
 12 get the number of cards for Amex.
 13 A. If you look at the next row up. So it is number 1. It
 14 says:
 15 "Based on number of cards issued."
 16 MR JUSTICE BARLING: Sorry, I'm with you now. Thank you.
 17 MR HOSKINS: If MasterCard had not been able to respond to
 18 the competitive threat posed by Amex in 2009, by
 19 offering a premium card with higher MIFs -- are you with
 20 me so far -- then Amex's market share would have
 21 continued to increase after 2009, in the same way it did
 22 from 2006 to 2009, wouldn't it?
 23 A. The people who are holding Amex third party card without
 24 a fee -- with a fee, are not the same people, if you
 25 think of competition, who are going to go for that

20

1 MasterCard offering in 2008.
 2 What we are talking about is the competition that is
 3 the fee paying, competition of the GNS and the Amex --
 4 the Amex GNS and then the MasterCard card.
 5 Q. Do you accept that the development of the MasterCard
 6 World card into a general offering in 2009/2010 had
 7 an impact on Amex's market share after its introduction?
 8 A. In terms of value, yes. In terms of volume, it doesn't
 9 say that, it is stable.
 10 Q. If, rather than introducing its World card with a level
 11 of MIF, which could compete with Amex, MasterCard had
 12 instead cut its existing MIF to a sixth of its existing
 13 level, so not increasing it, but cutting the existing
 14 MIF by a sixth, the loss of market share to Amex would
 15 have turned into a flood, wouldn't it?
 16 A. There is a tiny bit of a problem, we don't have 2015
 17 data.
 18 Q. Let's concentrate on the data we have.
 19 A. Well, if you --
 20 Q. Imagine, in my scenario what would have happened between
 21 2010 and 2014, if the real world data, which is the
 22 introduction on a general basis of the MasterCard World
 23 card with a MIF which could compete with the Amex
 24 offering, and we are imagining, in your counterfactual
 25 that rather than being able to do that, MasterCard could

21

1 only offer a card with a sixth of its existing MIF, ie
 2 0.15%. So rather than being able to compete with Amex
 3 by putting a higher MIF, it had to reduce its existing
 4 MIF which wasn't competing with Amex by a sixth. What
 5 would the effect have been on Amex's market share?
 6 A. The problem here is we are speculating.
 7 Q. Of course we are, it is a counterfactual. That's why we
 8 are here, I'm sorry.
 9 A. No, counterfactuals should really have some realistic
 10 basis, you should have a change.
 11 If we open the curtain on this beautiful day we
 12 notice that at point 3 the MasterCard MIF has come down
 13 from 0.81. We do not observe necessarily everyone
 14 rushing to get their Amex GNS at 0.69. So there has
 15 been a change in the market outside and yet we are not
 16 observing --
 17 Q. This is prior to the regulation, I'm looking at the
 18 period prior to the regulation.
 19 A. If you --
 20 Q. I'm asking you to imagine a counterfactual because
 21 that's what the Tribunal has to do to decide the case?
 22 A. So prior to the regulation, would we be looking at Amex
 23 being regulated at all?
 24 Q. No.
 25 A. Okay. So if we do that, then I think we then go back to

22

1 the Australian evidence.
 2 Q. If you are wrong about Australia, and Amex is able to
 3 and does maintain its actual merchant fee levels that
 4 applied during this period, but MasterCard has to cut
 5 its MIFs by a sixth of what it applied between the years
 6 2010 and 2014, there would have been a flood of issuers
 7 switching to Amex from MasterCard, correct or not?
 8 A. First off, there would be -- if I'm wrong about the
 9 Australian evidence, that there is no merchant pressure
 10 leading to the Amex discount rate falling, then for --
 11 issuers would have a choice whether they moved to issue
 12 Amex GNS cards. Whether they are going to do that for
 13 more than the premium segment, I would say not; that's
 14 my submission.
 15 In other words, it doesn't wipe out MasterCard. It
 16 may mean that they have to retrench, which is in the
 17 words, I think, of Mr Tittarelli, in some form.
 18 Q. So you accept that in the counterfactual I have
 19 described there would be significant switching from
 20 MasterCard to Amex?
 21 A. In the counterfactual you describe, yes, of some form.
 22 Q. Let's go to Australia. Bundle D2, tab 2. This is,
 23 again, your first report at page 161, paragraph 181:
 24 "In Australia the RBA capped the MasterCard and Visa
 25 credit card weighted average interchange fees which fell

23

1 from about 0.95% to 0.55% on 1st November 2003, and then
 2 to a maximum of 0.5% from 1st November 2006."
 3 So the Australian regulation applied on its
 4 introduction to both MasterCard and Visa, correct?
 5 A. MasterCard and Visa credit cards, yes.
 6 Q. Yes. The Australian experience doesn't tell us anything
 7 material, does it, about what would have happened in the
 8 UK if the MasterCard MIF had been materially lower than
 9 the Visa MIF?
 10 A. The effect was applied to both.
 11 Q. So it follows that the Australian experience can't tell
 12 us anything useful about what would have happened in
 13 a counterfactual where the MasterCard MIF had been low
 14 or zero and the Visa MIF had been maintained at its
 15 actual level; Australia can't help us with that, can it?
 16 A. Agree. Sorry, I said yes.
 17 Q. Sorry, I did not pick up your answer. Can we go to
 18 E3.14. You want to keep bundle D2 out. E3.14, tab 265.
 19 It is right at the front of --
 20 A. Sorry.
 21 Q. -- the bundle. It should be an article by Jean Tirole.
 22 A. That is right.
 23 Q. If you go through to page 5694 of this article. At the
 24 second paragraph on 5694:
 25 "In reaction to downward pressure on interchange

24

1 fees, cardholders and issuers who benefit from higher
 2 interchange fees, so long as merchants keep accepting
 3 the card, have an incentive to migrate toward card
 4 payment schemes that put more of the burden on the
 5 merchant.
 6 "A case in point is Australia, where, in the wake of
 7 the mandated decrease in the interchange fee, three of
 8 the top four Australian banks signed up agreements to
 9 issue American Express or Diners Club cards."
 10 Were you aware of that before you read this article?
 11 A. Yes.
 12 Q. But you did not mention it in your reports.
 13 A. Sorry, I think we did.
 14 Q. You mentioned in your reports that three of the top four
 15 Australian banks signed up to agreements to issue
 16 American Express or Diners Club's cards?
 17 A. In 2004 and then in 2009, two episodes.
 18 Q. Can we go back to D2/2. You can put away E3.14 for the
 19 moment. Again, it is your first report at page 69
 20 please. At paragraphs 69 to 70 --
 21 A. Sorry, Mr Hoskins for that last answer, can I just refer
 22 you to paragraph 192, which is on page 164 of my first
 23 report, just to clarify, for the reference. Now 64.
 24 Q. Back into -- yes, so we are in that report and it is
 25 page 69. Paragraph 69, you say:

25

1 "The reason why the Amex gain was so small in
 2 Australia, and would have been similarly small in the UK
 3 in a low interchange fee environment, is that Amex was
 4 unable to obtain its relatively ..."
 5 That should be "relatively high MSCs". Is that
 6 correct, the word "high" is missing?
 7 A. Yes, sir.
 8 Q. What happened was the Amex MSC fell in line with the
 9 fallen four-party Visa and MasterCard MSCs:
 10 "With lower income from merchants, this meant that
 11 Amex was not able to maintain their attractiveness of
 12 their rewards. As a result, it did not gain any
 13 competitive advantage over Visa and MasterCard following
 14 the reduction in the interchange fees. Although it was
 15 not directly affected by the regulation it nonetheless
 16 experienced a similar and in fact larger fall in its
 17 MSCs.
 18 "What ultimately drove this process was the
 19 willingness of merchants to fund rewards programmes via
 20 higher MSC payments and they would only be prepared to
 21 do this if there was compelling evidence that Amex cards
 22 could offer a significant level of incremental spend.
 23 In Australia a large number of merchants responded by
 24 starting to surcharge, meaning if a cardholder wanted to
 25 accumulate rewards points they would have to fund them

26

1 themselves. The increase in surcharging undermines the
 2 Amex business model and provides a strong incentive for
 3 Amex to reduce its MSCs."
 4 That's what you have been bursting to tell the
 5 Tribunal for most of your evidence, isn't it? That is
 6 the point you have been making?
 7 A. I think the point is actually not just 70, but actually
 8 going back to the data and looking at the impact of Amex
 9 in Australia, both in terms of its share and here in 70
 10 in terms of how the price -- the discount rate in
 11 Australia for Amex fell.
 12 Q. Can we go to page 199 of your report. 367 you say:
 13 "What we have seen in Australia is merchants react
 14 by making increased use of surcharging."
 15 Again, it is your point about merchants don't want
 16 to pay higher Amex fees so they react and put pressure
 17 on by surcharging; is that a fair summary of your
 18 evidence in these paragraphs?
 19 A. Yes.
 20 Q. If you go to E3.13, at tab 249, you should have
 21 a MasterCard Worldwide document entitled:
 22 "UK alternative premium model."
 23 A. Yes, a confidential one.
 24 Q. It is okay, I am going on show you something that's --
 25 A. We will make sure we can deal with it, yes?

27

1 Q. If you feel uncomfortable you can't give an answer, you
 2 shout.
 3 At 5334, you should have a slide that begins
 4 "Surcharging has risen rapidly since 2006"; do you have
 5 that?
 6 A. I do.
 7 Q. You will see top right, above the MasterCard symbol,
 8 Australia. So this is relating to Australia, yes?
 9 A. Yes.
 10 Q. This shows what you explained in your evidence, that
 11 there was a rapid increase in surcharging in Australia
 12 after the introduction of their regulation, correct?
 13 A. The regulation starts in 2006, in terms of debit cards,
 14 and 2003, yes.
 15 Q. But this confirms your evidence, that's what you are
 16 talking about, isn't it?
 17 A. It confirms that we have an increase in surcharging,
 18 yes.
 19 Q. If you put that away, can we go to bundle 5.4?
 20 A. Let me just say, this slide actually says "at least one
 21 credit card". It is not clear what this actually means,
 22 does it actually mean Amex only or is it MasterCard?
 23 I just wanted to clarify that. I don't know.
 24 Q. I was showing this to confirm your own evidence which
 25 was that surcharging increased (inaudible) in Australia

28

1 after the introduction of the regulation?
 2 A. I know but this terms of surcharging, there is the fact
 3 of surcharging and then it is how surcharging actually
 4 takes place. That was --
 5 Q. Can we go to 5.4, at tab 56. This is the Commission's
 6 impact assessment for the regulation; do you have that?
 7 A. I do sir.
 8 Q. Can we go through to page 1593, you will see there is
 9 a heading in the middle of the page:
 10 "2.6, option 16: exemption of commercial cards and
 11 three-party schemes."
 12 The third paragraph down:
 13 "Based on the experience in other constituencies, in
 14 particular Australia, we do not expect either commercial
 15 cards or three-party schemes could take over the debit
 16 and credit card markets in this situation by offering
 17 more advantages to customers."
 18 Then there is a discussion of the Australian
 19 situation. It is the next paragraph I want to look at:
 20 "Due to downward pressure on Visa and MasterCard IFs
 21 through caps and increased transparency measures, a ban
 22 on the no surcharge rule, removing the HACR between
 23 debit and credit cards, both the MSCs on Visa MSC and
 24 three-party schemes decreased. Though surcharging was
 25 slow to develop among merchants, by the end of 2010

29

1 almost 30% of merchants imposed surcharging on credit
 2 card products. The average surcharge on American
 3 Express was 2.9% and for Diners Club 4%, these
 4 surcharges being higher than the MSCs, 1 percentage
 5 point for Amex and 1.8 for Diners Club. The RBA has
 6 received evidence that consumers respond to surcharges
 7 by avoiding the use of more expensive cards where
 8 possible."
 9 So what we see in Australia, not only was there
 10 an increase in surcharging, but the average surcharge in
 11 relation to American Express was actually larger than
 12 its fees, correct?
 13 A. Yes.
 14 Q. If we can go back to -- you can put this way away, 5.4
 15 away. Go back to your first report, D2, tab 2. Go to
 16 page 224. You will see the heading at the bottom of the
 17 page:
 18 "Has surcharging been a realistic option for
 19 merchants and, if so, has this led indirectly to
 20 downward pressure on interchange fees?"
 21 This is in the context not of Australia but of the
 22 UK, correct, this part of your report?
 23 A. Yes.
 24 Q. You make a point about how surcharging would exert
 25 a significant constraint but on 551, over the page, you

30

1 say:
 2 "However, in practice many merchants are reluctant
 3 to surcharge for fear of losing ...(Reading to the
 4 words)... David Brooks witness statement. We do not
 5 surcharge our customers for card payments because our
 6 competitors do not. If we did, we would clearly risk
 7 losing our customer's business to others who do not
 8 surcharge."
 9 Then 5.12:
 10 "Additionally, the British Retail Consortium, BRC,
 11 noted that the majority of members do not levy
 12 surcharges. In addition to the competitive constraints,
 13 the BRC noted that there are practical ...(Reading to
 14 the words)... this would present a competitive advantage
 15 to another. Complex hardware, software and staff
 16 training would be required to implement an accurate
 17 surcharging mechanism and process this point of sale."
 18 Mr Brooks' evidence on this is at C1, tab 3. If we
 19 look at paragraph 32 on page 41 --
 20 A. Could you give me that reference again.
 21 Q. Tab 3 of C1, page 41, paragraph 32:
 22 "We do not surcharge our customers for card payments
 23 because our competitors do not. If we did we would
 24 clearly risk losing our customers' business to others
 25 who do not surcharge. Most retailers do not surcharge

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1 ...(Reading to the words)... should be banned on all
 2 cards. I agreed with the BRC position and this is
 3 basically what I understand the regulations provide."
 4 So according to Mr Brooks' evidence, surcharging is
 5 neither desirable nor feasible in the UK; do you agree?
 6 A. Correct me if I'm wrong, but I think I bought a Ryanair
 7 ticket, where there is surcharging in the UK? Certainly
 8 in the past; I haven't done it recently, I promise.
 9 MR JUSTICE BARLING: You weren't asked about -- you were
 10 asked whether you agreed it was undesirable.
 11 A. At the moment, in the current situation, what Mr Brooks
 12 says is a fact.
 13 MR HOSKINS: Can we go to E1, tab 3. You will see this is
 14 the OFT decision in relation to MasterCard that was
 15 subsequently annulled.
 16 A. Yes.
 17 Q. If we go to page 132 --
 18 A. Yes. Is it page 132 not the --
 19 Q. Page 132 of the bundle.
 20 A. I have got it.
 21 Q. Paragraph 281:
 22 "Lastly, the OFT considers that the relative rarity
 23 of surcharging by merchants in the UK is itself evidence
 24 that it is unlikely it would be a viable option for many
 25 merchants."

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1 Do you agree with that view of the OFT?
 2 A. At that time it would have been, yes.
 3 Q. So what we see from all this evidence, which is specific
 4 to the UK, is that, whilst in Australia Amex reduced its
 5 MSCs because merchants began to impose surcharges on the
 6 use of its cards, surcharging is not a feasible option
 7 in the UK; do you agree?
 8 A. Given the Visa and MasterCard situation at the time, it
 9 was not seen as a feasible option. That's what it says.
 10 Q. If surcharging was not a feasible option in the UK, the
 11 Australian experience is not relevant to the UK, is it?
 12 A. If in the counterfactual things change then the
 13 Australian experience is something to think about, about
 14 how the market may change. The OFT paragraph here is in
 15 the context of that situation which, in effect, we are
 16 saying is the actual.
 17 Q. Without any feasible prospect of surcharging, it is
 18 likely, is it not, that Amex would have maintained its
 19 merchant fees at a high level in the UK if MasterCard
 20 had had a MIF at a zero or low level?
 21 A. You are mentioning Amex?
 22 Q. Absolutely. I'm saying if, absent surcharging, then
 23 Amex would have maintained its merchant fee at a high
 24 level, if MasterCard had a zero or low MIF?
 25 A. Absent surcharging or non-acceptance of the Amex card.

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1 Q. You agree with --
 2 A. That is -- I'm just defining it properly.
 3 Q. It is obvious why it would have done that because it
 4 would have had a significant competitive advantage over
 5 MasterCard, wouldn't it?
 6 A. The competitive advantage of Amex is for the affluent.
 7 Not all merchants accept it. So to the extent that
 8 merchants do accept, that is the case.
 9 Q. Can we go back to E3.14. This time go to tab 270.
 10 (Pause)
 11 You will see that this is a Reserve Bank of
 12 Australia document. Sorry, are you there? It is 270.
 13 A. I am, sir.
 14 Q. Reserve Bank of Australia, review of card payment
 15 regulations issues paper for March 2015, yes?
 16 A. Yes.
 17 Q. Then if you can go through to page 6297, you see the
 18 heading "Interchange fees". RBA states:
 19 "The standards on interchange fees for MasterCard
 20 and Visa systems set benchmarks for the average
 21 interchange fee ..."
 22 The average interchange fee:
 23 "... that could be paid in those systems, the
 24 standards require that every three years or at the time
 25 of any other ...(Reading to the words)... of the most

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1 recent financial year. For credit cards the number of
 2 categories of interchange fees has risen from three to
 3 19 for the MasterCard system and from five to 23 for the
 4 Visa system since November 2003.
 5 "Furthermore, there has been a significant widening
 6 in the range of interchange rates. For the MasterCard
 7 system this range was widened from 63 basis points in
 8 2003 ...(Reading to the words)... 48 basis points to 180
 9 basis points."
 10 We see that in Australia the regulation provided for
 11 a weighted average interchange fee for MasterCard and
 12 Visa; that is correct, isn't it?
 13 A. That is correct.
 14 Q. MasterCard and Visa were entitled to apply different
 15 MIFs to different types of credit card, correct?
 16 A. That is correct.
 17 Q. When we look at graph 9 in this document, "Credit card
 18 interchange fees, range of interchange fees", you will
 19 see on the left the spread for MasterCard, we see that
 20 MasterCard did in fact apply a widespread of MIF rates,
 21 correct?
 22 A. It did, yes.
 23 Q. If we can go now to bundle E3. It is a document we have
 24 seen already, MasterCard Worldwide UK alternative
 25 premium model, yes? 2nd November 2012.

35

1 A. Which tab?
 2 Q. I'm so sorry, I'm ahead of myself, tab 249.
 3 A. This is the confidential document.
 4 Q. Thank you, you are right. Keep reminding me. The bit
 5 I'm going to show you is not confidential.
 6 A. We will try our best.
 7 Q. No, I'm very grateful. If you can go through to 5328.
 8 If you just bear with me for one second. (Pause)
 9 I'm told that we are safe to refer to this page:
 10 "In Australia surcharging and reduced Amex economics
 11 limited shift in scheme shares. Regulations introduced
 12 in 2003 caused interchange to drop by 45 basis points
 13 ... led to significant restructuring of credit card
 14 value propositions to compensate ...(Reading to the
 15 words)... issued Duo products."
 16 Which is the point we saw before:
 17 "... led to a significant but increase in Amex share
 18 from ...(Reading to the words)... VISA, albeit slower."
 19 That was the surcharging effect that we looked at
 20 a few minutes ago:
 21 "Merchants forced Amex to come down by surcharging."
 22 Yes?
 23 A. Yes.
 24 Q. Then:
 25 "... and because MasterCard/Visa extensively used

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1 premium interchange rates."
 2 So what we see, do we not, is that, due to its
 3 ability to apply higher MIFs for premium credit cards,
 4 MasterCard was able to limit the damage that Amex could
 5 do to it in the Australian market? It used its ability
 6 to apply a range of rates to apply high rates to premium
 7 cards to limit the damage from Amex, correct?
 8 A. The graph, graph 9, so we do see the differential
 9 widens. There were obviously some transactions at
 10 the 2, towards the Amex level, and other ones have to be
 11 correspondingly lower. So the argument is that Amex --
 12 there is a sufficient number being able to be charged
 13 at 2 to limit Amex's behaviour. Now, that's pretty hard
 14 as an explanation to understand why Amex then reduced
 15 its discount rate.
 16 Q. We know why because of surcharging, we have been through
 17 all that.
 18 A. But what we call anti-circumvention maybe. I don't want
 19 to use that term too loosely, but if that was the case,
 20 I would also expect that Amex rates would have raised in
 21 response, and they didn't, if that is the explanation.
 22 So I do not agree with you, sir.
 23 Q. We see there was a range, we see there was a high range
 24 and we see from a MasterCard internal document that
 25 MasterCard and VISA extensively used premium interchange

1 rates to compete with Amex. Are you saying that
 2 MasterCard and Visa did not extensively use premium
 3 interchange rates to compete with Amex?
 4 A. What we don't know --
 5 Q. Sorry, do you --
 6 A. They obviously did do --
 7 Q. Thank you.
 8 A. What we don't know is how much.
 9 Q. Under your proposed counterfactual, in the UK, of zero
 10 or low MIFs, MasterCard would of course have had no
 11 ability to apply higher MIFs for premium credit cards in
 12 the UK, would it, because your MIF is 0.15?
 13 A. It's 0.15, yes.
 14 Q. If an issuer sought to charge by way of an annual fee or
 15 a per transaction charge for a non-premium card, we're
 16 talking about charging the cardholder, for a non-premium
 17 card, what would happen? So if an issuer sought to
 18 charge for a non-premium card what would happen?
 19 A. Demand for the card should go down.
 20 Q. So the number of transactions using that credit card
 21 would fall, yes?
 22 A. Yes.
 23 Q. The number of consumers holding that credit card would
 24 fall, yes?
 25 A. Yes.

1 Q. If the issuer maintained that position for a reasonable
 2 period of time, say a year, the following cardholders
 3 would be material, yes? It is not de minimis, the
 4 effect.
 5 A. It is not de minimis.
 6 Q. If the number of cardholders fell, merchants would be
 7 less willing to pay an MSC to accept those cards,
 8 correct?
 9 A. Than otherwise would be the case, yes.
 10 Q. If we go back to D2, tab 2.
 11 A. The first expert report.
 12 Q. That is correct, yes. At page 207, paragraph 419, you
 13 say:
 14 "Both the prohibition on ex post pricing and the
 15 abolition of the HACR would involve bilateral
 16 negotiations between issuers and acquirers. These could
 17 potentially be costly and would yield little, if any,
 18 gain for issuers."
 19 Why would they be costly?
 20 A. In terms of the transaction costs of actually
 21 negotiating.
 22 Q. Why would they yield little, if any, gain for issuers?
 23 A. In terms of the ex post pricing that could be -- the
 24 outcome of the negotiation, remember we are not in the
 25 default MIF, we are in negotiation between the acquirers

1 and issuers. I think your point -- the ex post pricing
 2 may be zero and I'm saying it could be up to the level
 3 of transaction benefits. How do you measure those? It
 4 is roughly 0.15, is what I'm saying.
 5 Q. If the MasterCard system was subject to a prohibition on
 6 ex post pricing but the Visa scheme were not, what would
 7 happen?
 8 A. I explained my counterfactual, in response to the Visa
 9 staying up and the ex post pricing being applied to
 10 MasterCard yesterday.
 11 Q. Issuers would migrate to the Visa scheme, is the answer,
 12 isn't it?
 13 A. It depends whether that is a temporary or a permanent
 14 move.
 15 Q. Assume it applies over the period of the claim?
 16 A. Then your supposition is correct.
 17 Q. Then, going to page 220 --
 18 MR SMITH: Sorry, Mr von Hinten Reed, just staying on
 19 paragraph 419, again. When you say that there's
 20 potentially little gain for issuers negotiating
 21 bilaterals, is that a conclusion that you reach because
 22 of your assumption that there is a prohibition on
 23 ex post pricing?
 24 A. Yes. In other words, you have -- we are in a world of
 25 bilaterals, so forget about the default MIF for one

1 minute. We have an honour all cards rule and to stop the
2 collapse, which in my submission, obviously not in
3 Dr Niels', but in my submission that would result, you
4 impose an ex post pricing rule. All I'm saying to you
5 then is: what's the value? There would still be
6 negotiations, what is the value you could eke out from
7 those negotiations?

8 I think from the merchant's perspective, because
9 they are now in negotiation, they would say up to the
10 level of transaction benefits I'm willing to negotiate.
11 So that is the 0 to that value. I'm just simply giving
12 a value based upon how we calculate transaction
13 benefits. So it could be zero or it could be 0.15.

14 That's the sort of negotiation space you have got and it
15 all depends how difficult those negotiations are. If it
16 is quite easy because you have the protocols, then the
17 transaction costs of the negotiation are low, if not
18 they could be high. I don't know, sir, on that.

19 MR SMITH: On the assumptions in paragraph 419, absent
20 a bilateral agreement, the issuer's interchange fee is
21 zero; is that right?

22 A. You need some sort of acceptance. If you have the HACR
23 and I'm not assuming that the --

24 MR SMITH: Assume the HACR is in place, assume also that
25 there is a rule, as you say here, prohibiting ex post

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1 pricing.
2 A. It doesn't necessarily have to be zero.
3 MR SMITH: But the only way you move from zero is by
4 bilateral agreement?
5 A. Exactly. That's where the negotiation comes in.
6 MR SMITH: So I don't quite understand why you are saying
7 that there is little gain for issuers because the whole
8 reason for an issuer entering into a bilateral
9 negotiation would be to shift the interchange up.
10 A. Yes, to get some of that 0.15 over to their cardholders.
11 So the question is, if the costs of negotiation are
12 large, then you eat into that money that you are
13 shifting from the merchant over to the other side.
14 MR SMITH: Right, so the reason you are saying, in
15 paragraph 419, that it would yield little is because of
16 your opinion that the range for negotiation of the
17 interchange fee is up to 0.15?
18 A. It could, yes.
19 MR SMITH: But no --
20 A. I don't know where we lie on that continuum, okay?
21 Whether it is 0, 0.5 -- up to 0.15, I don't know.
22 MR SMITH: But what you are saying, I think, is that the
23 0.15 represents the maximum.
24 A. Yes, sir.
25 MR SMITH: In other words, the room for negotiation between

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1 issuer and acquirer is between 0 interchange and 0.15?
2 A. Exactly, and in the alternative world where you are not
3 thinking about the default MIF, you are thinking
4 about -- you then have a negotiation. If you have the
5 HACR, you have the ex post pricing rule, then that's the
6 range of negotiation value.

7 MR SMITH: Just to be absolutely clear, your 0.15 derives
8 from the MIT-MIF.

9 A. Yes, but I'm deriving the -- I'm using the methodology
10 to derive the value of transaction benefits. I'm not
11 saying it is because it is -- don't confuse it with the
12 default MIF.

13 MR SMITH: No, no.

14 A. It is simply a methodology.

15 MR SMITH: I understand, we are talking about bilateral
16 negotiations but I wanted to understand where your
17 ceiling came interest.

18 A. And that is where I take it.

19 MR SMITH: The savings, thank you.

20 MR HOSKINS: Sir, it is probably a good time. I could do
21 with lunch.

22 MR JUSTICE BARLING: Yes, I am sure you could. I am sure
23 Mr von Hinten Reed could as well.

24 Mr von Hinten Reed, remember you don't talk to
25 anyone about the case over the lunch break.

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1 A. Even my wife.
2 MR JUSTICE BARLING: Anyone. Thank you.
3 (1.00 pm)
4 (The short adjournment)
5 (2.00 pm)
6 MR HOSKINS: Good afternoon.
7 MR JUSTICE BARLING: Okay?
8 MR HOSKINS: Yes. Our old favourite D2, tab 2. This time
9 at page 207. Just before lunch we saw paragraph 419.
10 This time 420, you say:
11 "As noted in section 6.3.1, the evidence suggests
12 that issuers are likely to remain financially viable in
13 the absence of the MasterCard UK MIF. Therefore,
14 instead of incurring the costs of bilateral negotiations
15 for potentially little gain, issuers might be willing to
16 accept "at par" clearing, that is, issuers process the
17 transaction without deducting an interchange fee."
18 I just want to clarify that would be equivalent to
19 a zero MIF, wouldn't it?
20 A. Yes.
21 Q. Then, if you can go to D3, tab 3, which is Dr Niels'
22 first report. Then go to page 258, paragraph 3.59. He
23 says:
24 "In the absence of a default UK MIF and any
25 hypothetical explicitly or implicitly requiring the

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1 interchange fee to be zero, all transaction settlements
 2 between an acquirer and a issuer within the scheme would
 3 require a bilateral agreement between the two banks in
 4 their terms of dealing, including in relation to
 5 interchange. In such a situation, the relevant factor
 6 in the bilateral negotiation is that the acquirer
 7 effectively has no choice but to settle a payment with
 8 the issuer in question, since this transaction was made
 9 by one of that issuer's cardholders. In economic theory
 10 this has been described as the hold up, hold out or
 11 ... (Reading to the words)... Economic models commonly
 12 find that a situation with a series of bilateral
 13 interchange fees and no default MIF tend to result in
 14 higher interchange fees overall than one with a default
 15 MIF."
 16 Then you deal with that issue -- this is in your
 17 second report, so it is D2.1, tab 3, page 455. You
 18 refer to the passages we have just looked at, as
 19 I understand it, you agree with the existence of this
 20 economic theory, the hold up or hold out or Cournot
 21 theory; is that correct?
 22 A. I agree with the hold out theory.
 23 Q. Then at 185, you say:
 24 "Under bilateral negotiations under the honour all
 25 cards rule, HACR, interchange fees would be pushed so

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1 high that the scheme would collapse."
 2 I think what that means is that in the situation
 3 contemplated there, ie bilateral negotiations under the
 4 HACR, what you are saying one would find is that MIFs
 5 would have been driven higher than the actual level
 6 during the period of the claim, is that correct, in the
 7 first instance?
 8 A. In the first instance there is nothing to stop the MIFs
 9 under a HACR rising and rising.
 10 Q. Then, ultimately, you say the scheme would collapse
 11 under this system?
 12 A. That is right.
 13 Q. You will be glad to hear we can move on to a new topic,
 14 which is the exemptable level of the MIF.
 15 A. Can I just make a small -- the economic theory cited --
 16 I think it is the Small and Wright paper -- try not to
 17 read it before bed, it is very technical -- but it
 18 basically sums up that there would be a collapse in this
 19 sort of situation. So that the words "implosion" or
 20 "collapse" arise in that literature, that's where I get
 21 this from.
 22 MR JUSTICE BARLING: Thank you.
 23 PROFESSOR JOHN BEATH: I think it is referenced in Dr Niels'
 24 report anyway as a footnote to the paragraph we have
 25 just been looking at.

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1 MR HOSKINS: As we know, in relation to the exemptable level
 2 of the MIF, you have suggested that the merchant
 3 indifference test is the most appropriate way to
 4 calculate the acceptable level of the UK domestic MIF
 5 during the period of the claim, yes?
 6 A. Yes.
 7 Q. Can we go to E3.10, tab 202.
 8 A. I don't seem to have that.
 9 Q. Which: the tab or the bundle?
 10 A. No, the bundle is E3.10. I don't have --
 11 Q. Then tab 202.
 12 A. I don't have 202, sorry.
 13 Q. If someone can help find a copy, it is the Commission's
 14 2015 survey on merchants cost of processing.
 15 A. It is not there.
 16 MR JUSTICE BARLING: I think it was added to ours.
 17 PROFESSOR JOHN BEATH: Yes.
 18 MR HOSKINS: So the Tribunal has the document?
 19 MR JUSTICE BARLING: We have it because I think it was
 20 referred to in submissions.
 21 MR HOSKINS: Let me hand up an extra copy.
 22 You see this is the Commission's survey which you
 23 have probably read a few times, I imagine?
 24 A. Yes.
 25 Q. Can we pick it up at page 4295. Paragraph 6, the

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1 Commission says:
 2 "The determination of the nature of costs, in
 3 particular the actual split between fixed costs and
 4 variable costs, is crucial for the definition of the
 5 cost functions of payment instruments and the
 6 implementation of the MIT."
 7 Do you agree with that?
 8 A. Yes.
 9 Q. Then it goes on to say:
 10 "The total cost function of a payment instrument is
 11 typically defined as the sum of fixed costs, ie costs
 12 which do not vary with the number and value of payments
 13 with the payment instrument and variable costs."
 14 Do you agree with that?
 15 A. As a definition, yes.
 16 Q. If we go to paragraph 7, the Commission says:
 17 "The definition of fixed costs ... (Reading to the
 18 words)... costs become variable."
 19 Again, do you agree with that?
 20 A. Yes, although I think it is more helpful for the panel,
 21 in my report I have described these things as "avoidable
 22 costs". So, in other words, when you change from cash
 23 to card it is the costs that you don't need to incur, so
 24 that -- it is perhaps more helpful.
 25 Q. What sort of costs might vary or be avoidable over

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1 a longer period, give me some examples?
 2 A. If you think of the movement from cash to cards, it may
 3 be that the costs of transporting the cash to the bank
 4 may change. If the increment is sufficient. So if it
 5 is one transaction, it won't make an awful lot of
 6 difference, and if it is 10% of transactions that may
 7 change somewhat. It depends upon the circumstance.
 8 Q. So cost of transporting cash, cost of security, having
 9 cash on the premises?
 10 A. That could be. I have done -- in my annex B I have
 11 actually set out a very extensive classification, so if
 12 you would like to go to that, I would be happy to do
 13 that but --
 14 Q. I just want some examples of --
 15 A. So --
 16 Q. -- the sorts of things that might vary over time, over
 17 a longer period.
 18 A. For example, in a store, if you go to Sainsbury's round
 19 the corner you will see the tills, and the tills are
 20 self service -- some are self service and some are
 21 manned and that's changed over time.
 22 The wages that are paid by -- to people on the shop
 23 floor and the amount of labour you need to not transport
 24 but handle cash in the back office may change as well.
 25 That sort of thing.

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1 Q. Again, at paragraph 7 the Commission goes on:
 2 "The different sets of results obtained through the
 3 present study correspond to either short-term,
 4 medium-term, three to four years, or long-term
 5 definition of fixed and variable costs."
 6 In your report you have adopted a medium-term
 7 approach, correct?
 8 A. I did but I think there is a basic problem with this
 9 sentence because Deloitte's -- remember this is
 10 a one-year survey. So you can't really think of long
 11 term in terms of one year. If you are going to do
 12 a long-term approach you need to have more than one
 13 year, indeed many more than one year.
 14 Q. The same would apply to medium term then, three to four
 15 years, that is more than one year.
 16 A. You can assess it in terms of medium term, in terms of
 17 thinking about things that have changed over that period
 18 of time, but it depends upon the sort of analysis you
 19 are trying to actually do.
 20 Q. What Deloitte's did was ask the merchants to categorise
 21 costs according to particular timescales, so the fact
 22 that this was a survey for one year doesn't matter
 23 because, as we will see, what they were doing was asking
 24 merchants to classify costs as essentially fixed or
 25 variable over a certain period of time. They were asked

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1 to assess, weren't they?
 2 A. They were asked to assess and basically, in terms of
 3 that question, that is really scenario 2 when you think
 4 about how things have changed over a period of time. If
 5 in terms of long-term analysis, which is the econometric
 6 approach, that is based on one year and you are supposed
 7 to assume that that is long-term. That for me is not
 8 correct.
 9 Q. In your report, just to clarify, because I don't think
 10 you have answered a question yet, you have adopted
 11 a medium-term approach?
 12 A. Yes, sir, which, by the way for them -- I know we are
 13 going to use these terms quite often, so we may as well.
 14 The short term is scenario 1, that was one
 15 transaction. The medium term was a 10% increment or
 16 decrease in the use of cash to cards. That was measured
 17 over three to four years. Then the long term is the
 18 econometric approach. Is that helpful, sir?
 19 Q. I mean, that's what the Commission did, yes.
 20 A. Yes.
 21 Q. Again, this is a fairly obvious question, I hope, but
 22 a MIT-MIF, which is calculated on the medium-term
 23 approach will necessarily not take account of costs
 24 which would vary over a longer period; do you agree?
 25 A. Yes, it would be deemed to be fixed.

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1 Q. A MIT-MIF calculated on a medium-term approach will
 2 necessarily not fully reflect the total costs and
 3 benefit to the users or to society more generally of
 4 a given payment system; do you agree?
 5 A. Let me explain the medium-term approach, in terms of the
 6 costs of cash in payments for the merchant. In terms of
 7 social welfare, you are not thinking in terms of
 8 a producer on the other side. So what we are talking
 9 about are the merchants. So the answer to your question
 10 is yes.
 11 Q. Can we go to E3.14, at tab 266. You should have
 12 an article called the "Economics of payment cards", by
 13 Rysman and Wright?
 14 A. Yes.
 15 Q. If we can go to page 5736. You will see there the last
 16 paragraph on page 5736 begins "Another important
 17 practical concern"; do you have that?
 18 5736, and it is the last paragraph on that page, it
 19 begins "Another important practical concern".
 20 A. Mmm hmm.
 21 Q. If you go down six lines, you will see they say:
 22 "The concept of a merchant indifference test is
 23 based on a theory that ...(Reading to the words)...
 24 cards or cash and that the extra costs of one or more
 25 transaction is constant, it therefore focuses on

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1 marginal costs, ie the additional costs to the merchant
 2 if a cardholder uses cash rather than card for a single
 3 transaction."
 4 Do you agree with that statement?
 5 A. The theory that's referred to here is, I think, the
 6 Rochet and Tirole paper, in terms of the Tourist Test on
 7 one transaction. If you go to the medium-term approach,
 8 or think of it in terms of avoidable cost, you are
 9 actually thinking in terms of some of those costs of
 10 payments actually changing over time as the amount of
 11 cash reduces and the amount of cards increases. So it
 12 is not quite true.
 13 Q. Do you agree with the statement that the concept of
 14 a merchant indifference test is based on a theory which
 15 assumes no fixed costs to merchants of accepting cards
 16 or cash? I appreciate the definition of "fixed costs"
 17 can vary over time, we have established that?
 18 A. Okay.
 19 Q. But once you have adopted your timeframe and established
 20 their fixed costs, the MIT doesn't take account of them,
 21 does it?
 22 A. There are some fixed costs, yes.
 23 Q. Which are not taken account of?
 24 A. Which are not taken account of, no.
 25 Q. Then the authors go on to say:

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1 "However, in reality, there are some lumpy costs.
 2 For example, the costs saving of eliminating...(Reading
 3 to the words)... These types of costs should presumably
 4 still be averaged per transaction and included since
 5 they ensure the regulated interchange fee provides the
 6 right long-run incentives."
 7 Do you agree with that?
 8 A. Yes, that's why I preferred the scenario 2, over three
 9 to four years over the one transaction. I think we are
 10 agreed on that across the parties.
 11 Q. But, insofar as there are costs which may vary over
 12 a longer term, ie more than three to four years, do you
 13 accept that your MIT calculation underestimates a MIF on
 14 that basis?
 15 A. The calculation -- the central calculation does but
 16 I have also done a sensitivity test implying basically
 17 everything moves to variable by value or variable by
 18 volume.
 19 Q. I'm going to come onto that but the MIT itself, over
 20 three to four years, by definition, I think you have
 21 already agreed, will exclude costs that vary over
 22 a longer time period than three or four years?
 23 A. Yes.
 24 Q. Julian Wright, who is one of the co-authors of this
 25 paper is a well respected academic in this field, isn't

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1 he?
 2 A. Yes.
 3 Q. And so is Jean Tirole?
 4 A. Yes.
 5 Q. And so is Professor Rochet?
 6 A. Yes.
 7 Q. They are all recognised as having specialised knowledge
 8 in the economic analysis of MIFs, aren't they?
 9 A. Of the regulation of MIFs, that's the literature, yes.
 10 Q. If we look at page 5701 of this document --
 11 A. Sorry, 5701?
 12 Q. Yes, the first page.
 13 A. I apologise.
 14 Q. You see at the bottom of the page "Acknowledgements", it
 15 says:
 16 "This research was supported by a grant from Visa."
 17 Do you see that?
 18 A. Yes, I do.
 19 Q. If particular research or a paper has been supported in
 20 that way, it is good academic practice to state that
 21 expressly, isn't it?
 22 A. Yes.
 23 MR JUSTICE BARLING: Just to interject, I haven't got
 24 page 5701 -- I haven't got the beginning, I start at
 25 page 5703. If there's any chance at some point, no

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1 hurry, someone could -- thank you, Mr Cook. Sorry to
 2 deprive you. (Handed)
 3 MR HOSKINS: Do merchants want the MIF to be high or low?
 4 A. Low.
 5 Q. The calculation of the MIT-MIF in the Commission's 2015
 6 survey, under the medium-term approach, was based on
 7 data supplied by merchants, wasn't it?
 8 A. Yes.
 9 Q. Can we go back to the survey. So that is E3.10,
 10 tab 202. At page 4294, you see at the bottom
 11 "Methodology". If I can pick it up at the top of the
 12 next page, you will see five lines down there is
 13 a sentence that begins in the middle:
 14 "The detailed data collection ..."
 15 Do you see that?
 16 A. I see that, yes.
 17 Q. "The detailed data collection requested by DG
 18 competition was therefore very resource intensive and,
 19 as such, could not be carried out with a large number of
 20 merchants. In order to maximise coverage and to ensure
 21 the best quality data, it was decided to focus the cost
 22 measurement only on large merchants in ten countries
 23 with the highest retail turnover in the EU. Eventually
 24 this represents a trade off between provision of data
 25 and sample size and representativeness. Furthermore,

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1 the data collection did not manage to reach the target
2 number of replies. Several merchants mentioned resource
3 implications and confidentiality concerns to justify
4 their refusal to participate.

5 "Ensuring the representativeness of the sample is
6 another difficult task. DG competition requested
7 a random selection of merchants from the consultant.
8 However, given that participation in this survey was
9 voluntary and that the large volume of data required
10 limited the number of participating merchants, one
11 cannot entirely rule out potential self-selection bias."

12 So we see from this that the onerous nature of
13 participating in the survey led to potential problem of
14 self-selection bias; do you agree?

15 A. There was a potential problem of self-selection bias,
16 yes.

17 Q. Then at paragraph 6, as we have just seen, the
18 Commission said:

19 "The determination of the nature of costs, in
20 particular the actual split between fixed costs and
21 variable costs, is crucial for the definition of the
22 cost functions of payment instruments and the
23 implementation of the MIT."

24 If costs are classified as fixed rather than
25 variable, that is likely to lead to a lower MIF,

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1 correct?

2 A. It is best to explain -- I was going to actually, when
3 I was thinking about this this morning, I was thinking
4 in terms of a diagram for the panel. So, everything
5 else being equal, if you have a higher variable costs of
6 cards or higher variable costs of cash -- let's think of
7 cash, higher variable costs of cash, that would lead to
8 a higher MIF.

9 Q. But is it right: if costs are classified as fixed rather
10 than variable that would lead to a lower MIF? You are
11 excluding costs to the MIT and so it leads to a lower
12 MIF?

13 A. That is right.

14 Q. Can we go to your second report, so that is D2.1, tab 3.
15 Page 521. This is your second report.

16 A. Okay.

17 Q. It is paragraph 472 on page 521.

18 A. Yes.

19 Q. You say there:

20 "In determining the proper classification of costs
21 for the MIT-MIF calculation is a challenging task. It
22 requires a different type of thinking about costs than
23 typically done by merchants' finance departments."

24 Can you explain what you mean by "a different type
25 of thinking"?

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1 A. When we think about the classification of costs and
2 how -- for example, in scenario 2, the move from cash to
3 cards over a three to four-year period, trying to say to
4 what extent the change would actually affect either the
5 value or the volume was not something that necessarily,
6 for example, Sainsbury's finance department would
7 necessarily think of independently.

8 Q. Would they be well placed to carry out that analysis or
9 do you think it would be beyond them?

10 A. It is certainly not beyond them because they manage to
11 do one in 2010/2011. But there will -- not to be too
12 arrogant -- be mistakes from an economic perspective.

13 Q. The fact you make a submission doesn't actually mean you
14 have got the classification right; it just means you
15 have put in a submission.

16 A. That may be the case.

17 Q. At paragraph 473, you say:

18 "It is the case that the cost classifications
19 provided by merchants and their answers may include
20 a degree of error, due to the problems described above.
21 However, on the whole...(Reading to the words)... of
22 the MIT-MIF."

23 That assumption would not be correct if
24 participating merchants provided answers which were
25 designed to lead to a lower MIF, ie I'm asking you to

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1 assume a systematic bias.

2 A. Well, the systematic bias could actually be either way.
3 I will explain, probably in a minute, that it is not
4 obvious that the finance departments, if they were
5 thinking of trying to get a lower MIF as a strategic
6 advantage, their finance departments might not actually
7 achieve it, they may go the opposite way.

8 Q. That is not quite an answer to the question, which is:
9 your statement that the errors would average out across
10 merchants wouldn't be correct as an assumption if in
11 fact participating merchants had provided answers which
12 were designed to lead to a lower MIF, because all the
13 biases would be down, so they couldn't cancel each other
14 out?

15 A. Sorry, I misunderstood your question. If it was all in
16 one direction, then the answer is yes.

17 Q. The merchants were told what the purpose of the survey
18 was before they participated, weren't they?

19 A. The merchants were surveyed across Europe and they were
20 told.

21 Q. Whether they acted on it or not, merchants, therefore,
22 had an incentive to categorise costs as variable rather
23 than fixed, didn't they?

24 A. If people were thinking strategically they may have
25 done. I'm not ruling that possibility out.

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1 Q. Can we go to E3.14, at tab 266. So we are back in the
 2 Rysman and Wright article, yes?
 3 A. Okay, yes.
 4 Q. If you go to page 5737. It is the paragraph that
 5 begins:
 6 "First, these surveys are often conducted only with
 7 larger retail firms."
 8 Can you see that paragraph?
 9 A. I do, yes.
 10 Q. They go on to say in the third line:
 11 "Second, asking retail managers to report costs is
 12 unlikely to give unbiased estimates of the cost of
 13 different instruments."
 14 Do you agree with them that there's that risk of
 15 bias in this sort of survey?
 16 A. There is that risk of bias and as an expert before this
 17 court I have got to recognise that and try and actually
 18 avoid that bias. The way in which I, quite frankly,
 19 have approached this is the reason why I have asked
 20 Sainsbury's for cost data and to do these -- annex B, is
 21 to try to get a fix without the bias and not necessarily
 22 have to rely on what Deloitte managed to do.
 23 In that sense, I'm comparing -- I do not rely on
 24 Deloitte, I use it to inform whether my estimates are
 25 in the ballpark.

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1 Q. So, as we know, Sainsbury's took part in the Deloitte
 2 survey, and we also know from Mr Brooks' evidence, it is
 3 first Brooks, paragraph 38, that Sainsbury's was aware
 4 of the purpose of the survey, correct, or would you like
 5 me to show you that?
 6 A. No, let's not waste time. Let's assume yes.
 7 Q. Can we go to D3, tab 3, which is Dr Niels' first report.
 8 Go to page 329, paragraph 6.75, he says:
 9 "I have also assessed the extent to which
 10 Sainsbury's allocation of total costs between fixed and
 11 variable may have been subjective. To do this, I have
 12 reviewed Sainsbury's final survey submissions to
 13 Deloitte in several earlier draft versions of this
 14 submission. I have provided an overview of the cost
 15 allocations in the various drafts and how they changed
 16 in the different versions in appendix 2."
 17 If we go to page 422 we will find appendix 2.
 18 A. So this is yellow.
 19 Q. I don't need to refer to the detail of it.
 20 A. Okay, it is just for me to understand.
 21 Q. Mine is actually blue but it doesn't really matter.
 22 A. Okay.
 23 Q. But you were aware that he has carried that out, you
 24 rely on it and -- or you comment upon the exercise,
 25 rather?

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1 A. I comment on it and we will get on to what I rely on
 2 later --
 3 Q. We will. If you go to D2.1, tab 3, which is your second
 4 report. At page 522, at paragraph 482, and this is
 5 where you are commenting on the various Sainsbury's
 6 drafts, you say:
 7 "It is also not the cost that all cost items move
 8 from fixed to variable. For instance, out of the two
 9 relevant broad cash ...(Reading to the words)... 54% of
 10 cash costs move from variable to fixed but 13% also
 11 moved from fixed to variable."
 12 But as that demonstrates, the move in the
 13 Sainsbury's drafts was in favour of fixed rather than
 14 variable, wasn't it, the overall effect?
 15 A. The overall effect, yes.
 16 Q. If costs, as I think we have agreed, are classified as
 17 fixed rather than variable that is likely to lead to
 18 a lower MIF?
 19 A. That is correct, but may I clarify? Basically, if you
 20 go from the start -- and this is the example I say about
 21 the finance department not knowing quite what it was
 22 doing -- so, in the email of -- sorry, everyone, it is
 23 page 422.
 24 Q. This is confidential, if you are going to refer to the
 25 detail. I am not stopping you but we might need to go

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1 into close.
 2 A. I am trying to avoid --
 3 Q. I'm doing what you do for me.
 4 A. Thanks very much. In effect, what they -- Sainsbury's
 5 on their own did in 2010/2011 came up with an allocation
 6 and I was sent this version of the 5th/7th 2013.
 7 Q. So the first draft in this?
 8 A. The first draft, I was sent this and I commented on this
 9 saying "I don't understand what's going on here" because
 10 they have managed to actually reduce the number of
 11 categories that were by variable, compared with
 12 2010/2011, but the variable cost of cash actually had
 13 gone up significantly. So when it came to the
 14 estimates, which you can see in my report -- and we are
 15 referring to it, it is in table 7-6 -- if they had
 16 adopted their 2010/2011 categorisation, which they
 17 submitted to the Commission -- so in effect what
 18 happened between MDR -- does everyone have -- I'm sorry
 19 if I'm --
 20 Q. I'm actually about to come onto this, my next question
 21 is about table --
 22 A. Please do the question.
 23 Q. If that helps. First of all, you said you were shown
 24 the 5th July 2013 draft, had you already been retained
 25 by Sainsbury's in relation to this litigation?

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1 A. Yes, I was retained in October, late October 2012.
 2 Q. Did you see the other draft, did you see the 24th July
 3 draft?
 4 A. I was on holiday.
 5 Q. Did someone in your team review the 24th July draft?
 6 A. They must have seen -- I would assume so.
 7 Q. Were you involved throughout this process, you or your
 8 organisation?
 9 A. We were involved and it would have been my Rotterdam
 10 office who would have looked at this survey.
 11 Q. But were you principally responsible for it?
 12 A. I'm always responsible for anything I say in terms of
 13 this.
 14 Q. Let's go to D2.1, tab 3, which is your second report --
 15 A. Yes.
 16 Q. -- page 520 --
 17 A. Yes.
 18 Q. -- paragraphs 466 to 467, and table 7.6.
 19 A. Mmm.
 20 Q. My understanding of this is that if we are looking at,
 21 in relation to credit, the changes made by Sainsbury's
 22 to its cost classifications from its first draft to its
 23 final submission, would cause a MIT-MIF calculated on
 24 the basis of those costs to decrease by roughly
 25 threefold; is that right?

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1 A. This is why I need to explain the actual process. So,
 2 whoever -- I think it is Bruce Lessels or the
 3 department -- managed to come up with a survey that
 4 would have implied 0.31 and 0.29, you see the first
 5 email which is 5th July. If they had actually followed
 6 their classification in 2010/2011, basically they would
 7 have had MDR0062728, and then that 0.18.20 because they
 8 failed to actually be consistent and managed to actually
 9 get a higher MIT-MIF despite the incentive that you have
 10 outlined.
 11 So this is the error that they have made. When
 12 I received the 5th July email, I talked to my team and
 13 my team looked at the estimate and basically compared it
 14 with 2010/2011 and said: they are just not consistent.
 15 So what happened in the end was that they adopted
 16 eventually the 2010/11 classification and the rates came
 17 down, that is true, and the final submission is 0.09 and
 18 0.11.
 19 Q. So taking table 7.6, the MIT-MIF, comparing the analysis
 20 in the first draft with the final submission, the
 21 MIT-MIF -- resulting MIT-MIF decreased by roughly
 22 threefold, correct?
 23 A. As I say, if you had actually been consistent in
 24 Sainsbury's finance department, they should have
 25 employed 2010/2011 classification and they would have

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1 had something closer to the 0.118 and 0.20.
 2 Q. But am I right about the rate of decrease --
 3 A. Sorry, let me be very clear, there is a rate of decrease
 4 here.
 5 Q. That's also consistent -- I'm not saying this did or
 6 didn't happen, but it is also consistent with a merchant
 7 categorising cost so as to achieve a lower MIF?
 8 A. If you had had applied the 2010/2011 we actually have
 9 a MIT-MIF which is in the particulars of claim, which
 10 are in April 2013, which is a MIT-MIF based upon the
 11 scenario 1 of 0.04.
 12 MR JUSTICE BARLING: That's the one based on 2010/2011,
 13 which you say is the right one?
 14 A. It is but the thing is this is based on the different
 15 methodology. The 2010/2011 survey and the particulars
 16 of claim were based upon scenario 1, which is one
 17 transaction, and I have said I did not like that in my
 18 report, I wanted something different and in Deloitte's
 19 2011/2012, (a) the survey itself is not the same as 2011
 20 but they have also gone and asked different questions to
 21 elicit the avoidable costs over three to four years. So
 22 we are talking apples and pears here.
 23 PROFESSOR JOHN BEATH: So MDR0662728 uses scenario 1?
 24 A. No, it uses the 2010/2011 cost classification.
 25 PROFESSOR JOHN BEATH: Under --

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1 A. Under scenario 2.
 2 PROFESSOR JOHN BEATH: Under scenario 2, sorry.
 3 A. But we said "Look, at the start please do this, because
 4 you have submitted something to the Commission
 5 previously and you have got to have some sort of
 6 consistency". It is not that I wanted or I believe,
 7 even, Sainsbury's -- I mean they got it horribly wrong,
 8 horribly, and that's what I have detailed. And I hasten
 9 the add the first expert report is a totally and utterly
 10 different exercise because I viewed the final
 11 submission, and by the way, I actually -- I should state
 12 categorically, I was asked whether they should send this
 13 submission in and I said no because I was not happy
 14 about some of the supporting evidence. So when -- in
 15 June/July 2014 I started the process again, and
 16 Professor Beath that is the annex you have seen.
 17 PROFESSOR JOHN BEATH: Yes.
 18 A. I hope the Tribunal sees it is a quantitatively and
 19 qualitatively different exercise.
 20 PROFESSOR JOHN BEATH: Right.
 21 MR HOSKINS: In relation to reviewing these drafts, the
 22 Sainsbury's drafts, who at Sainsbury's was primarily
 23 responsible for dealing with you?
 24 A. David Brooks is head of finance and is still head of
 25 that particular department, but I was actually engaged

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1 with Mr Ed Anderson and Ms Kate Botting(?), who are in
 2 Sainsbury's legal team.
 3 Q. Was Mr Brooks aware of the function you were performing?
 4 A. Yes, as an independent outside expert. He was made
 5 aware that I was not there to try to get any particular
 6 figure.
 7 Q. If we go to paragraph 468 of your second report?
 8 A. Yes.
 9 Q. You say:
 10 "Secondly, in my own analysis, I have not relied on
 11 Sainsbury's cost classification but I have thoroughly
 12 reviewed all cost items and determined how they should
 13 be classified."
 14 A. Yes.
 15 Q. If we go still in this report to paragraph 744. It is
 16 page 577 --
 17 A. Yes.
 18 Q. -- you see what your results are. The resulting average
 19 MIT-MIF is 0.15% for credit cards. That's the figure
 20 you get taking the Sainsbury's data but reclassifying
 21 it, whether you think it is fixed or variable over the
 22 three to four-year period?
 23 A. That is correct. It is my classification. It is fully
 24 set out in annex B.
 25 MR JUSTICE BARLING: Sorry, I think I have missed something,

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1 I want to be sure before we leave this topic. When we
 2 looked at Dr Niels' report at tab 3 of D3, and we looked
 3 at the table which is confidential at page 422, which of
 4 those -- because it is so small I'm having trouble
 5 reading it -- drafts and scenarios is the one that you
 6 eventually -- is it the one dated 24th July 2013 on
 7 scenario 2, MDR0062728? Is that the one that represents
 8 your final position?
 9 A. It is not my final position.
 10 MR JUSTICE BARLING: No.
 11 A. Let's be very clear, these are emails about a process of
 12 filling out the Deloitte's 2010/2011 survey that was done
 13 in 2013. The eventual one, I think, was -- you are
 14 right it is too small -- but I think it was sent -- in
 15 fact, late September.
 16 MR JUSTICE BARLING: Yes.
 17 A. I think it is late September. But we don't have a date
 18 here. Basically there was confusion as to whether it
 19 was actually sent, and apparently it was sent even after
 20 I had said it wasn't fit for purpose.
 21 MR JUSTICE BARLING: None of these represent something which
 22 you thought was fit to be sent, is that the position?
 23 A. Exactly so.
 24 MR JUSTICE BARLING: Is that the position?
 25 A. Exactly. None of this. That's why I went through the

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1 process which you see in annex B, in the following year.
 2 MR JUSTICE BARLING: Could you just take me -- remind me
 3 where annex B is. I'm sorry, Mr Hoskins, I just want
 4 for my note to get this right. Where is your annex B?
 5 A. Annex B to the first expert report, so I think it is
 6 in --
 7 MR JUSTICE BARLING: D2.
 8 A. This is a weight lifting course.
 9 MR JUSTICE BARLING: I don't know whether this is
 10 confidential or not.
 11 MR BREALEY: D2.1.
 12 MR JUSTICE BARLING: It is in D2.1 the annex B, is it?
 13 MR BREALEY: Tab 3A.
 14 MR JUSTICE BARLING: Tab 3A. Right, okay, sorry.
 15 A. There is a letter from Mischon de Reya at the front.
 16 MR JUSTICE BARLING: It is at table B.
 17 A. So it is 659A.10, is the start. You can see the table
 18 of contents.
 19 MR JUSTICE BARLING: Right, I see.
 20 PROFESSOR JOHN BEATH: But the meat comes at A.83, doesn't
 21 it, where you actually give the reasoning behind the
 22 cost categorisation?
 23 A. That is right, sir.
 24 PROFESSOR JOHN BEATH: That's where the meat of the report
 25 is.

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1 A. I would say the meat is roughly --
 2 PROFESSOR JOHN BEATH: That's where the definitions are?
 3 A. It is where the definitions are and then I do
 4 a calculation. The whole purpose of this depth was to
 5 try to get a document that could be replicated by anyone
 6 who picked it up and could get the calculations and do
 7 sensitivity analysis. See, I recognise that Deloitte's
 8 and the confidentiality concerns in Deloitte's means that
 9 sometimes it is very hard to replicate.
 10 MR JUSTICE BARLING: Right. I think that's clarified that.
 11 Thank you very much. Sorry, Mr Hoskins, carry on.
 12 MR HOSKINS: Not at all. If we go back to your table 7.6,
 13 at D2.1, tab 3, 520. What we see in relation to credit,
 14 therefore, is five examples of a MIT-MIF based on
 15 different classifications of fixed and variable costs;
 16 is that correct? That's what that table is?
 17 A. There are different classifications, yes.
 18 Q. What that shows us is it proves the point of just how
 19 sensitive the MIT-MIF is to the classification of costs
 20 as fixed or variable, which the Commission described as
 21 critical, yes?
 22 A. It shows that if you get it wrong, then the numbers
 23 change, but the thing is, what you need to actually see
 24 is, if we go to the Deloitte's actual figure, that they
 25 quote, it is for credit cards, it is 0.13%. Now, let's

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1 get the causation right, the 0.15 is based on annex B,
 2 the 0.13, which they derive over 200-odd large merchants
 3 and we ought to define that as well, is 0.13.
 4 Q. It is not just if you get it wrong that it varies
 5 because fixed variable costs is a bit of science and
 6 a bit of art. It is subjective by nature. You accept
 7 that at paragraph 469.
 8 A. I do accept that.
 9 Q. All I'm saying is that, because of the degree of
 10 subjectivity in the classification of fixed or variable
 11 costs you can actually get a quite widely divergent
 12 MIT-MIF cost as you see in table 6, correct?
 13 A. You are able to achieve that.
 14 Q. Can we go to E3.10, back to the Commission's survey.
 15 A. Yes.
 16 Q. Tab 202, page 4297. At paragraph 13 the Commission
 17 says:
 18 "DG competition undertook computations of the MIT
 19 using all the data coming from surveyed merchants,
 20 including their allocation between fixed and variable
 21 costs. It has also undertaken a computation of the MIT
 22 which are based on...(Reading to the words)... The
 23 choice to deploy econometric techniques has been
 24 motivated by two main objectives. First reducing the
 25 dependency of the results on the merchant's judgments

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1 and cost nature and (2) treating the heterogeneity of
 2 merchants and trying to perform out of sample
 3 predictions."
 4 Then they go on to say:
 5 "First, econometric techniques are capable of
 6 identifying fixed and variable costs without relying on
 7 the merchants' views."
 8 Do you agree that the use of econometric techniques
 9 reduces the dependency on the merchants on judgments on
 10 whether costs are fixed or variable?
 11 A. It reduces the subjectivity but econometrics is not like
 12 pressing a button and getting the right result. If you
 13 are objectively measuring the wrong thing, and that's my
 14 contention here, then it is garbage in, garbage out.
 15 Q. Can we go back to your second report, D2.1, tab 3,
 16 page 520, paragraph 469 which we have seen you say:
 17 "It is the case that there is some degree of
 18 ...(Reading to the words)... which are themselves
 19 a matter of subjective judgment."
 20 In conducting its own econometric analysis, if
 21 anything, the Commission would have preferred a lower
 22 than a higher MIF, wouldn't it?
 23 A. Sorry, I don't quite understand the link to objectivity.
 24 Q. You say that, fairly, when you are putting together
 25 an econometric model, you have to make certain

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1 assumptions?
 2 A. That is right.
 3 Q. You have to use your skill?
 4 A. Yes.
 5 Q. So you say, well, econometrics involves a degree of
 6 subjectivity. My point to you is that the econometric
 7 model that the Commission created and carried out is not
 8 one that's created by someone with an incentive to
 9 produce a high MIF. The Commission would either have
 10 been neutral or may even have had a sneaking incentive
 11 to create a lower MIF, because that's what the
 12 Commission has been trying to do for years.
 13 So in terms of exercising subjectivity, it was the
 14 Commission who were being subjective and they had no
 15 interest in a higher MIF, correct?
 16 A. I think we need to get off the idea of subjectivity --
 17 Q. It is you that introduced it. It is 469, I'm dealing
 18 with your report.
 19 A. Okay, then I will explain it in very simple terms, in
 20 terms of what we are trying to measure: what we are
 21 trying to measure is the avoidable cost of going from
 22 cash to cards for a 10% increment over three to four
 23 years. That is a within firm estimation. Now, what
 24 they did econometrically was not that at all.
 25 It was an increment across a wide range of firms, so

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1 remember what "large" is here, it is 20 to 20 billion.
 2 20 million, 6 to 7, to 200 category, and then above that
 3 are very large firms. You can see there is an inherent
 4 number of different cost functions.
 5 They did it effectively with one year's data.
 6 PROFESSOR JOHN BEATH: I think what you mean is the only
 7 feasible set of data these people could have, because
 8 they have one year of data, is a cross-section?
 9 A. Is a cross-section it is not --
 10 PROFESSOR JOHN BEATH: So the only way you could estimate
 11 a fixed cost and variable cost is by fitting a linear
 12 line through this cross-section. I just make a factual
 13 point, I'm sorry.
 14 MR HOSKINS: No, it is very helpful.
 15 PROFESSOR JOHN BEATH: It is very hard to see how, if you --
 16 with given numbers, you fit a straight line through the
 17 cross-section, you can make any judgments at all about
 18 bias or trying to get particular results, the results
 19 are simply what the data you have -- they are embedded
 20 in the data.
 21 A. Yes, and --
 22 MR HOSKINS: I'm not trying to make submissions but, in
 23 a sense, that's what I was trying to get across because
 24 we have looked at Commission scenario 2, which is based
 25 on the merchant's approach.

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1 PROFESSOR JOHN BEATH: No, no --
 2 MR HOSKINS: You have my point, and the Commission itself
 3 says econometric analysis reduces the dependency on
 4 subjectivity.
 5 A. It is not about pressing the return button and get the
 6 right -- the thing is, if you are measuring the wrong
 7 thing, if you are thinking about the increment and you
 8 are thinking about all this huge range of firms from
 9 20 million to 200 or 12 -- 20 billion, you are not
 10 actually measuring -- if you don't take full account of,
 11 for example, the admitted variable bias issue,
 12 Professor Beath. So the econometrics, if it is not
 13 correct -- and I will show you why it is probably not
 14 correct -- when it produces certain estimates is
 15 objectively measuring the wrong thing. And, you know,
 16 what I will try to do and I --
 17 PROFESSOR JOHN BEATH: I think we could have a seminar on
 18 this but I don't think --
 19 MR HOSKINS: I think we are having a seven-week seminar.
 20 PROFESSOR JOHN BEATH: I just wanted to make a rigorous
 21 technical point.
 22 A. It was a very good point, sir.
 23 MR SMITH: When you say it is measuring the wrong thing,
 24 what exactly is wrong about it? What is the wrong
 25 thing?

1 A. Well, we have a cross-section of data, we have firms
 2 that go from 20 to Sainsbury's size, 20 million to
 3 Sainsbury's size, in that sample. There are all these
 4 different types of cross function and we are trying to
 5 estimate what the econometric scale across one year's
 6 data, across all these different sizes of firm.
 7 That is not really telling us what happens within
 8 a firm when you change the component of cash to the
 9 component of cards. Ultimately, that's what we are
 10 trying to measure. What changes? The avoidable cost
 11 over an increment. What's the increment? 10%. Is the
 12 10% reasonable or should it be higher, should it be
 13 lower? That's scenario 2.
 14 You know, I appreciate that there are these issues
 15 about DG competition wanting politically to get lower
 16 interchange fees. But my understanding, from living in
 17 Brussels and having been in the Commission, and
 18 understanding these political pressures, is that in this
 19 case, this was the economist team --
 20 MR HOSKINS: I'm not sure this is appropriate evidence, I'm
 21 sorry to interrupt. I don't want to go into what the --
 22 MR JUSTICE BARLING: I wouldn't worry too much about it.
 23 But I would still like to understand the answer better
 24 to Mr Smith's question, you know, about --
 25 MR HOSKINS: Can I see if I can manage it with a question

1 which is: is your main objection to the Commission's
 2 econometric analysis, the fact that it doesn't
 3 sufficiently take account of the heterogeneity of the
 4 merchants in the sample?
 5 A. We can do the heterogeneity --
 6 MR JUSTICE BARLING: Can you not answer yes or no to that
 7 question? It would help us.
 8 A. It is a no, it is more than the heterogeneity.
 9 MR HOSKINS: But is that part of it?
 10 A. It is part of it.
 11 Q. Well, that's a start.
 12 MR SMITH: Okay, apart from heterogeneity then, is it the
 13 fact that one only has one year of data, is that another
 14 issue you have?
 15 A. That is another issue. That is what it is. What we are
 16 trying to get here is the average transaction benefit.
 17 I'm not worried whether it is the average merchant or
 18 not, I'm worried about the average transaction benefit
 19 because I'm trying to get something that is actually
 20 measurable for the purpose of article 101.1. That's
 21 what I'm trying to measure. So I want to know what are
 22 the benefits of swapping cards and cash, and I don't
 23 think I'm getting that via the econometric approach, or
 24 at least there is something going on here -- and I will
 25 show you in practical terms later why I think it is

1 coming up with wrong estimates. Let's leave that for
 2 now.
 3 MR SMITH: Let me just ask you one very simple question,
 4 just this: are you saying that the econometric approach
 5 is a misconceived approach no matter what data you use?
 6 In other words, that it is --
 7 A. No --
 8 MR SMITH: -- simply not the way to do it, you should look
 9 at, as you have done, the actual costs of an enterprise.
 10 A. If we had managed to have ten years' worth of data and
 11 we had managed to account for all those reasons why
 12 costs change in a firm, or between firms, so as you get
 13 the issuers -- as you get larger, you have different
 14 things, you have legal departments coming in, so you
 15 have different fixed costs and all those other things.
 16 If it had taken account of that, you could understand
 17 it. But it is not taking into account that. It is
 18 trying to measure across firms when it is easier in this
 19 case actually to do, within the firm, and measure the --
 20 then the issue is, is that estimate representative?
 21 Then you have to work out whether it represents a fair
 22 share. That is the exam question.
 23 MR SMITH: Right, just identifying the issues you have with
 24 the data, it is period of time and the fact that the
 25 data doesn't sufficiently differentiate between sizes of

1 firm?
 2 A. The data itself goes between 20 and 20 billion, in terms
 3 of size, but we are not actually taking full account
 4 then of how things --
 5 MR SMITH: The cross balance may be different --
 6 A. The reasons why things are changing over time in terms
 7 of the cost function. So we have a large -- the implied
 8 increment in the econometric approach is rather large,
 9 so it is an empirical point, should it be large or
 10 should it be 10%, or should it be some other number?
 11 MR SMITH: Thank you.
 12 MR HOSKINS: Can we go to your annex B, so that is D2.1, at
 13 tab 3A. It is page -- I will ignore the 659A, it is
 14 page 127 in that tab. (Pause)
 15 A. I have 125.
 16 Q. So you don't have 127? It runs out?
 17 MR JUSTICE BARLING: Mr Cook has it. (Handed)
 18 MR HOSKINS: Have you got 126?
 19 A. I don't have 126 either.
 20 MR SMITH: Are you referring to bundle numbering or to the
 21 internal numbering?
 22 MR HOSKINS: The page I'm looking at has the number 659A.127
 23 on it.
 24 A. Sorry.
 25 MR HOSKINS: That's fine. It's not the easiest numbering

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1 system.
 2 A. So 126 is the DSS cost and cost of equipment.
 3 Q. Yes, and it is the top of 127 I want to look at. So at
 4 8.6:
 5 "Relative use of cash and cards in the UK in the
 6 past 10 years, the number of value and card
 7 transactions ..."
 8 I think it has been cut off. It probably should be
 9 "in the UK".
 10 A. Yes.
 11 Q. "... has been steadily increasing", I think it should
 12 say.
 13 A. Mmm hmm.
 14 Q. Then if we go over the page, 259, you say:
 15 "However, the increase in card transactions cannot
 16 be directly interpreted as a displacement of cash
 17 transactions, as at least a part of this increase may be
 18 due to the general increase in the value and number of
 19 transactions."
 20 What you then go on to do is try to estimate the
 21 cash displacement rate; is that correct?
 22 A. Yes.
 23 Q. Then at 261 you come up with your estimate and your
 24 estimate is for an annual displacement ratio of about
 25 7%; is that correct?

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1 A. It states there 7% but that's a mistake.
 2 Q. What should it be?
 3 A. If I go to Dr Niels' table, figure 3.1, I think we will
 4 get a ballpark idea of what it should be.
 5 Q. The place I was going to take you to, to see if this was
 6 correct or not, let's see if we can shortcircuit it, was
 7 D3.1, tab 6. This is Dr Niels' second supplemental
 8 report. Then if you go to page 601, it is
 9 paragraphs 339 and 340. He supports what I hope is the
 10 same error that you have said there is, and he says that
 11 because you give an annual figure of 7%, given that we
 12 are dealing with a three to four-year period, what you
 13 should have actually said was a cash displacement rate
 14 of 20 to 25%; is that the error you are referring to?
 15 A. The error I refer to is the 7%. In fact, the next error
 16 is actually in Dr Niels' next sentence. It is not
 17 an error in the sense that if you take cards, that is
 18 debit and credit cards, you would get that figure, but
 19 we are talking about credit cards and, hence, I wanted
 20 to go to figure 3.1 of Dr Niels' first report just to
 21 give you a --
 22 Q. So you agree with his correction there at 340 but you
 23 want to -- he deals with cards and you want to clarify
 24 it further in relation to credit cards; is that correct?
 25 A. Yes, sir.

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1 Q. Show us what you want to --
 2 A. It is figure 3-1 of Dr Niels' first report. It gives
 3 you an overview of how things have changed in the UK.
 4 Q. 247, Mr Brealey kindly informs me.
 5 MR BREALEY: D3, 247.
 6 A. D3.
 7 MR HOSKINS: D3, tab 3, page 247.
 8 A. So figure 3.1, which is on 247, the point I'm making is
 9 that if you see over -- it is a very nice figure going
 10 from 2000 to 2014, credit cards is the -- can everyone
 11 see the colour at the bottom? It is the very dark one.
 12 That is credit cards. You will see share of the payment
 13 methods, it actually has not moved much. Let's assume
 14 zero.
 15 The displacement of cash, which I assume is the ATM
 16 and cash, which is the light green, so cash is getting
 17 squeezed. What's squeezing it is actually the debit.
 18 So the shift is actually the debit card. That's also,
 19 by the way -- we see that, a similar picture, in
 20 Australia.
 21 Q. So what is the correction you want to make to your
 22 figure, D2.1, tab 3A, page 130, paragraph 261?
 23 A. So the Commission has an increment of 10% but if you
 24 took these figures on face value, the cash displacement
 25 to credit card would be 0.

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1 Q. You are changing your evidence from annual displacement
2 ratio of about 7% and you want to say it is now 0?
3 A. I'm just looking at this figure saying, look, we have to
4 sort of step back --
5 Q. But what's your evidence, because we have got your
6 evidence at the moment -- let's look at it, it is
7 D2.1 --
8 A. The reason --
9 Q. Please let's look at, this is important.
10 A. Sure.
11 Q. D2.1, tab 3A, page 130, paragraph 261. Now, there is
12 a fair bit of reasoning before that, but the punchline
13 is the last sentence of 261:
14 "This corresponds to an annual displacement ratio of
15 about 7%."
16 What is now evidence now? What's the figure that
17 you want to give?
18 A. Look, I would be quite happy if we keep to the
19 Commission's 10%, as a very conservative figure.
20 MR JUSTICE BARLING: So you change your 7% -- you prefer to
21 have 10% there; is that what you are saying?
22 A. No, the point about this paragraph is to say was the
23 Commission's 10% reasonable? And I made the point,
24 which is erroneous, that it looks like 7%. If you go to
25 the figure, it could be 0 but I'm simply saying, look,

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1 let's keep to 10%.
2 MR JUSTICE BARLING: You say it doesn't matter what it is?
3 A. It doesn't matter. It doesn't matter, we could actually
4 have said zero.
5 MR JUSTICE BARLING: As a matter of interest why did you say
6 it was 7 again, what was the mistake?
7 A. Because I looked at it and I basically, as Dr Niels has
8 pointed out, I have made an arithmetic error and if
9 Dr Niels' calculation -- he made -- he suggested it was
10 25%, and that was for cards, and I'm making the point
11 that actually the growth or the substitution seems to be
12 debit card and cash, not credit card and cash.
13 MR HOSKINS: To be fair to Dr Niels, he was actually
14 following through the logic of your 7%.
15 A. He did.
16 Q. That was not his own figure, he said on your own
17 analysis of 7% that should have been the correct figure
18 if you followed the logic through.
19 A. If I followed the logic in terms of credit cards but in
20 terms of -- sorry. He followed my logic, my logic was
21 wrong. It should have been on credit cards. I got the
22 arithmetic error. This 25% though is on cards and, as
23 I suggested in figure 3.1, the substitution looks to me
24 on this basis of this evidence from cash to debit, not
25 cash to credit.

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1 Q. But you are ignoring charge cards, aren't you, in figure
2 3.1? We are dealing here with credit and charge cards
3 as against cash, aren't we? If you include charge
4 cards, then the displacement is more marked, isn't it?
5 A. I can't even read that up there.
6 Q. Well, the charge card is the light blue.
7 A. Yes.
8 Q. You will see that colour, it is -- if you go on the
9 vertical axis, 80%, you will see a little blue block.
10 We have all got different colours. It is a dark grey.
11 The first block between the 80 and 90 on the vertical
12 axis?
13 A. That looks like it has grown by, let's say, 5% over the
14 period.
15 Q. You have to add that in when you are comparing
16 displacement of cash as against credit cards.
17 A. I agree.
18 Q. So you have to put that in as well?
19 A. Yes, we should.
20 Q. In terms of the costs, because we are looking at here
21 costs which vary over time in terms of handling cash, as
22 opposed to accepting cards, and in this specific
23 instance credit cards, but the costs of accepting debit
24 and credit cards, it doesn't matter, you have to look at
25 them altogether, because the infrastructure is the same,

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1 whether you are accepting a debit or a credit card.
2 A. Mmm hmm.
3 Q. So the distinction you make in saying you have to look
4 at just credit cards isn't correct, is it, because the
5 infrastructure is the same, therefore one is looking at
6 the total costs?
7 A. The infrastructure may be fixed costs which are not
8 contained in the calculation. If they don't vary over
9 time, that's the three to four years. If they do, they
10 are in.
11 Q. For this purpose, there is no utility in the distinction
12 between debit or credit because the infrastructure is
13 the same: yes or no?
14 A. In terms of the actual increment, can I think about it
15 for a few more minutes?
16 Q. We do have to move on. I have one more question on this
17 topic --
18 PROFESSOR JOHN BEATH: Before we move on, and while he is
19 thinking about it, could I be assured that the data set
20 that was used to construct figure 3.1 is exactly the
21 same as the data set that was used to construct figure
22 B6.5?
23 MR HOSKINS: Sir, 3?
24 PROFESSOR JOHN BEATH: In Mr von Hinten Reed's second
25 report, before the phrase we have been looking at about

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1 displacement ratio, it is based upon a chart.
 2 MR HOSKINS: Sir, can you give me the bundle reference?
 3 PROFESSOR JOHN BEATH: Sorry, D2.1, tab 3, 659A.129, then on
 4 the page before the statement about 7%, the paragraph
 5 says it was based upon this calculation and this figure,
 6 and it covers not quite the same but almost the same
 7 period, has a larger aggregation of units, I just wonder
 8 whether it is the same data set used.
 9 MR HOSKINS: I will ask Dr Niels --
 10 MR JUSTICE BARLING: In that case --
 11 MR HOSKINS: I have one more question on this, otherwise we
 12 will lose the chain. So if you will just let me finish
 13 off.
 14 MR JUSTICE BARLING: Okay, go on.
 15 MR HOSKINS: I need to go back to D3.1, tab 6, page 601. At
 16 paragraph 3.41, he says:
 17 "As I explained above, the Commission's medium-term
 18 approach...(Reading to the words)... over a three to
 19 four-year period."
 20 Then he goes on to say:
 21 "Given that a larger level of cash displacement
 22 ...(Reading to the words)... timeframe ..."
 23 You corrected your error, but if you have a higher
 24 cash displacement rate, that provides evidence that
 25 a greater proportion of fixed costs should be included

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1 than the medium-term approach considers.
 2 I want to unpack, because that obviously includes
 3 the area you corrected, but is it correct that the
 4 greater the cash displacement, the greater proportion of
 5 fixed costs should be included than the medium-term
 6 approach suggests, ie the greater the cash displacement,
 7 the less costs are fixed?
 8 A. The greater the cash displacement, the costs that are
 9 displaced will increase.
 10 Q. Therefore it should be variable rather than fixed?
 11 A. It should be variable rather than fixed.
 12 MR HOSKINS: Sir, that is a good point to break.
 13 MR JUSTICE BARLING: Good, right, we will have a break.
 14 (3.20 pm)
 15 (A short break)
 16 (3.30 pm)
 17 MR HOSKINS: I'm glad it is Friday. Am I allowed to say
 18 that?
 19 MR JUSTICE BARLING: Yes, you are now.
 20 MR HOSKINS: It's too late.
 21 PROFESSOR JOHN BEATH: Some of us have been away from home
 22 for a while.
 23 MR HOSKINS: There we are.
 24 MR JUSTICE BARLING: Okay.
 25 MR HOSKINS: I have an answer to Professor Beath's question

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1 on whether these are based on the same data. The answer
 2 is: they are not.
 3 PROFESSOR JOHN BEATH: They are not, okay.
 4 MR HOSKINS: So if we go to Mr von Hinten Reed's figure 6.5,
 5 which is at D2.1, tab 3, 659A.129 --
 6 PROFESSOR JOHN BEATH: Yes.
 7 MR HOSKINS: -- you will see that the source stated there is
 8 the UK Cards Association --
 9 PROFESSOR JOHN BEATH: Yes.
 10 MR HOSKINS: -- and have debit cards credit and charge cards
 11 cash and cheques. Figure 3.1 in Dr Niels' report, so
 12 that is D3, tab 3, 247 came from MasterCard internal
 13 documents.
 14 PROFESSOR JOHN BEATH: Thank you.
 15 MR HOSKINS: Whether they obtained information from the UK
 16 Cards Association, I don't know, but they are not on
 17 their face from the same source.
 18 PROFESSOR JOHN BEATH: Thank you.
 19 MR HOSKINS: Obviously, it is clear, figure 3.1 includes
 20 more types of payment.
 21 PROFESSOR JOHN BEATH: Yes. That's why I mentioned in
 22 relation to Mr von Hinten Reed's -- it seemed to me
 23 aggregating things together.
 24 MR HOSKINS: Yes.
 25 There was a question that Mr von Hinten Reed asked

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1 for more time to think about, I don't know if he wants
 2 to take up that --
 3 A. Yes, just a small -- in terms of thinking about common
 4 costs and fixed costs, in annex B, 659A.34, so in
 5 effect, we have the first table which is table B2.13 on
 6 debit cards. The second table is overleaf, B2.14 on
 7 credit cards. So I have separately treated the fixed
 8 and variable costs involved in debit and credit card
 9 payments. To the extent that there are common aspects
 10 to them, they are in the cost allocations. In my view,
 11 the increment is not the place to actually change. What
 12 we are trying to ask there is, what is the change that
 13 we observe from cash to a credit, or in charge card, not
 14 a debit card. That's not what we are trying to assess
 15 here.
 16 So I have actually calculated the MIT-MIF separately
 17 for the credit card and the debit card, the debit card
 18 being slightly higher.
 19 Q. Can we go to E3.10, which is the Commission's survey
 20 again.
 21 A. Sure.
 22 Q. Tab 202, page 4315, paragraph 82. So E3.10, tab 202,
 23 page 4315. It is paragraph 81, the Commission says:
 24 "Merchants in this population are likely to be
 25 heterogeneous with respect to the relative cost payments

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1 ...(Reading to the words)... need to be taken into
 2 account."
 3 A. Mmm.
 4 Q. Skipping the next sentence:
 5 "The size of the merchant may also have an impact
 6 since a larger size may imply different organisation of
 7 the business or a specific payment process and therefore
 8 a different transaction cost."
 9 First of all, do you agree with the Commission that
 10 the relative costs of payment methods may vary between
 11 merchants?
 12 A. Yes.
 13 Q. Do you agree that one of the factors that may have
 14 an impact on costs is the size of the merchant?
 15 A. Yes.
 16 Q. Can we go to E3.14, tab 266. It is the Rysman and
 17 Wright article. If we can go to page 5737. We looked
 18 at this again earlier in another context. It is
 19 a second complete paragraph on the page that begins
 20 "Firstly surveys are often conducted":
 21 "Firstly surveys are often conducted only with large
 22 retail firms, firms that will tend to have lower costs
 23 of accepting cash due to the economies of scale involved
 24 in cash handling, as opposed to cards which are fairly
 25 scale invariant."

1 Do you agree that large retail firms will tend to
 2 have lower costs in accepting cash due to economies of
 3 scale?
 4 A. Yes.
 5 Q. Can we go to E3.5, tab 99A. This is the Rochet and
 6 Tirole article from 2008, yes?
 7 A. That is correct.
 8 Q. The numbering is 2194A, it's 0029 that I would like to
 9 go to. You will see the third paragraph on that page
 10 begins "First, in the short run"; do you see that?
 11 A. Yes.
 12 Q. If you skip five lines down, there is a sentence that
 13 begins:
 14 "Third, merchants are heterogeneous and an IF that
 15 properly guides cardholders' decisions must reflect the
 16 ...(Reading to the words)... at the social optimum."
 17 Do you agree with that?
 18 A. In terms of the statement, yes.
 19 Q. Can we go to E3.10, tab 202, so the Commission survey
 20 again. E3.10, tab 202 at 4295. Again, it is something
 21 I think we looked at in another context. The first
 22 paragraph in that page, paragraph 4 continues at the top
 23 of the page. If you go up from the bottom of that
 24 paragraph seven lines, you get to a sentence that
 25 begins:

1 "In order to maximise coverage ..."
 2 It begins in the middle of the page.
 3 A. Yes.
 4 Q. The Commission says:
 5 "In order to maximise coverage and to ensure the
 6 best quality data, it was decided to ...(Reading to the
 7 words)... Eventually, this represents a trade off
 8 between precision of data and sample size and
 9 representativeness."
 10 We see from that the Commission study only took
 11 account of large merchants, yes?
 12 A. Large merchants above 20 million.
 13 Q. The Commission believed that that had implications for
 14 the representativeness of the study, correct?
 15 A. In that it didn't actually have small firms in it.
 16 Q. Can we go to paragraph 23 in this document. The
 17 Commission says:
 18 "The report finally explores the possibility to
 19 obtain figures that would describe the whole merchant
 20 population and not only large merchants. This, however,
 21 requires very strong assumptions on the cost functions
 22 of the different payment means for smaller merchants.
 23 Taking this into account and after careful
 24 consideration, the Commission therefore considers that
 25 without further data from small merchants, it is not

1 possible to draw reliable conclusions from the study
 2 concerning the level of indifference of all merchants."
 3 Do you agree with the Commission that without
 4 further data from small merchants it is not possible to
 5 draw reliable conclusions from the study concerning the
 6 level of indifference of all merchants?
 7 A. You cannot get the level -- at least you can calculate
 8 what it should be for all merchants but you can't get
 9 the level of indifference for all merchants because we
 10 don't have small firms.
 11 Q. Do you agree it is not possible to draw reliable
 12 conclusions concerning the level of indifference of all
 13 merchants for that reason?
 14 A. The meaning of "indifference" to me is -- in the exam
 15 question is that firms are no worse off, that's the
 16 Article 101.3(b) criterion. So I can tell you that
 17 large firms will be worse off if, for example, they have
 18 to pay a MIF, which is estimated for the category 6
 19 to 7, but what I can't do is tell you whether actually
 20 the small firms are benefiting and offsetting the loss
 21 made by large firms. That's what I can't do.
 22 Q. Do you agree or not with the Commission's own assessment
 23 of its own survey that, without further data from small
 24 merchants it is not possible to draw reliable
 25 conclusions from the study concerning the level of

1 indifference of all merchants?
 2 A. In that context which I have just said, yes.
 3 Q. Dr Niels has sought to deal with this problem by relying
 4 on the cost data for the group of smaller merchants
 5 within the Commission's sample of large merchants, which
 6 he has taken as merchants with an annual turnover
 7 between EUR20 million -- sorry, the Commission's sample
 8 is EUR20 million and EUR200 million, but you are aware
 9 of that, aren't you, he relies on a subset of that data?
 10 A. I am and let's be clear it is category 6 to 7 and the
 11 larger merchants than that are category 8. So if
 12 I refer to that --
 13 Q. If we go to your second report, that's D2.1, tab 3, 523.
 14 D2.1, tab 3, at page 523, it is your paragraph 489, this
 15 is where you deal with what Dr Niels has done in terms
 16 of the sample he has taken, and you say:
 17 "I note that excluding the largest merchant
 18 seriously limits the reliability of results and their
 19 applicability to the UK. As 130 merchants out of 256
 20 included in the sample ...(Reading to the words)... as
 21 also shown by lower R2 values."
 22 Your preferred approach is to rely on the cost data
 23 submitted by Sainsbury's to Deloitte which you then
 24 reassess for fixed or variable, correct?
 25 A. That is correct and then I try and do sensitivity tests,

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1 which kind of replicate what category 6 to 7 would look
 2 like.
 3 Q. But your basic approach, by relying on the cost data
 4 submitted by Sainsbury's, is to rely on a sample of one,
 5 isn't it?
 6 A. It is a sample of 1 and then we conduct sensitivity
 7 tests to try to replicate data for a wider sample.
 8 Q. So you rely on a sample of one with sensitivity analyses
 9 and Dr Niels relies on a sample of 126?
 10 A. He relies on a sample of 126, but by excluding or
 11 focusing on the average merchant you are not actually
 12 focusing on the average transaction benefit, which is
 13 what we get from the literature as being the appropriate
 14 thing to measure.
 15 Q. Let's go to your second report, again. D2.1, tab 3 at
 16 526. Paragraph 505, you say:
 17 "We know, however, that in the UK a typical payment
 18 takes place at a large retailer."
 19 Then at the end of the paragraph you conclude:
 20 "Therefore, it is reasonable to assume that the
 21 MIT-MIF obtained for these retailers would be
 22 representative for the vast majority of the UK sales."
 23 Then at 506 you go on to say:
 24 "As a sensitivity check I consider how the MIT-MIF
 25 ...(Reading to the words)... based on the Eurostat data

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1 for the UK discussed above.
 2 "As I mentioned earlier, no data is available for
 3 the cost of payments to small merchants ...(Reading to
 4 the words)... being twice as high and three times as
 5 high. I apply the sensitivity test to three MIT-MIF
 6 estimates."
 7 You don't cite any evidential basis for your
 8 assumption that the MIT-MIF for small merchants is twice
 9 or three times as high as for large merchants, why is
 10 that?
 11 A. That is correct, because I do not have any evidence on
 12 the exact costs for cash and cost of payments for small
 13 firms. In 7.7, by the way, large merchants there are
 14 categories 6, 7 and 8.
 15 Q. Can we go back to the Commission's survey. That's E3.10
 16 at tab 202. This time can we go to page 4350, it is
 17 paragraph 185. It is E3.10, tab 202, page 4350. If you
 18 pick it up at paragraph 185:
 19 "As regards the distribution of the MIT MSC levels
 20 of individual merchants, the figures below indicate
 21 heterogeneity among the merchants in the sample. In
 22 particular, where the MIT MSC is between 0 and 0.5 for
 23 the majority of merchants, there is a non-negligible
 24 number of observations resulting in very high or
 25 negative sales."

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1 Then, over the page, the Commission sets out
 2 figure 11, which is a distribution of estimated MIT MSCs
 3 by number of merchants. We know from paragraph 14 the
 4 number of merchants in the sample is 254, yes?
 5 A. Yes.
 6 Q. The range of MIT MSCs is on the horizontal axis. You
 7 see that below 0, minus 2, minus 2 to minus 1, minus 1
 8 to 0.5 etc, that is the range of MSC MITs, yes?
 9 A. Yes.
 10 Q. Then the number of merchants within each range is on the
 11 vertical axis, yes?
 12 A. Yes.
 13 Q. We see from this graph that most merchants had a MIT MSC
 14 from the 0 to 0.5 range. That's in the middle of this,
 15 yes?
 16 A. Yes.
 17 Q. If you move to the right, we see around 15% had a MIT
 18 MSC in the 0.5 to 1% range, yes?
 19 A. Yes.
 20 Q. If you take the median point of those ranges, so for the
 21 first we are looking at the median of 0 to 0.5 is 0.25,
 22 and the median of the 0.5 to 1 is 0.75, yes?
 23 A. Could you re-do that one?
 24 Q. Of course. I'm looking, first of all, at the most
 25 popular category, 0 to 0.5. The median of that is 0.25.

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1 I'm just saying half of 0.5 is --
 2 A. I should have said yes.
 3 Q. If you go to the next range, 0.5 to 1, the median is
 4 0.75?
 5 A. Yes.
 6 Q. 0.75 is around three times higher than 0.25?
 7 A. Yes.
 8 Q. So that indicates that around 15% of larger merchants
 9 had a MIT MSC around three times higher than the
 10 majority of large merchants, yes?
 11 A. Yes.
 12 Q. Let's do the same exercise for the 1% to 2%. That's
 13 three in from the right. 1% to 2%.
 14 A. Yes.
 15 Q. Around 6 to 7% of large merchants had a MIT MSC in that
 16 range, yes?
 17 A. Yes.
 18 Q. Take the median of that, that's 1.5%, yes?
 19 A. Yes.
 20 Q. If you compare that again with the most popular range,
 21 the median of which is 0.25, what we see is 6% to 7% of
 22 large merchants had a MIT MSC around 6 times higher than
 23 the majority of large merchants, correct?
 24 A. Yes.
 25 Q. We will do the same again for the 2% to 5%, the median

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1 of that is 2.5%. There is about 5% in that range, yes?
 2 A. Yes.
 3 Q. That shows therefore that around 5% of large merchants
 4 had a MIT MSC that was 14 times higher than the
 5 majority, yes?
 6 A. Mmm.
 7 Q. Then, finally, if you take the last category on the
 8 right, around 2% of large merchants had a MIT MSC above
 9 5%, and if you do the same exercise that tells us that
 10 around 2% of large merchants had a MIT MSC that was
 11 20 times or more higher than the majority of large
 12 merchants; is that correct?
 13 A. Yes. Remember that you have got MSC, so you have got
 14 the acquirer margin coming in here.
 15 Q. But that's minimal compared to the --
 16 A. It is not so minimal all the time. But your point is
 17 taken.
 18 Q. Of course this survey was based only in large merchants,
 19 we know that, don't we?
 20 A. Yes, above 20 million.
 21 Q. One would expect the disparity to be even greater
 22 between small and large merchants, wouldn't you?
 23 A. Small in terms of small 1 to 5 and 6 or?
 24 Q. I mean small outside this category --
 25 A. So 1 to 5?

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1 Q. You accept that, the disparity you would expect to be
 2 greater?
 3 A. I don't know what 1 to 5 really is, but I'm just --
 4 I will assume for the purpose of this that it is.
 5 Q. I think you are saying the answer is yes, you would
 6 expect the disparity to be greater.
 7 A. I would expect it to be greater, based on my estimates.
 8 Q. In your evidence yesterday you referred on a number of
 9 occasions to the interest that issuers earned from
 10 cardholders. Just to be clear, are you suggesting that
 11 the interest that is earned in that way is large enough
 12 to cover the whole scheme costs; is that your evidence?
 13 A. The interest earned by issuers?
 14 Q. Yes.
 15 A. For issuing cards is greater than the cost of them
 16 issuing the cards.
 17 Q. Is the logic of that that no MIF is necessary?
 18 A. The logic of that is that lending, which is the process
 19 by which banks are offering credit, for example, would
 20 happen anyway, with or without the MIF.
 21 Q. Is your logic that no MIF is necessary?
 22 A. On that, yes.
 23 Q. How does that tally with what you also said yesterday,
 24 which is that a MIF is necessary to balance the two
 25 sides of a four-party system?

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1 A. If the revenues and the costs are all on one side, then
 2 the issuers are making more than the costs of actually
 3 providing the service.
 4 Q. So is your evidence that a MIF is necessary or not
 5 necessary?
 6 A. A MIF is necessary for the part which attracts
 7 transaction efficiencies. So the switch between cash
 8 and cards. To that extent, that benefit, I think
 9 a MIT -- a MIT-MIF measures it, also Visa 2 indirectly
 10 measures it and that's the justification for a MIF.
 11 Q. Your MIT-MIF analysis doesn't take account of interest
 12 revenue received by issuers, does it?
 13 A. That is right.
 14 Q. Can we go to E3.14. At 265, it is the Tirole article we
 15 have looked at earlier today.
 16 A. I'm with you.
 17 Q. Page 5696, it is the top of that page, the first
 18 paragraph, Tirole says:
 19 "There is substantial debate as to whether
 20 anti-trust authorities should factor profits into the
 21 computation of social welfare and they rarely do. Take
 22 issuer profits. If the profits associated with
 23 cardholders and...(Reading to the words)... leads to
 24 enhanced cardholder welfare. Ultimately, what fraction
 25 of profits should be factored into the computation of

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1 interchange fee is an empirical question which we will
 2 not attempt to resolve here but there is no question
 3 that not including any leads to a conservative estimate
 4 of the desirable interchange fee."
 5 Do you accept that it follows from that analysis
 6 that your MIT analysis results in a MIF that is too low?
 7 A. My MIT-MIF is based upon Article 101.3. It is not based
 8 on Rochet/Tirole or Rochet/Wright or Wright and
 9 something else. The issue that Jean Tirole comes up
 10 with here is quite interesting because if we are right
 11 that interest is above the cost of issuing cards, then
 12 what is the exact market failure that necessitates some
 13 subsidy from merchants to achieve that end? I don't
 14 think there is.
 15 Q. Let's assume, leave aside what the legal position is or
 16 isn't --
 17 A. That's your job.
 18 Q. That is right. If one accepts Tirole's analysis of
 19 profits as being capable of driving technological and
 20 pricing innovations as well as new entry, if one accepts
 21 that the test is social welfare, do you agree with his
 22 logic? I know you don't agree with everything but
 23 assume those factors are corrected, do you agree that
 24 failing to take account of them would lead to a MIF that
 25 was too low?

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1 A. A MIT-MIF could be too low compared with the social
 2 optimum.
 3 Q. Not all credit card holders are revolvers, are they?
 4 A. Transactors.
 5 Q. If a MIF were to take account of the interest that
 6 issuers earned from revolvers, then the MIF would be
 7 lower than it would otherwise be?
 8 A. Yes.
 9 Q. I think you said yesterday, but I want to clarify, would
 10 that, in effect, lead to a degree of cross subsidisation
 11 of revolvers by transactors?
 12 A. Transactors benefit or use the 28-day funding. The
 13 question, again, is the additionality of that particular
 14 funding thing and what benefits that actually derives.
 15 It is not a benefit in terms of transactions. If it is
 16 additional sales, well, a transactor is basically paying
 17 off next month what they have used this month and it is
 18 a fact of financial services that the reason why you
 19 offer a 28-day funding is to actually attract people
 20 into having a card and, eventually, you want to become
 21 revolvers, and that's where the stickiness comes in.
 22 Q. But do you agree that if the MIF were to take account of
 23 interest that issuers earn from revolvers, there would
 24 be a degree of cross-subsidisation of revolvers by
 25 transactors?

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1 A. Yes.
 2 Q. Some banks are primarily transactor banks, aren't they?
 3 A. Yes.
 4 Q. If a bank is primarily a transactor bank it couldn't
 5 operate without the MIF, could it?
 6 A. The issue is primarily and the issue then is basically
 7 whether that is a statement of truth.
 8 Q. But it is a possibility?
 9 A. It is a possibility. If, for example, their interchange
 10 income went down, they have an option of increasing
 11 cardholder fees. If that was really on the margin of
 12 the decision, but that's not obvious.
 13 Q. Does the MIT-MIF apply to online transactions? Is it
 14 intended to cover them?
 15 A. MIT-MIF was designed for the cash and cards, online is
 16 cards.
 17 Q. So is your MIT-MIF intended to cover online
 18 transactions?
 19 A. My MIF, the 0.15 covers till operations not online.
 20 Q. But a MIT-MIF is for not just for Sainsbury's, it is for
 21 all people who use MasterCard or Visa, isn't it? It has
 22 to be a general application?
 23 A. That's true, that's why I go back to the way in which
 24 I characterise it. What is the benefit we are trying to
 25 measure under Article 101.3. If it is basically the

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1 substitution of card for card, then there is no
 2 efficiency. Therefore, we don't need to measure it.
 3 Q. But your MIF as you said therefore does not take account
 4 of online transactions?
 5 A. That's true.
 6 Q. Can we go to E3.14 at 265. Back to the Tirole article,
 7 if we can pick it up at 5689. It is the second
 8 paragraph on that page, the first complete one, "Even
 9 for debit cards" it begins. It is page 5689, second
 10 paragraph down begins:
 11 "Even for debit cards ..."
 12 Do you have that?
 13 A. Yes.
 14 Q. At the end of that paragraph Tirole says:
 15 "More importantly still, e-commerce is vastly
 16 facilitated by the use of electronic payments. Cash or
 17 even cheques cannot easily substitute for cards for
 18 online purchases."
 19 Do you agree that cash is not generally suitable for
 20 online transactions?
 21 A. Yes.
 22 Q. Can we go to your second report at D2.1, tab 3,
 23 page 528. You say:
 24 "To assess efficiencies, the first issue to address
 25 is what would happen if the MIFs were not at the level

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1 obtained by Dr Niels, but at a lower level...(Reading
2 to the words)... by more efficient card transactions."
3 But that statement isn't true, is it, if a consumer
4 has a choice between buying online or going to a shop,
5 because then he does have a choice between a card or
6 cash, correct?
7 A. If he goes to the shop he has a choice between a card or
8 cash.
9 Q. A consumer has a choice between buying online or buying
10 in a shop?
11 A. Yes.
12 Q. Failure to take any account of online transactions will
13 result in a MIT-MIF which is too low won't it, because
14 the MIT-MIF has to be applied generally across all sorts
15 of transactions?
16 A. The MIT-MIF is applied to online transactions. One has
17 to think -- that is a distribution channel. So the
18 benefits are all in terms of the cardholders not having
19 to get out of bed or use their shoes to go down to
20 Sainsbury's, or wherever.
21 So I don't quite get where the efficiencies in terms
22 of transaction on the merchant's side -- and that's what
23 we are measuring -- come in. In fact, the merchants are
24 actually having to build out, imply lots of cost to
25 actually achieve that end. I think that's in John

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1 Roger's second statement.
2 Q. Are you suggesting that online transactions are a burden
3 for retailers?
4 A. Online transactions are basically another distribution
5 channel, if you are favouring one over another, what is
6 the additional sale you are getting? Well, it may be to
7 the individual. So Amazon may have, for example, a real
8 interest in promoting online sales but that's not
9 necessarily the case for a book store.
10 Q. Retailers set up online stores because they believe it
11 is going to be profitable, don't they?
12 A. They believe that they should actually earn a profit
13 otherwise they wouldn't do it.
14 Q. I'm not sure whether you accept or not that failure to
15 take any account of online transactions will necessarily
16 compromise the accuracy of a MIT-MIF?
17 A. The MIT-MIF is about measuring transaction benefits on
18 the merchant's side, of getting the efficiencies, of
19 transfer of cash to cards. I can't see where the
20 efficiency of card use comes in on its own.
21 Q. Is your evidence then that the MIT-MIF does not need to
22 take any account of online transactions?
23 A. If you come back up to the point of what is the benefit,
24 if you can't see the benefit according to 101.3 then you
25 don't need to measure it.

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1 Q. So your evidence is MIT MIF does not need to take any
2 account of online transactions?
3 A. That is my evidence, sir.
4 Q. Can we go to E3.14, tab 266. This is the Rysman and
5 Wright article. If we can go to 5736, pick the first
6 paragraph up from the bottom, where it says:
7 "Future work might consider ..."
8 Do you have that?
9 A. Yes.
10 Q. It says:
11 "Future work might consider a broader range of
12 possible...(Reading to the words)... case of internet
13 transactions, in case these make use of only payment
14 cards and no other payment instruments."
15 So Rysman and Wright believe that further work is
16 necessary in order to take account of online
17 transactions, correct?
18 A. They do, they don't consider that in the context of
19 101.3.
20 Q. The Commission's 2015 survey doesn't take any account of
21 online transactions, does it?
22 A. That's true.
23 Q. Amex is a closed platform, isn't it?
24 A. Yes.
25 Q. Looking, again, at what we have just been looking at,

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1 the Rysman and Wright at 5376, in the section I just
2 read out they said, in relation to future work that
3 might be necessary:
4 "For instance, existing theory does not cover the
5 case in which the relevant alternative to the open
6 platform cards is closed platform cards."
7 They think that further work is necessary to take
8 account of closed platform cards such as Amex, correct?
9 A. They believe that.
10 Q. The Commission's 2015 survey doesn't take account of
11 Amex where it is a relevant alternative to open platform
12 cards, does it?
13 A. It doesn't. I can't talk about the Deloitte or the
14 Commission but, in my view, again, there is no
15 efficiency benefit.
16 Q. Your analysis doesn't take any account of Amex where it
17 is a relevant alternative to an open platform cards,
18 does it?
19 A. That's true.
20 Q. Can we go to your first report, D2, tab 2, at page 263.
21 Paragraph 707, you say:
22 "For face to face payments, the most appropriate
23 comparator to card payments is cash."
24 Do you say that is true for both face-to-face debit
25 and credit card purchasers?

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1 A. Yes.
 2 Q. Can we go to Dr Niels' first report, that's D3, tab 3 at
 3 page 335. This is Dr Niels' first report, page 335,
 4 paragraph 6.99:
 5 "Cash is a comparator for credit card purchases. In
 6 its implementation of the ...(Reading to the words)...
 7 credit card purchases."
 8 You just told us that's your approach as well,
 9 correct?
 10 A. Yes.
 11 Q. "While cash would be a closer comparator for
 12 face-to-face debit card purchases ...(Reading to the
 13 words)... funds credit purchases."
 14 That's where you and Dr Niels not for the first time
 15 differ, correct?
 16 A. Yes.
 17 Q. Can we go to E3.6, tab 130A. You see that this is the
 18 article by Rochet and Wright. You see that on the
 19 second page of this.
 20 A. Sorry, I have got the wrong bundle. (Pause)
 21 Found it.
 22 Q. Thank you. Again, it is the horribly convoluted
 23 numbering. If you turn over the first page, you will
 24 see the title. You will see it is an article called
 25 "Credit card interchange fees" by Rochet and Wright,

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1 yes?
 2 A. I do.
 3 Q. Then if we can go to point 6. You will see in the
 4 middle of the page there is a paragraph that begins:
 5 "In our model, credit cards can be used for two
 6 types of transactions: ordinary purchases for regular
 7 convenience usage, for which cash or a debit card will
 8 soon provide identical benefits and for credit purchases
 9 where credit is necessary for purchases to be realised.
 10 Credit purchases include a range of different types of
 11 purchases such as unplanned purchases, impulse purchases
 12 and large purchases for which the consumer does not have
 13 the cash or funds immediately available to complete the
 14 purchase or for purchases to which the deferment of
 15 payment facilities facilitates the transaction. For
 16 ordinary purchases we assume credit cards are
 17 inefficient given that we assume ...(Reading to the
 18 words)... for ordinary purchases."
 19 Then they go on to say:
 20 "Taking into account both types of transactions,
 21 a monopoly card network always sets its interchange fee
 22 too high in our setting. Thus, regulators ...(Reading
 23 to the words)... only likely to give a lower bound of
 24 possible interchange fees that maximise consumer
 25 surplus."

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1 Now, the view you express in your report is not
 2 consistent with Rochet and Wright's view expressed
 3 there, is it?
 4 A. That is right for, I think, a good reason, that you are
 5 going to ask me.
 6 Q. Well, according to Rochet and Wright, if you accept
 7 their analysis, the MIT test that was developed by
 8 Rochet and Tirole in 2008 is not suitable for credit
 9 cards; that's their view, correct?
 10 A. That's their view. I think Jean Tirole in footnote 13
 11 makes the point, in his paper, that the MIT test has
 12 a few problems in terms of competition law.
 13 Q. Can we go to E3.14?
 14 A. Sure.
 15 Q. Tab 265 is the Tirole article, 5696. You will see
 16 a heading halfway down the page:
 17 "Subsidise competing means of payment."
 18 A. I do.
 19 Q. Tirole says:
 20 "The analysis assumed that alternative payment
 21 methods, cash/cheques, are fairly priced. This,
 22 however, need not be the case. In some countries banks
 23 are not allowed to charge for the costs they incur on
 24 cheques. In this case cheques are subsidised in that
 25 their costs are recovered through cross ...(Reading to

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1 the words)... cash is then unduly favoured."
 2 What he is doing is identifying that there are
 3 social costs of cash and your MIT analysis doesn't take
 4 account of those social costs of cash, does it?
 5 A. The MIT analysis consistent with Article 101.3 does not
 6 take account of those social costs of cash.
 7 Q. If one accepts Tirole's analysis it will be likely to be
 8 too low.
 9 A. If you view his assumptions as correct then it would be
 10 too low.
 11 MR HOSKINS: It is probably a good time to stop, sir, I'm
 12 about to move on to a new topic.
 13 A. Sir, may I make just one -- two small points about
 14 Rochet and Wright?
 15 MR JUSTICE BARLING: Yes.
 16 A. The existence of a credit card, we establish usually in
 17 terms of the restriction on whether you can actually --
 18 it is an objective necessity. When you get to 101.3,
 19 a credit card exists, so you have to ask yourselves,
 20 what is the benefit that Rochet and Wright are actually
 21 thinking about, that the MIF is actually contributing
 22 to. If I go to Rochet and Wright's model, you can look
 23 through the mathematics but, essentially, it is saying
 24 it aids rivalry between retailers.
 25 So using a credit card has some benefit between

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1 retailers. That is an additional sales argument at the
 2 retail level but he actually says, explicitly, in his
 3 model that there's no global additional sales to the
 4 totality of merchants which is our test.
 5 The second thing is that I think even -- I'm not
 6 saying even you -- but you have read the mathematics,
 7 but you also note that there is no interest in his
 8 model. So if, actually, as I have said before interest
 9 on the issuer side is greater than the cost, then the
 10 additionality of providing that credit is absent.
 11 I was given the homework last night of reading these
 12 lovely surveys and I really appreciate it because it
 13 brought home to me that we can have as many theories as
 14 possible, but ultimately they have got to be grounded in
 15 the law. I'm the economist, you are the lawyers, that's
 16 the basis.
 17 Q. Before we finish then, is your evidence that you believe
 18 your MIT-MIF complies with 101.3, but the logic, the
 19 result of everything we have seen so far is that what
 20 you are saying is, in order to comply with 101.3, one
 21 has to apply a MIT-MIF which Rochet, Tirole and Wright
 22 all consider would not be appropriate economically
 23 because it would be too low? That's your evidence?
 24 That is the impact of it, isn't it?
 25 A. The impact of Rochet Tirole is: I think we ought to

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1 measure transaction benefits. Everything apart from
 2 that I do not think is much use in the context of 101.3,
 3 where the central issue is actually fair share. That is
 4 not a straight economics point because you asked me
 5 yesterday: does economics worry about the level? Well,
 6 the law worries about the level and that's fair share.
 7 Q. Let's stick to economics because that's your expertise.
 8 A. Indeed.
 9 Q. Your evidence is that you would prefer a MIT-MIF which,
 10 according to Rochet, Tirole and Wright, would be too
 11 low?
 12 A. Yes.
 13 Q. Thank you.
 14 PROFESSOR JOHN BEATH: Might I ask exactly on that point,
 15 because I think this whole line of questioning arose in
 16 looking at the final sentence of the Rochet paper,
 17 E3.14, page 5696, tab 265.
 18 "The use of this term leads to a conservative
 19 estimate of the desirable IF."
 20 I think we should be careful that the word
 21 "conservative" is being -- as it seems to be being used
 22 is too low. In fact, if you take the range of
 23 theoretical results, the word "conservative" means it
 24 has not accounted for all the relevant factors. It
 25 could be either too low or too high.

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1 MR HOSKINS: Sir, can I respond to this with the legal
 2 submissions I made in opening, which is remember here we
 3 are in the context of the broad axe.
 4 PROFESSOR JOHN BEATH: Yes.
 5 MR HOSKINS: And the judges have applied the broad axe in
 6 the past and recognised the need to favour the defendant
 7 rather than the claimant. So when one is looking -- the
 8 reason why I'm taking you to all these articles is to
 9 show you there is a series of issues, a series of
 10 factors that would lead to a higher MIF that are not
 11 taken account of. My submission, giving nothing away,
 12 at the end in closing is going to be, if you want to
 13 apply the broad axe you have to be nice to me and you
 14 have got to take account of all these factors that
 15 aren't in the MIT-MIF.
 16 PROFESSOR JOHN BEATH: I take the point and I still believe
 17 I am correct in my use of the term "conservative" to
 18 mean not all factors taken into account. Okay.
 19 MR SMITH: Mr Hoskins, one query that we had. We had some
 20 mention earlier today of the introduction of the
 21 MasterCard World card in 2008/2009.
 22 MR HOSKINS: Yes.
 23 MR SMITH: It may well be in the documents but, if so,
 24 I haven't been able to find it. But did Visa have
 25 an equivalent premier card at any time, no need to

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1 answer this now.
 2 MR HOSKINS: No.
 3 MR SMITH: And if it did, can you give us a rough date as to
 4 when it was introduced. Thank you.
 5 MR JUSTICE BARLING: Thank you very much.
 6 Mr von Hinten Reed, I have already said to you you have
 7 to be very careful not to talk about your evidence or
 8 the case except in that one respect where you are going
 9 to raise it with the team.
 10 A. I appreciate that. Thank you very much, sir.
 11 MR JUSTICE BARLING: Have a good weekend.
 12 A. And you.
 13 MR JUSTICE BARLING: Thank you very much.
 14 (4.31 pm)
 15 (End of open session)
 16 (The court adjourned until 10.30 am on
 17 Monday, 22nd February 2016)

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