

# OPUS 2

## INTERNATIONAL

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

Day 17 Redacted

February 26, 2016

Opus 2 International - Official Court Reporters

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1 Friday, 26th February 2016  
 2 (10.30 am)  
 3 (Open session)  
 4 MR JUSTICE BARLING: Good morning Dr Niels.  
 5 A. Good morning.  
 6 MR JUSTICE BARLING: Good morning Mr Brealey.  
 7 MR BREALEY: Good morning.  
 8 MR JUSTICE BARLING: As you know we have got some visitors  
 9 this morning --  
 10 MR BREALEY: Yes.  
 11 MR JUSTICE BARLING: -- from the university. Can I just say  
 12 before you start, I'm pretty sure there won't be any  
 13 problem given where we are at, but we have to finish  
 14 pretty sharply this afternoon, at about probably 4.20 pm  
 15 would be the latest I think.  
 16 MR BREALEY: I think it is an absolute racing certainty that  
 17 we shall finish before then.  
 18 MR JUSTICE BARLING: Well done. Coming from a racing man,  
 19 I will rely on that.  
 20 DR GUNNAR NIELS (continued)  
 21 Cross-examination by MR BREALEY (continued)  
 22 MR BREALEY: Good morning Dr Niels. I'm going to move on to  
 23 the second of your proposed methodologies for exemption,  
 24 that is the adjusted MIT approach, yes?  
 25 A. Yes.

1

1 Q. We don't have to go to it at the moment but that is in  
 2 section 6 of your first report at bundle D, tab 3,  
 3 page 310. We will be going to it but D3, tab 3,  
 4 page 310, the second methodology is in section 6.  
 5 On the adjusted methodology I understand you are  
 6 prepared to adopt the information in the Deloittes  
 7 report but with certain adjustments, is that correct?  
 8 A. Yes.  
 9 Q. In essence you make three adjustments, if I can just go  
 10 through them and then we will look at them. First, you  
 11 prefer the scenario 3, whereas the Commission and  
 12 Mr von Hinten-Reed prefer scenario 2?  
 13 A. Yes.  
 14 Q. Second, you exclude large merchants from the survey?  
 15 A. There is an adjustment in terms of merchant size, yes.  
 16 Q. And third you take again the increased sales point but  
 17 this time you use Amex as a comparator rather than just  
 18 purely cash. I know you mix Amex and cash up, but Amex  
 19 is a comparator rather than just cash?  
 20 A. Well, I should clarify, that third adjustment is  
 21 actually two different things. One is the fact that  
 22 there are online transactions for which cash isn't the  
 23 right comparator, so I have used other comparators,  
 24 PayPal and Amex in particular and then the second of  
 25 those adjustments is an adjustment for the credit

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1 function, to recognise the credit functionality of  
 2 credit cards and therefore the right comparator there is  
 3 merchants providing credit themselves, so store cards in  
 4 essence and there I have used Amex as a proxy for the  
 5 costs that merchants would incur to provide credit  
 6 themselves. So that is also where the Amex numbers come  
 7 in.  
 8 I should also clarify that I have made those three  
 9 adjustments indeed to the EC cost data, but when I talk  
 10 about adjusted MIT there are also a number of conceptual  
 11 adjustments I have made to the whole concept of MIT, or  
 12 to how the European Commission has interpreted it.  
 13 Q. Okay. Now, what I want to do, I think you accept that  
 14 those in broad terms are the three adjustments, yes?  
 15 I understand that in section 6 there is a lot more  
 16 detail to it, but they are the three adjustments, and  
 17 I just want to establish the differences. If we can go  
 18 to bundle A, tab 1. Now, this is Sainsbury's' opening  
 19 submissions at tab 1 and if you go to page 82, this is  
 20 where we deal with your adjusted MIT approach. So  
 21 paragraphs 233 to 251. Now, I'm obviously not going to  
 22 take you through our submissions, I will take you  
 23 through the evidence, but what I would like to establish  
 24 is the reasons that they are increased and to what. So,  
 25 if I, for example, take paragraph 238, if you just read

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1 that, where you favour scenario 3 -- and I don't believe  
 2 the percentage is confidential? No.  
 3 So what I'm trying to establish is the importance of  
 4 the disagreement. That's essentially what I just want  
 5 to establish at the moment, the importance of the  
 6 disagreement. And at 238 we have set out -- it is based  
 7 on Mr von Hinten-Reed -- the difference between  
 8 scenario 2 and scenario 3 doesn't really amount to very  
 9 much.  
 10 Now, these were put in opening. MasterCard has not  
 11 challenged them. Clearly if you do, you and  
 12 Mr von Hinten-Reed may have to have a chat. But as we  
 13 understand it at the moment the difference between  
 14 scenario 2 and scenario 3 essentially would take  
 15 Mr von Hinten-Reed's percentage from 0.15 to 0.2. Have  
 16 you any reason to disagree with that? So just taking  
 17 his approach, but taking the scenario 3.  
 18 A. I think the difference is a bit bigger than that.  
 19 I would have to go back to my own calculations and to  
 20 the calculations referred to here, but if the question  
 21 is about the importance, it is -- this adjustment is in  
 22 essence the question: do you consider fixed costs as  
 23 part of the MIT. That is part a fundamental conceptual  
 24 question. I think there are very good reasons why fixed  
 25 costs should be included and I think it is also

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1 recognised by the Commission itself that if you include  
 2 fixed costs, the cash has a lot higher costs than just  
 3 the variable costs because cash has a bigger fixed cost  
 4 component than credit cards.  
 5 In a nutshell the reasons why I think fixed costs --  
 6 Q. Sorry Dr Niels -- I don't want to stop you but all I'm  
 7 trying to establish at the moment, otherwise my racing  
 8 certainty won't finish, is just the importance of the  
 9 percentage increase. This is all I want to focus on at  
 10 the moment; not what is in your section 6, just the  
 11 importance.  
 12 A. So if I can have a quick look at my numbers because  
 13 I think I discussed this in my report and also at  
 14 Mr von Hinten-Reed's calculation in his table 7, because  
 15 then I can --  
 16 Q. Maybe we can cut this short and you can do that at the  
 17 short break, but if I just take you where I'm going. So  
 18 paragraph 238 --  
 19 A. (sotto voce) Could I have my report please?  
 20 Q. Okay, you can do it now if you want to.  
 21 A. Not the detail but it is helpful for me to have my own  
 22 report in front of me.  
 23 Q. Of course, yes. You want the first report?  
 24 A. Yes.  
 25 Q. So Ms Love reminds me that at page 339 of the bundle.

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1 Does this help you? Page 126 of your report, 339 of D3.  
 2 All I'm trying to do at the moment Dr Niels is work out  
 3 the importance of the differences and at the moment I'm  
 4 putting to you that according to Mr von Hinten-Reed the  
 5 difference between scenario 2 and scenario 3 is not that  
 6 great -- obviously we have got to deal with it, but it  
 7 only leads to a marginal increase on his percentage.  
 8 A. I will come back to it.  
 9 Q. Okay.  
 10 A. My impression was that the difference is a bit bigger  
 11 than that but I will come back to it.  
 12 Q. Okay, that is the first adjustment. Then the second  
 13 adjustment is the exclusion of the large merchants and  
 14 if you go to paragraph 244 of the skeleton, at our  
 15 opening submissions, according to Mr von Hinten-Reed it  
 16 does increase the MIF significantly. So it is going  
 17 from his 0.15 and now it is going to 0.45 to 0.73. Does  
 18 that ring any bells or would you like to also take stock  
 19 of that over the short adjournment? All I'm trying to  
 20 establish is the significance of excluding large  
 21 merchants.  
 22 A. Yes, if you look at my table 6.4, there are three  
 23 columns, low, medium and high, and I think they are the  
 24 main -- so, the adjustments -- so the adjustment that  
 25 I make for this question of is it the average

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1 transaction or the average merchant, I prefer average  
 2 merchant and therefore I make the adjustment because the  
 3 Deloitte's survey is clearly biased towards the very  
 4 large merchants. So having made the adjustment I made,  
 5 you can see the difference in my table 6.4, that if I am  
 6 not mistaken the two columns to the right are already  
 7 adjusted with the -- have already made the adjustment  
 8 for large versus -- for taking out very large merchants.  
 9 So you can see leaving the very large merchants in, that  
 10 is the low estimate, so the first column of numbers you  
 11 get -- at the end you get 2.23 and then the adjustments,  
 12 one of the adjustments leads to 0.45 and the other  
 13 scenario is the high estimate leads to 0.73 which is  
 14 probably the same 0.45 and 0.73 here.  
 15 Q. Right.  
 16 A. So, yes, that is the difference that the size adjustment  
 17 makes. And I will come back to it but I think the  
 18 difference then still raises the question of what's the  
 19 difference between 0.45 and 0.73 and I think that is to  
 20 do with the other adjustment that we just talked about  
 21 whether you take the medium -- sort of the medium term  
 22 scenario or the long run scenario. So maybe the  
 23 difference between 0.45 and 0.73 answers the previous  
 24 question as well, but I can come back to that to  
 25 confirm.

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1 Q. Okay. So that is the second adjustment and then the  
 2 third adjustment, which I will call the Amex point, the  
 3 additional sales and the Amex point, you can see this at  
 4 paragraph 246, "online sales and face to face  
 5 transactions" and the adjustment for online adds another  
 6 0.27 and the adjustment for face to face adds a further  
 7 0.29. Again, this is based on Mr von Hinten-Reed's  
 8 calculations, we mentioned it in opening and we haven't  
 9 had any push back, but maybe it is something you want to  
 10 verify over the short adjournment?  
 11 A. No, I think at the end, after those adjustments I end up  
 12 with a MIT range between -- so a MIT-MIF range between  
 13 0.73 and 1.05. That's in my table 6.11. And that is  
 14 indeed after having made all the adjustments, so the  
 15 incremental difference, if you like, is probably  
 16 thereabouts, so 0.27, 0.29, but again to be clear,  
 17 I wouldn't label that the Amex adjustment, it is two  
 18 adjustments, it is one to capture online as  
 19 a relevant -- where other payment methods are relevant  
 20 comparators including Amex and the credit facility point  
 21 adjustment -- the credit facility adjustment, so this is  
 22 two adjustments.  
 23 Q. I call it the Amex point, Dr Niels, because you are not  
 24 taking cash solely as a comparator now, you are taking  
 25 Amex.

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1 A. I'm taking Amex and PayPal for online and the idea is in  
 2 line with Rochet and Wright that for the credit facility  
 3 you take store card costs or merchant credit provision  
 4 costs; as a proxy for that I have taken Amex.  
 5 Q. Good, right, so that is that established. Could we go  
 6 to your first adjustment. One of the reasons you have  
 7 rejected scenario 2 is self-selection bias, correct?  
 8 A. Yes.  
 9 Q. Could you go to bundle E3.6 please. You will need E3.6  
 10 and you will need J2, which is the transcript bundle.  
 11 So E3.6, tab 126, which is our famous MasterCard 2008  
 12 cost study, do you have that?  
 13 A. Yes.  
 14 Q. And J2, which is 28 of the transcript, 1399. It is  
 15 tab 11 page 1399, page 28.  
 16 Now you were in court obviously, you told us  
 17 yesterday, when Mr Sidenius was giving evidence,  
 18 correct?  
 19 A. Yes.  
 20 Q. So, if you go first to the 2008 UK cost study.  
 21 A. Yes.  
 22 Q. Internal page 7. Page 2504. I took Mr Sidenius through  
 23 this. Have you read this?  
 24 A. Yes.  
 25 Q. Have you re-read it after the evidence that Mr Sidenius

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1 has given?  
 2 A. No.  
 3 Q. You will see there that there is a data collection  
 4 process and quality assurance.  
 5 A. Yes.  
 6 Q. And you see at the bottom:  
 7 "Edgar Dunn draws on its extensive experience in  
 8 payment services, utilises statistical methods ..."  
 9 It goes on. Second paragraph over the page at 2505:  
 10 "Upon receipt of the completed questionnaires EDC  
 11 undertook a review of the data quality based on  
 12 statistical analysis of the returns and our market  
 13 experience."  
 14 So this whole section is dealing with how Edgar Dunn  
 15 looks at the quality of the data, do you accept that?  
 16 A. Yes.  
 17 Q. If you go to the passage of Mr Sidenius' evidence at  
 18 page 28. Have you read this?  
 19 A. I was in court when he said this.  
 20 Q. Have you read this since the --  
 21 A. No I haven't.  
 22 Q. So I took Mr Sidenius to this page 7, which is dealing  
 23 with how the quality of the data is checked. So I say:  
 24 "Question: If you go to page 7, as with many  
 25 studies you have to check the quality of the data. So

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1 as I understand it, you are telling the reader, me and  
 2 the Tribunal and the others ... that you draw on your  
 3 extensive experience in payment service and utilised  
 4 statistical methods basically to validate the quality of  
 5 the data.  
 6 "Can you assist the Tribunal how you go about  
 7 ensuring that the quality of the data is achieved?  
 8 "Answer: Yes.  
 9 "Question: But why is that? Is that because of  
 10 some sort of self-selection bias? The issuers here know  
 11 the reason that they are giving the data, I guess. They  
 12 know that it is going to go and form the basis of an  
 13 interchange fee?  
 14 "Answer: You could argue that. In our case I think  
 15 it is just as much if we are going to put our name on  
 16 a study you want to make sure that that data is correct.  
 17 We are not just going to accept what people tell us."  
 18 So there I am putting to Mr Sidenius that you are  
 19 getting data from the issuers, the banks, and arguably  
 20 there is the same self-selection bias. They know the  
 21 purpose for which it has been provided, that is to say  
 22 the level of an interchange fee; do you accept that?  
 23 A. Well, self-selection bias is I think slightly different  
 24 concept but if you -- if the question is about do  
 25 issuers, at the time when they submit data to EDC, do

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1 they know what it is for; yes, I accept that.  
 2 Q. If you go on. Rather than me read it out, if you want  
 3 to read it. (Pause).  
 4 A. No I'm fine.  
 5 Q. We will go over the page then at 1401, where I ask him:  
 6 "Question: So you are looking for outliers, are  
 7 you?  
 8 "Answer: We are looking for outliers as well as  
 9 understanding the organisational structure of them.  
 10 You know, how big is the department they're running and  
 11 how many applications ...  
 12 "Question: I see. Even after that, drawing on your  
 13 expertise, as I understand it you get the cost study  
 14 audited by, or you did, by Ernst & Young; is that right?  
 15 "Answer: As I said, this was the EC Commission that  
 16 requested that the study ... it was a complete  
 17 independent process.  
 18 "I think Deloitte -- no, it was Ernst & Young ..."  
 19 So Ernst & Young, he got it wrong, it wasn't  
 20 Deloitte, it was Ernst & Young, audited the data.  
 21 My simple question to you Dr Niels is why would you  
 22 reject the Deloitte data on self-selection bias when  
 23 you rely on a report which has the same capability of  
 24 self-selection bias? It just works the other way.  
 25 A. I think comparing the two studies, there is a very

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1 significant difference between the two. The EDC cost  
 2 studies is, as we saw yesterday, an established  
 3 methodology, has been carried out periodically for  
 4 30 plus years. EDC has developed a really good  
 5 understanding of the issuer's costs. Probably the  
 6 issuers as well they know what sort of costs, what the  
 7 categories mean when they are asked for that and there  
 8 is a process in place for verification, for independent  
 9 audit indeed. Looking at that, in its own right,  
 10 I think that that was for me good enough reason to say  
 11 I rely on this data. The merchant cost study is  
 12 a completely different story, there were grave  
 13 difficulties in getting the data, which was one thing  
 14 that has been acknowledged by the European Commission.  
 15 Still it is the best data that there is, but there were  
 16 great difficulties. The response in itself had  
 17 an element of self-selection, as in it was in the end  
 18 they ended up with the larger -- with much more larger  
 19 merchants and I also made adjustments from that. But  
 20 also importantly this was the first time ever that  
 21 someone did an exercise like this. It took them many,  
 22 many years, but importantly it hadn't been done before,  
 23 no one had asked before "Okay, what exactly, what type  
 24 of costs are we after?" and in particular asking the  
 25 merchants themselves to make this separation themselves

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1 between fixed and variable cost of cash handling, where  
 2 normally, in their normal course of business, probably  
 3 they don't look at it that way. That is what caused  
 4 some difficulty and that is what I pointed out, the  
 5 difficulty it seems to have been taking place at  
 6 Sainsbury's as an example of that. It is very hard to  
 7 ask merchants: well do it yourself, this fixed versus  
 8 variable.  
 9 So that was one of my reasons why I would rely more  
 10 on the overall cost data in the merchant -- in the EC  
 11 merchant cost study and therefore in the long-term the  
 12 econometric -- the third scenario -- it just takes the  
 13 data overall, and therefore doesn't rely on this  
 14 self-selection by merchants of what is fixed and what is  
 15 variable.  
 16 So that was one reason but I think actually my other  
 17 and probably my main reason for preferring the long-term  
 18 scenario that the Commission analysed is this point  
 19 about I think fixed costs, or long run marginal costs if  
 20 you like, is the right basis for the MIT.  
 21 Q. But on the self-selection bias point you are simply not  
 22 giving any credit whatsoever to the team at Deloitte's,  
 23 the economists and the team at the Commission for  
 24 checking the quality of the data, are you? You are not  
 25 giving any credit?

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1 A. I'm giving credit to the -- Deloitte's didn't play the  
 2 same role as EDC in the issue, there wasn't that same  
 3 interaction. It is my understanding that Deloitte's just  
 4 was given the data from the surveys as it was, there  
 5 wasn't then a interaction between Deloitte's and the  
 6 merchants. So I'm not criticising Deloitte's for this  
 7 aspect. And then I'm giving the economists at the  
 8 European Commission a lot of credit because the  
 9 economists said, well we can also look at this data  
 10 econometrically and that is the bit in the EC merchant  
 11 cost study that I then rely most on.  
 12 Q. You say you are giving them credit but the economists at  
 13 the Commission don't actually like scenario 3, they  
 14 prefer scenario 2. You are not giving any credit to  
 15 them whatsoever?  
 16 A. I don't know whether it is the economists at the  
 17 Commission who then prefer at the end scenario 2.  
 18 I think the Commission in the end, yes, prefers  
 19 scenario 2, but from looking independently what  
 20 the Commission has done, I would prefer scenario 3. And  
 21 probably some economists who did this in the European  
 22 Commission might also be happy with their analysis.  
 23 Q. You also exclude large merchants and so on this could we  
 24 just go back. So you have got E3.6, you have got the  
 25 transcript bundle. If you go back to internal page 4,

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1 page 2501 of the cost study. So the "Sampling  
 2 methodology":  
 3 "The overall objective of the sample selection was  
 4 to achieve a representative sample of the issuers across  
 5 which to measure the interchange costs. As with every  
 6 sampling exercise this involved a trade-off between the  
 7 additional cost of collection information for a larger  
 8 sample and the improvement in accuracy of the results  
 9 that would be obtained from increasing sample size."  
 10 I put this to Mr Sidenius but I will just go on:  
 11 "Given that the cost of collecting relevant  
 12 information from issuers was unrelated to the size of  
 13 the issuers in terms of proportion of transactions and  
 14 that the incremental cost of adding issuers to the  
 15 sample was significant, the proposed approach focused on  
 16 the largest issuers in order to limit the overall number  
 17 of participants while ensuring the sample included  
 18 a significant proportion of the transactional volume in  
 19 the market."  
 20 They give the benefits for that. Then at the  
 21 bottom, "Selection of participants":  
 22 "In other regulatory environments, MasterCard has  
 23 aimed to measure a majority of transactions in the  
 24 market to provide a statistically valid sample.  
 25 For example, MasterCard Europe has agreed with the

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1 European Commission that a representative sample for  
2 undertaking a cost study in a given market would be  
3 achieved if the participating banks would account for at  
4 least 70% of the transaction volume in the market.  
5 Edgar Dunn & Company has applied the same rationale for  
6 the selection of participants in the UK market."

7 Now, just pausing there. I understand that those  
8 names in table 1 are confidential. If you then go to  
9 what Mr Sidenius said about this when I asked him. So  
10 if you go back -- this is now page 24 of the transcript,  
11 page 1395. If we pick this up at line 12. This is the  
12 sample size. Then I read it out. Then over the page at  
13 1396, line 6.

14 "Question: So there you are concentrating on the  
15 largest issuers and transactional volume, correct?"

16 "Answer: As part of the selection for the study,  
17 yes.

18 "Question: Then you go on, I will ask you about  
19 this ..."

20 Then I read out what I have just read out in court  
21 and you can see what he says at the bottom:

22 "Answer: That goes back many years ago. That was  
23 when we started ..."

24 He goes on, if you want to read that. Then picking  
25 this up at 1398, page 27:

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1 "Answer: So in reference to this, the 70% was  
2 a minimum requirement. We have tried always where we  
3 could to go higher than that --

4 "Question: Pausing there. 70% was sufficient for  
5 a robust study?

6 "Answer: Well, for the purposes of the Commission.  
7 But you should compare that to markets such as ..."

8 And he goes to Norway, and then down at line 17,  
9 I ask him to look at table 1, which is the confidential  
10 table which I have just referred to:

11 "Question: There is seven is there? There is  
12 seven. They are the issuing banks. I mean, they seem  
13 quite large to me."

14 I'm saying:

15 "Question: Clearly in the UK, even at that time,  
16 you had other banks."

17 Then I set out the various other banks:

18 "Question: Why pick those big seven and exclude the  
19 smaller ones?"

20 "Answer: We are seeking representative samples of  
21 transactional activity. That's what the Commission  
22 asked us to do and that's how we chose the sample.

23 "So as you can see, this was over 90% of all the  
24 domestic transactions in the UK. That would be, in all  
25 instances I have come across, deemed to be a very

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1 representative sample."

2 So again I'm emphasising here the large people:

3 "Question: So picking the largest you thought was  
4 a representative sample?"

5 "Answer: Yes."

6 Again, you are relying in your report on this report  
7 which has taken large issuers as a representative  
8 sample. So why do you exclude it when you rely on the  
9 Deloitte survey?

10 A. I think again there is not really -- it is not really  
11 the right comparison. In the issuer cost study I think  
12 again it is an established method etc and the idea is to  
13 get a good picture of what the issuer costs are. In  
14 terms of 'are there biases therefore'; well, possibly.  
15 If there is a significant bias from looking at the  
16 largest merchant, then probably it is that -- sorry, at  
17 the largest issuers, then probably it is that the  
18 smaller issuers have higher costs, if anything, I think  
19 Mr Sidenius has also said that in his evidence.

20 So if anything the result of the EDC, if there is  
21 such a bias indeed -- although he also I think says  
22 there isn't such a difference, but if there is, then if  
23 anything the costs that come out of the EDC cost study  
24 are too low because if you include all the smaller  
25 issuers of higher costs you would get a higher number.

19

1 So there is no risk also from my perspective and I rely  
2 on these numbers that we somehow produce a MIF that is  
3 too high.

4 For the -- coming back to the MIT, to the EC  
5 merchant cost study, it is a different -- it is a whole  
6 different -- it is a very different situation. What you  
7 are after there is the average merchant. We are not  
8 after some representative or typical transaction value.  
9 So in that context saying "Oh we just take the largest  
10 80% of merchants", which is sort of what they got, or  
11 merchants, the very large merchants representing 80% of  
12 all transactions is not good enough for MIT purposes  
13 because it doesn't give you a good feel for what's then  
14 the MIF. So if you rely on that entire sample, which is  
15 biased towards the large merchants, you are going to  
16 clearly underestimate the MIT because you are -- because  
17 those larger merchants have much lower cost of cash  
18 handling than smaller merchants.

19 Even within the sample, as we have seen in the  
20 evidence of the merchant cost study, you could also see  
21 that the very, very large merchant had a much lower cost  
22 of cash handling than even the still large but somewhat  
23 smaller merchants.

24 So that was for me enough basis to say well, if you  
25 had included the even smaller merchants, your cost of

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1 cash handling would be much higher and therefore your  
 2 MIT would be much higher. Therefore I felt that it was  
 3 correct to make an adjustment for size, taking the EC  
 4 merchant cost data, but making adjustment for size to  
 5 incorporate -- to take account of the fact that smaller  
 6 merchants who were not included in the survey would have  
 7 on average substantially higher cost of cash.  
 8 Q. We will come onto the average transaction in a moment,  
 9 but I will ask you this question: if you are wrong on  
 10 that and it is correct to take the average transaction,  
 11 do you accept that you are then wrong to exclude large  
 12 merchants?  
 13 A. The average transaction. So, yes I think that is  
 14 incorrect for MIT, but let's say, let's take the  
 15 proposition --  
 16 Q. It is a simple question Dr Niels.  
 17 A. So I have -- so my adjustment is still based on the full  
 18 sample, but it excludes the cost of cash of the very,  
 19 very large merchant. So I still have in there, in my  
 20 MIT, the other -- so the size 6 and size 7 category  
 21 merchants, between 20 and 200 million revenue. So it is  
 22 basically my MIT, my adjustment there is their MIT based  
 23 on their cost of cash handling as mentioned in the  
 24 survey.  
 25 Now, if they in the survey represented the typical

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1 transaction, as was ours, then that is still captured in  
 2 my MIT. So what I'm getting at is I have excluded the  
 3 very largest merchant. If the average or typical  
 4 transaction takes place at those, then, yes, I accept  
 5 that I have excluded it. But if the average transaction  
 6 takes place among merchants in size 7, 6 and 7 category,  
 7 then I still capture the average transaction.  
 8 PROFESSOR JOHN BEATH: Could I just ask for a clarification.  
 9 In making your adjustment for large merchants, did you  
 10 exclude all the very large merchants?  
 11 A. Yes.  
 12 PROFESSOR JOHN BEATH: So in a sense what you have done is  
 13 to truncate the distribution of costs, haven't you, by  
 14 getting rid of the very largest ones?  
 15 A. Yes.  
 16 PROFESSOR JOHN BEATH: Why didn't you leave some of them?  
 17 Because after all what you are after is the average  
 18 merchant. Could you explain to me why you did what you  
 19 did?  
 20 A. Yes. In essence, you have to make some -- you have to  
 21 draw the cut somewhere, so I thought it was cleanest to  
 22 just --  
 23 PROFESSOR JOHN BEATH: You chopped off the top end of the  
 24 distribution.  
 25 A. Yes, because what we are missing is the other very large

22

1 tail end of the distribution of the very small  
 2 merchants, which isn't in there at all. I thought  
 3 therefore the middle bit, indeed the truncated middle  
 4 bit, so merchants of categories 6 and 7, I have taken  
 5 those as more likely to be representative of the overall  
 6 average than even with some of the very large merchants  
 7 included.  
 8 PROFESSOR JOHN BEATH: I understand your argument now.  
 9 MR BREALEY: If you can put that bundle away, E3.6, and take  
 10 out E2. Have a look at another survey that MasterCard  
 11 has undertaken. E2, tab 3. Now this is an annex. I do  
 12 not think this is confidential. This is DotEcon  
 13 economic evidence. This was submitted to the OFT. Do  
 14 you recognise this document?  
 15 A. Yes.  
 16 Q. December 2003. Referred to this at 115 is a merchant  
 17 survey. We haven't -- we were refused disclosure of the  
 18 whole survey, but we can pick it up on this description  
 19 of annex 1. But I note yesterday you said that Oxera or  
 20 you were involved in some sort of merchant survey. Is  
 21 this the merchant survey you were involved in?  
 22 A. No, we did a separate merchant survey at the time in  
 23 probably just even before 2003, but this was done  
 24 by DotEcon but not by us. DotEcon were advising  
 25 Mastercard International in the OFT proceedings.

23

1 Q. But you were aware of the survey at the time? Your  
 2 client was MMF.  
 3 A. Yes.  
 4 Q. So if we look at 115. This is a survey. We don't --  
 5 unless you want to explain we don't have to go to the  
 6 nature of the survey, the purpose of the survey. It was  
 7 rejected by the OFT and the European Commission, but I'm  
 8 interested in how it was conducted. So this is  
 9 a merchant survey undertaken by MasterCard. Page 115,  
 10 paragraph 93:  
 11 "The sample was drawn randomly from the set of UK  
 12 merchants sold directly to consumers turnover 55,000 or  
 13 more."  
 14 So probably the small corner shops are excluded:  
 15 "The sample was drawn ... sampling from 100 plus...  
 16 The survey was designed by PwC executed by MORI [and]  
 17 a total of 502 merchants completed..."  
 18 So that is how it starts. If one goes to  
 19 paragraph 100 on 117:  
 20 "In order to provide data from organisations of  
 21 different sizes as defined by turnover, interview quotas  
 22 were set. These quotas were not pro rata."  
 23 There you get small, medium and large.  
 24 "The sampling, 101, was designed to oversample  
 25 merchants with high turnover. If a purely random sample

24

1 had been selected without quotas being set for size of  
2 business only a small number of organisations, with  
3 an annual turnover of 10 million or more, would have  
4 been interviewed. While such organisations account for  
5 a large proportion of all UK sales they represent only  
6 a small fraction of individual businesses. Within each  
7 of the three turnover categories companies were  
8 conducted randomly with the exception that for large  
9 companies a small number of key companies, eg the large  
10 supermarket chains, were added to the sample. Such  
11 companies account for many billions of sales and it was  
12 therefore considered important that each had the  
13 opportunity to participate in the study."

14 If you continue with this theme, at paragraph 111,  
15 at page 125:

16 "As noted above, the sampling method was designed to  
17 ensure that larger merchants who account for a greater  
18 proportion of all transactions are well represented in  
19 the survey. This inevitably leads to some over and  
20 under sampling, not only in terms of turnover balance  
21 but also in terms of the representation of different  
22 sectors."

23 But again Dr Niels this is an example of MasterCard  
24 doing a survey and emphasising the importance of large  
25 merchants, do you accept that?

25

1 A. Yes. This is -- again one has to look at the objectives  
2 of the survey. So this survey -- and I can't recall the  
3 details, but my understanding is this DotEcon exercise  
4 was done with I think two main objectives in mind: one  
5 was to assess the competitive constraints that merchants  
6 imposed on the scheme, so it was that whole question of  
7 restriction of competition, is there competitive  
8 constraint, because that was a relevant question at the  
9 time in the OFT proceedings; and the survey is designed  
10 to get a good picture of merchant benefits in general.  
11 So from those object -- with those objectives in mind  
12 I think it is reasonable at least to get a good  
13 representative sample and also to get the larger  
14 merchants representing more transactions in the survey,  
15 because then you can get a good feel for okay how big is  
16 really the total merchant constraint on schemes, or, you  
17 know, what are the merchant benefits overall. But for  
18 the MIT exercise, the objective is different. It is  
19 much more important, because we are after the average  
20 merchant, at least in my opinion, and then it is -- then  
21 having representation for the whole merchant sample is  
22 very important.

23 So that is a different objective. I don't think --  
24 I think that's where the comparison between the two  
25 stops.

26

1 Q. You can put that bundle away. We will have a look at  
2 the objectives in a moment. Go back to your first  
3 report at D3, tab 3. Page 319, paragraph 6.39.

4 You are looking after, as I understand it, the small  
5 merchants, are you, at 6.39? You say:

6 "A further reason why setting individual or very  
7 specific MIFs is inappropriate is it would disadvantage  
8 smaller merchants who have higher costs of cash and  
9 would have correspondingly higher MIFs as well. In  
10 practice smaller merchants already tend to pay higher  
11 MSCs but the MIF is generally the same."

12 As I understand it, you don't want small merchants  
13 to be disadvantaged by higher MIFs, is that correct?

14 A. Well, I think this is one of the reasons why it is  
15 preferable that one looks at an average -- that one sets  
16 a MIT-MIF for the -- that applies to all merchants on  
17 average. It is not that I particularly want to protect  
18 small merchants but this is a good policy or economic  
19 reason for not distorting competition by having let's  
20 say Sainsbury's -- let Sainsbury's have a very low  
21 MIT-MIF because their cost of cash handling is lower and  
22 let the corner shop or the Tottenham restaurant have  
23 a very high MIT-MIF because its costs of cash handling  
24 are much higher. So I think there is a reasonably  
25 commonly accepted principle that what we are after and

27

1 also what the Commission and also the interchange fee  
2 regulation is after, that we have one MIT -- one MIF for  
3 the whole market.

4 Q. By excluding large merchants you are ensuring that the  
5 small merchants now pay a higher MIF. In other words,  
6 if you include the large merchants, the corner shop, the  
7 small restaurant in Tottenham pays a lower MIF; that is  
8 correct isn't it? If you include the large merchants,  
9 the small restaurant in Tottenham will pay a lower MIF?

10 A. If you --  
11 Q. Include the large merchants, as Mr von Hinten-Reed has  
12 done, the small restaurant in Tottenham will pay a lower  
13 MIF?

26

14 A. So, yes, if you include the large merchants and get  
15 a very -- so get a much lower MIT-MIF then the average  
16 is lower, that is correct, I agree with the proposition.  
17 And therefore -- but still the very large merchants  
18 still pay -- are paying a MIT-MIF that actually covers  
19 their cost of cash, but the smaller merchants are still  
20 paying -- are still -- still have a higher cost of cash  
21 handling for it.  
22 But yes, maybe so as not to complicate matters  
23 further I agree with that proposition, yes.  
24 Q. Let's just have a look to see how the Commission has  
25 treated this. Could you go, I don't know -- what

28



1 bundles have you got there? Have you still got E2  
 2 there?  
 3 A. I have my own report, the transcripts and E2.  
 4 Q. You can put E2 away. You will need E3.10.  
 5 So this question of large merchants was something  
 6 that the Commission was aware of; you accept that do  
 7 you?  
 8 A. Yes.  
 9 Q. So at E3.10 we have at tab 202 our trusted survey, the  
 10 Deloitte's European Commission survey.  
 11 A. Yes.  
 12 Q. If you go to page 4324, the relevant paragraphs are 120  
 13 onwards. You have obviously read these before, have  
 14 you?  
 15 A. Yes.  
 16 Q. So at 120 the merchant population is heterogeneous, the  
 17 merchants differ in respect to several characteristics,  
 18 we know that. At 121:  
 19 "For this reason it was decided to limit the number  
 20 of characteristics that were going to be reflected in  
 21 the sample. DG Competition decided to focus on  
 22 surveying large merchants. Two main reasons supported  
 23 this choice, first, large merchants are most likely to  
 24 be able to provide the necessary data. Second, focusing  
 25 on large merchants would maximise the coverage of the

29

1 samples in terms of transactions and in this way to  
 2 enhance the liability of the outcome."  
 3 So they are aware of it. Then you will see at 122  
 4 that:  
 5 "An argument often made with respect to merchant's  
 6 cost of payment is that they exhibit economies of scale  
 7 and thus large merchants have considerably lower costs  
 8 of payment than smaller merchants."  
 9 And that you would agree with.  
 10 "Several stakeholders ..."  
 11 Is that including you, MasterCard? Do you know who  
 12 he pointed out?  
 13 A. I don't know.  
 14 Q. Anyway:  
 15 "Several stakeholders pointed out that surveying  
 16 large merchants only will provide an incomplete picture  
 17 of costs and possibly a biased estimation of MIT-MIF.  
 18 It should be noted that this potential bias would not  
 19 necessarily result in lower MIT-MIFs since such  
 20 economies of scale might concern both cash and cards.  
 21 In particular, as the Commission also concluded in its  
 22 decision, the acquirer margin under card payments was  
 23 higher for small merchants than for large merchants,  
 24 which implies the existence of scale effects for  
 25 merchants on credit card transactions."

30

1 You see there at footnote 55 that DG Competition  
 2 carried out a stakeholder consultation on the  
 3 methodology which proposed surveying large merchants.  
 4 So the Commission was well aware of this issue and  
 5 it decided that it was preferable or desirable to select  
 6 the data from the large merchants and do you disagree  
 7 with paragraph 122, where the Commission says it is not  
 8 necessarily the case that MIFs would be lower and that  
 9 small merchants would affect the overall outcome?  
 10 A. I disagree. In theory it could be right but actually  
 11 the actual data that has come out of the survey, and we  
 12 have seen that in the evidence actually, confirms that  
 13 there is significant economies of scale, significant  
 14 differences in cost of cash handling, even taking into  
 15 account the card costs, because even when you look at  
 16 the MIT, the implied MIT-MIF level between very large  
 17 merchants and then the smaller merchants in the sample,  
 18 there are significant differences. While in theory this  
 19 statement here might hold, the actual data that has come  
 20 out of the survey confirms that there are significant  
 21 differences even in the survey sample.  
 22 Q. Remembering, Dr Niels, that the burden of proof of this  
 23 is on MasterCard, have you undertaken a study taking the  
 24 large merchants as identified in the Deloitte's survey  
 25 and placed on top detailed data relating to small

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1 merchants?  
 2 A. No, that was the big unknown, the big absence of data on  
 3 any data on small merchants. I think that data is just  
 4 isn't out there. Everyone is struggling with it. With  
 5 that fact. The Commission is aware of it, as is clear.  
 6 We are aware of it. Still, I found it unsatisfactory to  
 7 just therefore rely on the sample because while  
 8 the Commission is aware of it, they then don't make any  
 9 further adjustments and I found that bit unsatisfactory.  
 10 So I did make the further adjustment.  
 11 The burden of proof on the defendants I think there  
 12 is the beautiful symmetry with the damages overcharge.  
 13 I also very much did this analysis as part of my  
 14 assessment of damages. So the beautiful symmetry where  
 15 calculating the exemptable level of MIF also gives you  
 16 the calculation of the overcharge.  
 17 Q. If you go to bundle D2.1, which is where you will find  
 18 Mr von Hinten-Reed's second report. Tab 3, page 526,  
 19 paragraph 506. He, unlike you, has at least tried to  
 20 factor in smaller merchants. So 526, at the bottom. He  
 21 has taken the large merchants as the Commission has done  
 22 and he says at paragraph 506:  
 23 "As a sensitivity check I consider how the MIT-MIF  
 24 for credit cards would be affected by the inclusion of  
 25 small merchants, assuming that they account for 25% of

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1 retail sales based on the Eurostat data. As I mentioned  
2 earlier no data is available for the cost of payments to  
3 small merchants. In my sensitivity analysis I consider  
4 two scenarios, the MIT-MIF for small merchants being  
5 twice as high and three times as high. I apply this  
6 sensitivity test to three MIT-MIF estimates."

7 Then he says at 507:

8 "The results are shown in table 7.7. As can be  
9 seen, including small merchants and assuming for them  
10 an extremely high MIT-MIF does not change the results  
11 dramatically."

12 Now, have you any basis to challenge that? Have you  
13 attempted to challenge that in your reports?

14 A. Well this was Mr von Hinten-Reed's second report and  
15 I haven't had a reply on that since, but I clearly  
16 disagree with this adjustment. I think it is  
17 an inappropriate adjustment. So both Mr von Hinten-Reed  
18 and I -- well I tried it in my first report,  
19 Mr von Hinten-Reed in his second report, we tried to  
20 adjust for this size issue or to do a sensitivity check.  
21 I have done it my way as explained. This sensitivity  
22 check, the reason why I fundamentally disagree with it  
23 actually is in the assumption that the MIT-MIF for small  
24 merchants being twice or three times as high, when we  
25 saw clearly from the data, and maybe we can have a look

33

1 at it again, but even in the full sample in the EC  
2 merchant cost study, there were already significant  
3 differences, much more than 2 or 3 times, there were  
4 differences, 5, 10, even 20 times. So to say that the  
5 even smaller merchants have 2 or 3 times higher costs of  
6 cash I think is inappropriate. It should be a lot  
7 higher and I have given actually an example in my second  
8 report why this adjustment actually significantly  
9 understates the resulting MIT-MIF.

10 Q. Don't you, as an expert economist, recognise that the  
11 approach of taking large merchants and then sense  
12 checking it by reference to small merchants is  
13 preferable to just ignoring all the large merchants?

14 A. I don't agree that that is the right characterisation of  
15 what I have done. What I have done is to say we have  
16 a sample which is biased towards the very large  
17 merchants, let's truncate that and that's a better  
18 indication of the overall size, including the small  
19 merchants, the big chunk that we don't have. I think  
20 this adjustment here requires some guesswork, some  
21 assumption as to: okay, if you include the small  
22 merchant, well what is their cost of cash? No one  
23 knows, that's the unsatisfactory part. But what I do  
24 know for certain is that it will be -- the cost of cash  
25 of smaller merchants will be more than 2 or 3 times

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1 higher than that of the larger merchants.

2 I have included, I believe, a numerical example  
3 showing that in my second report, that very rapidly --  
4 if you assume something higher than 2 or 3 times as  
5 high, then you rapidly get a much higher MIT-MIF.

6 Q. Let's see what the effect on the data is excluding your  
7 larger merchants. If one goes back in  
8 Mr von Hinten-Reed's second report to page 523,  
9 paragraph 489. Let's just see what effect your approach  
10 has to the robustness of the data. He says:

11 "I note that excluding the largest merchant  
12 seriously limits the reliability of results and their  
13 applicability to the UK. 130 merchants out of 256  
14 included in the sample observation belong to the largest  
15 group, excluded by Dr Niels. Excluding the largest  
16 merchants reduces the sample size by more than half.  
17 Given that the sample is already small such an operation  
18 seriously reduces the reliability of the results as also  
19 shown by our lower R2 values. In the total sample UK  
20 merchants account for 10% of merchants but for 40% of  
21 total sample turnover. Out of 27 UK retailers in the  
22 sample 19 belong to the largest size group. Thus the  
23 MIT-MIFs obtained for the whole sample are largely  
24 influenced by UK retailers and can therefore be expected  
25 to be relatively close to the UK MIT-MIFs. By excluding

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1 the largest retailers Dr Niels also removes most of the  
2 UK sales from the sample. Therefore, the MIT-MIFs  
3 obtained by the smaller group are likely to bear little  
4 relationship to the MIT-MIFs for even small UK  
5 retailers. According to Eurostat data, in 2013 69% of  
6 retail turnover in the UK was generated by retailers  
7 above 200 million turnover, while retailers with  
8 turnover between 20 million and 200 million accounted  
9 for 9%. Even if the MIT-MIF estimated for those smaller  
10 merchants is representative of the UK, which is unlikely  
11 as argued above, it is difficult to justify ignoring the  
12 MIT-MIF for merchants representing almost 70% of  
13 transactions."

14 Do you not agree that it is undesirable to ignore  
15 for the purposes of the UK MIT-MIF merchants  
16 representing almost 70% of transactions?

17 A. I disagree with these conclusions here. I think there  
18 is agreement that an adjustment is needed for size  
19 because not making any adjustment, in my opinion,  
20 certainly would be incorrect for the reasons we have  
21 discussed.

22 There is not a lot of information to decide which  
23 adjustment is the most appropriate one -- that is  
24 unfortunate but it is a fact. I think my adjustment, it  
25 is quite clear, yes, it then throws out the very largest

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1 merchants, I'm clear on that, and yes, a lot of those  
 2 were from the UK, I'm clear on that. I still think that  
 3 my truncated average is more likely to reflect the  
 4 average MIT in the market overall.  
 5 Q. Just to conclude on this point and then maybe we can  
 6 have the short break. Just picking up on the average  
 7 transaction, you have majored on you have got to look at  
 8 the average merchant not the average transaction. Do  
 9 you still have E3.10 in front of you?  
 10 A. Yes.  
 11 Q. Tab 202.  
 12 A. Yes.  
 13 Q. Page 4315, paragraph 82:  
 14 "Merchants in this population are likely to be  
 15 heterogeneous ...(Reading to the words)... process and  
 16 payments need to be taken into account."  
 17 The simple question is, are you disagreeing with the  
 18 European Commission here that it is the average  
 19 transactional benefit that is relevant not the average  
 20 merchant?  
 21 A. I think the principle of MIT is that you are looking for  
 22 the average merchant in the market. I'm not sure  
 23 whether the distinction here is drawn very precisely  
 24 between average transactional benefit or average  
 25 merchant. I think what we are after with the MIT-MIF

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1 approach is the MIT-MIF for the average merchant.  
 2 Q. If you still have Mr von Hinten-Reed's second report, at  
 3 525, he deals with this point in some detail. Again he  
 4 interprets Rochet and Tirole completely differently to  
 5 you. 496:  
 6 "The rationale for the MIT-MIF methodology is to  
 7 measure the transaction efficiencies. Efficiencies are  
 8 measured in terms of reduced costs of transactions.  
 9 Efficiencies are about incremental costs."  
 10 497:  
 11 "In their original paper Rochet and Tirole conclude  
 12 that when merchants are heterogeneous in the sense they  
 13 derive different benefits from replacing cash by cards,  
 14 the MIT-MIF should be based on the average transactional  
 15 benefit amongst the merchants."  
 16 So he and the Commission are at one, not only in  
 17 applying the average transaction, but also in  
 18 interpreting Rochet and Tirole. Again I put it to you,  
 19 are you disagreeing with the approach of  
 20 Mr von Hinten-Reed and the European Commission?  
 21 A. I think Rochet and Tirole elsewhere also talk about  
 22 "average merchants" and generally I think they talk --  
 23 or the literature talks more about average merchants  
 24 rather than the average transaction value. The concept  
 25 of average transaction benefits I think is again --

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1 again it is generally worded, that could still apply --  
 2 or that still leaves open the question, are you talking  
 3 about the average merchant or the merchant where the  
 4 average transaction takes place.  
 5 MR BREALEY: If that's a convenient moment?  
 6 MR JUSTICE BARLING: We will have a short break.  
 7 A. I said I would clarify something, can you just remind me  
 8 of the reference in Mr von Hinten-Reed's report, because  
 9 I think --  
 10 MR BREALEY: Sorry, the reference of what?  
 11 A. There was a question about whether the impact of the  
 12 adjustment from fixed and variable costs, 0.15 to 0.2,  
 13 you pointed me to your opening statement with a footnote  
 14 to Mr von Hinten-Reed's --  
 15 (Pause).  
 16 MR BREALEY: I'm told by Mr Cook it is footnote 266.  
 17 MR JUSTICE BARLING: If you want to try to find that  
 18 reference for Dr Niels and then he can look it up in the  
 19 break. We will have a short break.  
 20 (11.40 am)  
 21 (A short break)  
 22 (11.50 am)  
 23 MR JUSTICE BARLING: You found the bit you were looking for?  
 24 A. Yes, I have. If I may briefly. So the question was  
 25 what is the impact of that first adjustment, so looking

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1 at fixed or variable costs rather than just variable.  
 2 I think the best indication for that is table 6.4 in my  
 3 first report.  
 4 MR JUSTICE BARLING: Yes. Table 6.4. Do you have a page  
 5 reference? Here we are, page 339.  
 6 A. Yes. I think the best way to look at it is there  
 7 between the medium estimate and the high estimate, so  
 8 the second and third columns. The MIT-MIF that results  
 9 is 0.45, versus the 0.73. The difference between those  
 10 scenarios is whether you take the Commission's medium  
 11 term middle scenario approach or you take  
 12 the Commission's long-term econometric approach. So  
 13 that is in essence the difference. So in my analysis  
 14 it produces -- the makes the difference from 0.45 to  
 15 0.73 basically.  
 16 MR JUSTICE BARLING: More costs become fixed in the  
 17 long-term?  
 18 A. Yes, so more fixed costs become variable in the  
 19 long-term, so you --  
 20 MR JUSTICE BARLING: Yes, exactly.  
 21 A. Yes, so you account for them. But this is still what  
 22 the Commission itself did. It is just that I prefer the  
 23 third approach from the Commission over the second.  
 24 If I compare that then with what was put to me,  
 25 table 7 in Mr von Hinten-Reed's report -- that's

40

1 table 7.6.  
 2 PROFESSOR JOHN BEATH: Which is?  
 3 A. In his second report on page 520. In that table you can  
 4 see -- I think there the point was if you make the  
 5 adjustments, you go from 0.15 for credit card, so the  
 6 far right number in the bottom, to 0.20.  
 7 Now, so that is one adjustment but that is not the  
 8 full adjustment. I think this is still in  
 9 Mr von Hinten-Reed's own analysis which is based on  
 10 Sainsbury's and what he does here is test for the  
 11 sensitivity to a different cost allocation by  
 12 Sainsbury's itself. That gives you one difference. But  
 13 it is still in the context of the medium-term approach  
 14 that the Commission -- which he relies on.  
 15 PROFESSOR JOHN BEATH: That's scenario 2?  
 16 A. Yes, scenario 2. I prefer scenario 3. So the effect of  
 17 that first adjustment is the difference mainly between  
 18 scenarios 2 and 3 as per my table. So it is a bit  
 19 bigger than just going from 0.15 to 0.2.  
 20 MR BREALEY: So what was the difference in the end?  
 21 I missed that sorry.  
 22 A. It is in essence the jump in my numbers from 0.45 in  
 23 table 6.4 at the bottom, to 0.73.  
 24 Q. So if you take Mr von Hinten-Reed's approach and all you  
 25 do is -- so you take the cost of cash, you take the

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1 large merchants, but all you do is take scenario 3,  
 2 rather than scenario 2 -- I'm sorry. If you leave all  
 3 the large merchants in and the only -- I tried to  
 4 establish at the beginning there are three main  
 5 adjustments, yes?  
 6 A. Yes.  
 7 Q. Scenario 2 versus scenario 3?  
 8 A. Yes.  
 9 Q. Large merchants, what I have called the Amex point --  
 10 A. Yes.  
 11 Q. So let's assume that you are wrong on Amex, let's assume  
 12 that you are wrong on the merchants and you adopt  
 13 everything that Mr von Hinten-Reed has done, all you are  
 14 doing is taking scenario 3 rather than scenario 2; what  
 15 difference does that make to his calculation?  
 16 A. So yes, for that first adjustment it is in essence going  
 17 from the Commission's scenario 3 to the Commission's  
 18 scenario 2. I have shown the effect. You can also look  
 19 actually at the Commission's own results which are  
 20 probably sort of -- they also show the difference. So  
 21 in paragraph 19 of the Commission's study you can also  
 22 see that the Commission itself gets higher results for  
 23 scenario 3 when they do the econometrics. So those  
 24 results go up to 0.47. If the question is what  
 25 difference does it make to Mr von Hinten-Reed's

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1 assessment, I can't answer that question right now.  
 2 I think the adjustment that I was shown here is just  
 3 an adjustment to Sainsbury's allocation of fixed and  
 4 variable costs. So that is part of it. But it is still  
 5 within the scenario 2 scenario.  
 6 Q. Maybe we will try and get some common ground between  
 7 you. Quickly on the third adjustment, just to sort that  
 8 out, the third adjustment, what I have called the Amex  
 9 point, you put forward a third adjustment to the MIT-MIF  
 10 whereby Amex is the comparator and not cash -- I know  
 11 there is a mix but Amex is through there the whole  
 12 piece -- and this applies to online and face to face  
 13 credit; correct?  
 14 A. Yes, so it captures two elements, online and the credit  
 15 functionality of credit cards, yes.  
 16 Q. You are aware that the MIT-MIF as calculated in the  
 17 Deloitte report and as calculated by Mr von Hinten-Reed  
 18 and as calculated in the interchange fee regulation, so  
 19 the MIT-MIF that they arrive at applies to online sales.  
 20 So they apply the MIT to online sales?  
 21 A. I believe that is right. I believe that they measure it  
 22 on the basis of the cash versus card comparison.  
 23 I think they -- the Commission explicitly says "Well we  
 24 couldn't do a merchant cost study for online", so it is  
 25 a card cash comparison based MIF, but my understanding

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1 is also that the MIF in the regulation 0.3/0.2 applied  
 2 to all transactions, so again we have one MIT-MIF,  
 3 including online.  
 4 Q. So it is not as if online are excluded from interchange  
 5 fees, it is just that online is a slightly different  
 6 calculation and the regulators have taken the cash  
 7 comparator and applied it to online sales, correct?  
 8 A. Correct. I found it possible to actually make a more  
 9 explicit adjustment or measurement of payment methods as  
 10 compared to other than cash for online payments and  
 11 that's what I have done. That is part of my third  
 12 adjustment.  
 13 Q. You are aware that Mr von Hinten-Reed regards this as  
 14 something of a windfall to the card schemes, because he  
 15 says that a MIF is not necessary to achieve any  
 16 efficiency gain within the meaning of article 101(3).  
 17 He says you don't actually need a MIF for online sales,  
 18 they would happen anyway. So there's no efficiency  
 19 gain, but for reasons of practicality, it will be  
 20 applied. That effect is, according to him, schemes  
 21 obtain a windfall.  
 22 A. From an economic perspective, I see that differently.  
 23 I think the principle of the MIT-MIF is that you set  
 24 a regulatory price or fair price or exemptible price.  
 25 With reference to the cost of -- or the price of

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1 comparator payment systems, so alternative payment  
 2 systems, the next best alternative, this idea of online  
 3 would happen anyway, I think that's then -- that's not  
 4 right because clearly there are still costs to that. So  
 5 I think it is right that if we are talking about online  
 6 payments, you have to apply the same principle of  
 7 benchmark pricing regulation, so you look at the next  
 8 best alternatives, and for online payments they are Amex  
 9 and PayPal we have taken. Now the fact that that  
 10 actually makes the MIF higher, so because the cost of  
 11 those alternatives, PayPal is more expensive to  
 12 merchants than credit cards, generally, you may call it  
 13 a windfall or it has been compared with Kafka,  
 14 Kafkaesque, but I think it is only Kafkaesque if the  
 15 cost of the next best alternative, say PayPal or Amex  
 16 online, is higher then it is perfectly efficient that  
 17 you are allowed under this price cap approach to price  
 18 all the way up to that level. So I do not think it is  
 19 wrong that including online payments where alternatives  
 20 are more expensive leads to a higher MIF.  
 21 Q. At paragraph 6.82 of your first report you say that  
 22 online merchants gain a large benefit from accepting  
 23 cards. As we established yesterday, it is not the right  
 24 question. It is not the question whether cards are of  
 25 benefit, the question is whether the MIF leads to

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1 an efficiency gain. That is the question isn't it,  
 2 whether the restriction of competition, the MIF, is  
 3 necessary to achieve an efficiency gain?  
 4 A. I understand that that is the question for the legal  
 5 assessment under article 101(1), but when we are talking  
 6 here about what's the right economic approach to  
 7 MIT-MIF, and following the same principles why someone  
 8 may like the MIT-MIF and cash as a comparator, following  
 9 those very same principles, I think it is consistent  
 10 then to also look at online because it does benefit  
 11 merchants at the end of the day and there is a cost  
 12 involved in providing credit card services also for  
 13 online payment. So it is only fair that the MIT-MIF in  
 14 that same logic should cover also the relative costs to  
 15 merchants for online payments and not just cash as  
 16 a comparator.  
 17 Q. Have you included in any calculation the cost to the  
 18 merchants of accepting online payments?  
 19 A. Yes, I tried as an approximation to look at the costs to  
 20 merchants of the alternative methods for online  
 21 payments, so Amex and PayPal. I have described that in  
 22 my report.  
 23 Q. The actual cost that merchants incur for online  
 24 payments, that Mr Rogers refers to in his witness  
 25 statement?

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1 A. I don't think I had much more basis than -- much more  
 2 specific information for merchants for these purposes  
 3 than looking at what my understanding was of PayPal and  
 4 Amex.  
 5 Q. On face to face, as I understand it, your evidence is  
 6 that the Amex based MIF is based on a notion that for  
 7 some transactions the customers may not have enough  
 8 cash, is that correct?  
 9 A. Yes, that's in line with the --  
 10 Q. The academic articles?  
 11 A. The Rochet and Wright thinking, which recognises that  
 12 credit functionality has a benefit to merchant and there  
 13 the next best alternative is actually not cash but for  
 14 that type of payment it is other credit that would have  
 15 been extended to the consumer at that point.  
 16 Q. So you and the academics are basically saying, as  
 17 I understand it, that every merchant that accepts  
 18 a MasterCard is effectively operating a store card?  
 19 A. Yes. In that approach of Rochet and Wright, the  
 20 effective comparator is a store card. Now, clearly not  
 21 all merchants operate store cards but nonetheless the  
 22 concept of store card, and within that I have then taken  
 23 Amex as a proxy -- as a conservative proxy because  
 24 I think the real cost of providing a store card would  
 25 probably be a bit higher than just Amex. But, yes, the

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1 comparator is that the retailer somehow would have to  
 2 provide credit, otherwise that transaction would not  
 3 take place. So whether the retailer actually provides  
 4 store credit or would have to do something else, the  
 5 premise of the theory, which I agree with, is that the  
 6 comparator there is not cash for those transactions but  
 7 credit provided by the stores themselves.  
 8 Q. This is a store card that the small restaurant in  
 9 Tottenham is operating without any opportunity of  
 10 obtaining interest payments. You don't take interest  
 11 into account yet again in this analysis.  
 12 A. That is correct. So you look -- for this approach, the  
 13 Rochet and Wright approach, you look at the costs that  
 14 the merchant would have to incur to provide the credit.  
 15 Now, yes, of course, merchants also can earn credit --  
 16 interest revenue on it and somehow one would -- one  
 17 might have to take that into account perhaps, although  
 18 I would also think that the logic in Rochet and Wright  
 19 most of the time is that when merchants provide credit  
 20 it is not that they are a bank, they are in the business  
 21 of lending, they do that to promote spending in their  
 22 store, so I think even most store cards are probably  
 23 more charge cards or transactional benefits orientated  
 24 then actually being a source of profit. But that I have  
 25 no further information on.

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1 Q. You have no information, as we established yesterday, on  
 2 the magnitude of the benefits that you say accrue to  
 3 merchants, you haven't done any calculations that would  
 4 give us an indication of the magnitude.  
 5 A. Correct. In this context we are talking about the costs  
 6 to merchants of the alternative payment system. So in  
 7 this context it wouldn't be relevant to quantify the  
 8 benefits to merchants.  
 9 Q. You have calculated the costs to merchants, but the  
 10 whole point of article 101(3) is to measure the  
 11 benefits.  
 12 So what are the benefits you say that accrue to  
 13 merchants?  
 14 A. Merchants obtain benefit from extending credit, both  
 15 merchants individually --  
 16 Q. Sorry Dr Niels, we are talking about increased sales  
 17 again are we?  
 18 A. Yes, increased sales. Both individually and in  
 19 aggregate merchants benefit.  
 20 Q. And you haven't calculated at all the nature of the  
 21 increased sales?  
 22 A. I have analysed the nature and I have explained the  
 23 theory on extended -- so the effect on aggregate sales  
 24 and I conclude that there is a positive effect. What  
 25 I haven't been able to do and I think no one would ever

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1 be able to do is quantify the exact benefits to  
 2 merchants.  
 3 Q. Can I just ask one last question on exemption Dr Niels.  
 4 It is quite an important question. Not that any of the  
 5 others haven't been important, but this is an important  
 6 question. Mr von Hinten-Reed has put forward  
 7 an exemption methodology, which broadly follows  
 8 Commission, correct?  
 9 A. He has put forward a methodology which broadly follows  
 10 the Commission, correct.  
 11 Q. And you have put forward two methodologies, one is  
 12 an issuer's based methodology, and the other is this  
 13 adjusted MIT-MIF?  
 14 A. Yes.  
 15 Q. And you know that in the last hour or so of  
 16 cross-examination that we have issues with your  
 17 methodology, correct?  
 18 A. Yes.  
 19 Q. You know that the burden of proof is on MasterCard to  
 20 prove an exemption, correct?  
 21 A. Yes.  
 22 Q. So my question is this: is the calculation that  
 23 Mr von Hinten-Reed has undertaken one that is within  
 24 a range in your view that the Tribunal could adopt  
 25 sufficient to give MasterCard an exemption? If you want

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1 me to repeat that I will, but essentially what I'm  
 2 asking you is, I know you have your two methodologies,  
 3 but is Mr von Hinten-Reed's methodology within a range  
 4 in your view that the Tribunal could adopt sufficient to  
 5 give MasterCard an exemption?  
 6 A. My answer to that is no. My adjusted MIT methodology is  
 7 in essence the same as Mr von Hinten-Reed's MIT  
 8 methodology, so if Mr von Hinten-Reed's methodology is  
 9 accepted as a good approach for exemptible level, then  
 10 in my opinion so should my adjusted MIT, it is just the  
 11 adjustments that I make to my MIT approach are better  
 12 founded in economic theory and economic principles. So  
 13 it is still a MIT, I agree that it is still a MIT  
 14 approach, but it has better foundations in economic  
 15 theory, it is based -- so Mr von Hinten-Reed's approach  
 16 is based on the very narrow interpretation of Rochet and  
 17 Tirole. I think we have seen evidence already that even  
 18 in Rochet and Tirole there are some doubts expressed  
 19 about is that the right MIF or should you get a higher  
 20 one, but there are five adjustments in later theoretical  
 21 papers that express some doubts about that very narrow  
 22 interpretation. The first one is that when assessing  
 23 welfare do you also look at issuer profits or not?  
 24 Rochet and Tirole themselves said it. Whether that  
 25 applies to article 101(3), I don't know.

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1 But the other four adjustments are -- and they all  
 2 mean that if the narrow interpretation of MIT-MIF is too  
 3 low, so all these adjustments would raise it, one is the  
 4 fact that if, as Tirole in a later paper recognised,  
 5 other payment systems, like cash, are also subsidised  
 6 from a social perspective, so the consumer doesn't face  
 7 the cost of -- the real cost of cash, then the MIT-MIF  
 8 is too low.  
 9 Thirdly, if -- so the MIT-MIF in the narrow  
 10 interpretation doesn't recognise the credit  
 11 functionality, so that is the Rochet and Wright  
 12 adjustment that I have also adopted.  
 13 Fourthly, in the Rysman and Wright paper we saw that  
 14 there is concern that the MIT-MIF should -- so the  
 15 interpretation of Rochet and Tirole of cost should be  
 16 longer marginal costs so including fixed costs, so that  
 17 you get the right long-term incentives between payment  
 18 systems.  
 19 And the last adjustment, also in Rysman and Wright's  
 20 paper, is that it is not just cash that is the  
 21 comparator, you should also look at other comparators,  
 22 in particular for online and that's also an adjustment  
 23 I have made.  
 24 So in sum I would say we have tried to follow --  
 25 both the experts have tried to follow the MIT-MIF

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1 approach, but I have said why I prefer my adjustment to  
 2 it.  
 3 MR BREALEY: I'm moving on to a different subject, which  
 4 relates to Amex and internal documents relating to  
 5 Sainsbury's.  
 6 MR JUSTICE BARLING: How do you feel about the possibility  
 7 of framing questions and answers sensibly -- I mean can  
 8 it be sensibly done or is it really too difficult in  
 9 view of the material to do it in public, without  
 10 revealing the material?  
 11 MR BREALEY: I will try. Can I just ask Mr Hoskins: E13,  
 12 tab 249, is that confidential? That's one of  
 13 Mr Hoskins'. E13, tab 249?  
 14 MR HOSKINS: It is currently marked confidential.  
 15 MR BREALEY: I'm going to go to essentially page 531 ...  
 16 MR JUSTICE BARLING: If you think there is a significant  
 17 risk that it is just going to be too difficult for the  
 18 witness --  
 19 MR BREALEY: Actually it is the negotiation between  
 20 Sainsbury's and Amex.  
 21 MR JUSTICE BARLING: So it is sensitive material.  
 22 MR BREALEY: It is really.  
 23 MR JUSTICE BARLING: The sort of questions you want to raise  
 24 probably require --  
 25 MR BREALEY: I could just let Dr Niels look at them but --

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1 MR JUSTICE BARLING: It sounds as though it is going to be  
 2 too difficult. I think rather than waste time.  
 3 MR BREALEY: I will tell you what I could do, I could take  
 4 the cross-examination a bit out of order.  
 5 MR JUSTICE BARLING: Well I'm a bit reluctant for you to do  
 6 that ...  
 7 MR BREALEY: Why don't I do that and then it may be the  
 8 afternoon will be in private because then I have to deal  
 9 with Maestro, which is confidential. So if I was to do  
 10 the Amex/Sainsbury's and the Maestro this afternoon  
 11 and --  
 12 MR JUSTICE BARLING: If you think you can do it like that  
 13 without, as it were, totally dislocating your --  
 14 MR BREALEY: It is a bit better than yesterday when I got to  
 15 page 7 and I realised I didn't have about five pages of  
 16 my cross-examination notes. But I found them.  
 17 MR JUSTICE BARLING: All right.  
 18 MR BREALEY: Okay, Dr Niels. Do you want to put everything  
 19 away and then we will go on to something new.  
 20 Do you want to take bundle E1 out. Before we get to  
 21 the documents, I know you are experienced in these  
 22 matters, can you explain to the Tribunal what you  
 23 understand by the concept of ancillary restraints?  
 24 A. I'm afraid I haven't got that really clear in my mind,  
 25 it is a legal concept.

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1 Q. I ask that because that is the basis upon which you give  
 2 your economic evidence on the Visa counterfactual?  
 3 A. I can't say much more on that.  
 4 Q. Well let me show you some documents to assist you.  
 5 So when you have given your evidence on the Visa  
 6 counterfactual and how there would be a migration from  
 7 MasterCard to Visa, you haven't had regard to the  
 8 concept of ancillary restraints?  
 9 A. Not as such, I have done my analysis in the context of  
 10 knowing that counterfactual analysis is relevant for  
 11 article 101(1) and 101(3) so I looked at various  
 12 counterfactuals from an economic perspective. Where  
 13 exactly it fits in the legal framework, in terms of  
 14 ancillary restraint versus just generally agreements,  
 15 I don't know. I didn't look at that specifically.  
 16 Q. But normally economists deal with ancillary restraints  
 17 in mergers, don't they? They look at whether the  
 18 overall transaction is pro-competitive and they look at  
 19 whether the restriction is necessary for it; that's  
 20 essentially what it is, isn't it?  
 21 A. Yes, I'm just confused by the term "ancillary". We look  
 22 at restraints and we look at their effects on  
 23 competition, but whether something is ancillary or not,  
 24 that's the bit I'm saying that I don't have so clear in  
 25 my head.

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1 Q. Okay. Let's just try and put your economic evidence in  
 2 some proper context then. If we can go to E1, tab 2A.  
 3 I won't labour this point but I will go to the  
 4 guidelines and the Court of Justice.  
 5 At tab 2A you have the Commission's guidelines on  
 6 101(3), which you say that you have read, yes?  
 7 A. Yes.  
 8 Q. Then if you go to page 38A.5, paragraph 28, it is headed  
 9 "Ancillary restraints".  
 10 A. Yes.  
 11 Q. So, this is the concept of ancillary restraints.  
 12 Paragraph 18 sets out a framework analysing the impact  
 13 of agreement and its individual restrictions on  
 14 inter-brand competition and intra-brand competition:  
 15 "If on the basis of those principles it is concluded  
 16 that the main transaction covered by the agreement is  
 17 not restrictive of competition, it becomes relevant to  
 18 examine whether individual restraints contained in the  
 19 agreement are also compatible with article 81(1) because  
 20 they are ancillary to the main non-restrictive  
 21 transaction."  
 22 29:  
 23 "In community competition law the concept of  
 24 ancillary restraints covers any alleged restriction of  
 25 competition, which is directly related and necessary to

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1 the implementation of a main non-restrictive transaction  
2 proportionate to it."

3 Just pausing there. The question we are looking at,  
4 so you know that our submission is that there are three  
5 anti-competitive vices. There is a restriction between  
6 the issuers, there is a floor, there is a high floor.  
7 So what we are having to do is work out whether those  
8 three restrictions of competition are necessary for the  
9 implementation of the main agreement, which is the  
10 payment card scheme.

11 It goes on:

12 "If an agreement in its main part, for instance  
13 a distribution agreement or a joint venture, does not  
14 have as its object or effect the restriction of  
15 competition, then restrictions which are directly  
16 related to and necessary for the implementation of that  
17 transaction also fall outside article 101(1). Those  
18 related restrictions are called ancillary restrictions.

19 A restriction is directly related to the main  
20 transaction if it is subordinate to the implementation  
21 of that transaction and is inseparably linked to it.

22 The test of necessity implies the restriction must be  
23 objectively ..."

24 And we will pick up on this word again when we see  
25 the court:

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1 "The test for implementation must be objectively  
2 necessary for the implementation of the main transaction  
3 and be proportionate to it."

4 Then 30:

5 "The application of the ancillary restraints concept  
6 must be distinguished from the application of the  
7 defence under article 101(3) which relates to certain  
8 economic benefits produced by the restrictive agreements  
9 and which are balanced against the restrictive effects  
10 of the agreement. The application of the ancillary  
11 restraints concept does not involve any weighing of  
12 pro-competitive or anti-competitive effects. Such  
13 balancing is reserved for article 101(3)."

14 Now, I take it from your answer a moment ago that  
15 when you are dealing with the Visa counterfactual you  
16 have not had this in mind?

17 A. Well, my analysis is about MIF and the competitive  
18 effects on MIF in various counterfactuals and I think my  
19 analysis fits very well into the overall framework.  
20 What I haven't done explicitly is to say the overall  
21 agreement is the scheme and the MIF is the ancillary  
22 restriction. I think for my economic analysis, making  
23 that explicit wasn't necessary, I think my analysis  
24 would in any event be informative for the legal  
25 assessment.

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1 Q. Okay. If you move on to what the Court of Justice said  
2 about this at tab 19, page 419. It is not just  
3 an exercise in law, Dr Niels, I promise you, but it is  
4 extremely important when it comes to the context of your  
5 economic evidence.

6 So, page 419, MasterCard and I imagine your clients,  
7 which were RBS, were appealing this concept of ancillary  
8 restraints to the General Court and ultimately to the  
9 main court, the CJEU, and the findings of the main court  
10 are at page 419, paragraph 89:

11 "It is apparent from the case law of the Court of  
12 Justice that if a given operation or activity is not  
13 covered by the prohibition laid down in article 101,  
14 owing to its neutrality or positive effect in terms of  
15 competition, a restriction of the commercial autonomy of  
16 one or more of the participants in the operation is not  
17 covered by that prohibition rule either if that  
18 restriction is objectively necessary to the  
19 implementation of the operation."

20 Now I ask you to remember the word "objectively"  
21 because it is quite important.

22 "Where it is not possible to dissociate such  
23 a restriction from the main operation or activity  
24 without jeopardising its existence and aims, it is  
25 necessary to examine the compatibility of that

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1 restriction with article 81... 101... in conjunction  
2 with the compatibility of the main operation or  
3 activity, even though taken in isolation such a  
4 restriction may appear on the face of it to be covered  
5 by the prohibition."

6 91:

7 "Where it is a matter of determining whether  
8 an anti-competitive restriction ...

9 So again the three vices:

10 "... can escape the prohibition laid down in  
11 article 101(1), because it is ancillary to a main  
12 operation that it is not anti-competitive in nature, it  
13 is necessary to inquire whether that operation would be  
14 impossible to carry out in the absence of the  
15 restriction in question. Contrary to what the  
16 appellants..."

17 Which I understood to be your clients:

18 "... claim, the fact that their operation is simply  
19 more difficult to implement or even less profitable  
20 without the restriction concerned cannot be deemed to  
21 give that restriction the objective necessity required  
22 in order for it to be classified as ancillary. Such  
23 an interpretation would effectively extend that concept  
24 to restrictions which are not strictly indispensable in  
25 the implementation of the main agreement. Such

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1 an outcome would undermine the effectiveness of the  
 2 prohibition laid down in article 1."  
 3 Then 92 and 93 are important, but in the time I will  
 4 go quickly to 94:  
 5 "In ruling that only those restrictions which are  
 6 necessary in order for the main operation to be able to  
 7 function in any event may be regarded as falling within  
 8 the scope of the theory of ancillary restrictions and  
 9 the fact that the absence of the MIF may have adverse  
 10 consequences for the function of the MasterCard system  
 11 does not in itself mean that the MIF must be regarded as  
 12 objectively necessary if it is still apparent from  
 13 an examination of the MasterCard system in its economic  
 14 and legal context that it is still capable of  
 15 functioning without it. The General Court did not err  
 16 in law."  
 17 Again, have you had regard to -- it is not just  
 18 a question of economic evidence because essentially what  
 19 you are stating in your report -- you say so in terms  
 20 really -- you say that article 101 does not apply  
 21 because the MIF is so important to the MasterCard  
 22 scheme. It is essentially what you are saying in your  
 23 report, yes?  
 24 A. Yes. For various reasons, I have arguments -- 101(1) --  
 25 one category of reasons is, is it a restriction in the

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1 first place and I have arguments on: no, because it is  
 2 bilaterals and it is not a restriction actually --  
 3 acquiring competition isn't even restricted by common  
 4 cost law. But indeed also I try to relate my economic  
 5 evidence to the concept of objective necessity and there  
 6 I have drawn the distinction between the European  
 7 situation, or EC situation, which refers to the  
 8 intra-EEA MIFs and domestic MIFs in the UK, in the  
 9 relevant claim period and there I have laid out my  
 10 evidence as to why the MIF was, in my mind, objectively  
 11 necessary in those counterfactuals depending on what the  
 12 other schemes do in competition.  
 13 But in essence competition, or the MIF was  
 14 objectively necessary -- although that is a legal  
 15 concept -- it was necessary in my mind to allow  
 16 MasterCard to remain competitive in this specific period  
 17 in the UK that we have seen.  
 18 Q. So that is one of the questions you have been asked to  
 19 address, whether it is objectively necessary, and that  
 20 is essentially the doctrine of ancillary restraints,  
 21 because what is being asked is whether it is objectively  
 22 necessary for the operation of the main transaction.  
 23 The court has said you have to look at whether it is  
 24 impossible and that is a question of law to a certain  
 25 extent, but this is the ambit of what we are talking

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1 about, yes?  
 2 A. Yes.  
 3 Q. Now, you yourself just mentioned the word "objectively"  
 4 necessary. What do you understand by the term  
 5 "objectively"? You have applied it.  
 6 A. Again I can only apply it as an economist, but if I look  
 7 at the evidence and my own analysis, we are talking here  
 8 about the MasterCard MIF that was in place. In the  
 9 counterfactual in which the MasterCard MIF was much  
 10 lower, as low perhaps as the claimants put it, then  
 11 I think -- my objective analysis shows that you get  
 12 significant competitive dynamics in the intra-scheme  
 13 competition market. Now, those dynamics do depend  
 14 of course on what Visa does. I have clearly shown,  
 15 I think objectively, that if Visa -- if it is only  
 16 MasterCard that goes down to that level, Visa stays the  
 17 same and Amex is still also there, then the MasterCard  
 18 scheme could not compete effectively, or probably would  
 19 cease to exist in that market and therefore -- that was  
 20 my ground for concluding in that scenario it is  
 21 objectively necessary.  
 22 There is also the other scenario of course, if Visa  
 23 also goes down. I have also outlined that in my report.  
 24 I think there it is less clear, I'm less clear overall  
 25 how the legal tests would apply. To me economically it

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1 is clear that in that scenario, if both MasterCard and  
 2 Visa went down, they would still struggle against Amex,  
 3 so I have modelled it and clearly a lot of the premium  
 4 business would be lost to Amex. But whether at that  
 5 stage you would say they would go completely out of  
 6 business, that I'm not clear about.  
 7 Q. Again, just -- this may be a legal point but it governs  
 8 the parameters of your economic evidence. When you are  
 9 looking at a objective necessity, are you looking at  
 10 objective necessity simply from the perspective of  
 11 MasterCard or are you looking at it from the perspective  
 12 of a four-party scheme?  
 13 A. I think --  
 14 Q. It is quite an important distinction.  
 15 A. Yes, I think my analysis -- so the empirical evidence  
 16 I have looked at MasterCard and I used the Maestro  
 17 example. But actually my logic applies to any  
 18 four-party scheme -- not to three-party schemes because  
 19 they don't need a MIF to compete, but any four-party  
 20 scheme. Any individual four-party scheme that is in  
 21 competition with other schemes, four-party or  
 22 three-party, if that scheme was the only scheme that was  
 23 forced to go far down with its MIF, it would not be able  
 24 to compete, it would be competed out of the market. So,  
 25 in that sense, my analysis would also, if you flip it,

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1 apply to Visa if you flip it around and Visa were the  
 2 only scheme to be forced to set its MIF lower.  
 3 Q. I'm pleased you said that because I think at last you  
 4 agree with something the European Commission has said,  
 5 which is, if you take bundle E3.10, which is  
 6 the Commission's survey again, tab 202, and turn to  
 7 paragraph 52, page 4307, you said that essentially your  
 8 economic approach applies to both Visa and MasterCard.  
 9 You see there at -- I think we saw this yesterday -- but  
 10 paragraph 52, where you see:  
 11 "A restriction of competition may fall outside the  
 12 scope of article 101, if it can be shown that it is  
 13 objectively necessary for the existence of  
 14 agreement ~..."  
 15 And these are the important words:  
 16 "... of that type or that nature."  
 17 So a restriction of competition may fall outside the  
 18 scope of 101 "if it can be shown that it is objectively  
 19 necessary for the existence of an agreement of that type  
 20 or nature", and that is what objective necessity is  
 21 looking at, it is looking at whether a four-party scheme  
 22 of that nature can exist without a MIF; do you accept  
 23 that?  
 24 A. Yes, so I think in terms of the nature, I'm talking  
 25 about four-party credit card schemes and then in the

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1 specific context of the UK market over this claim  
 2 period. We have seen it before but the Commission in  
 3 a number of times refers then also to comparable payment  
 4 card schemes in other member states and I don't think  
 5 I have gone into a lot of detail on that but I think  
 6 those payment card schemes are not good comparators for  
 7 these purposes. They were all domestic debit card  
 8 schemes with a monopoly acquiring business. So not  
 9 really competing in the same sense with other payment  
 10 card schemes as MasterCard and Visa were clearly in the  
 11 claim period with each other and with Amex.  
 12 From that perspective, if the question is about  
 13 agreements of that type or that nature, I think we are  
 14 talking here about four-party credit card schemes in the  
 15 UK, in the relevant period.  
 16 Q. With that in mind, that's your economic approach -- do  
 17 you still have E1 open?  
 18 A. Yes.  
 19 Q. If you go to tab 3, which is the decision of the Office  
 20 of Fair Trading. I think at the time you were involved  
 21 in this and there are many references to the submissions  
 22 of MMF, which is your client.  
 23 A. Yes.  
 24 Q. If go to page 224 of this document. Something that  
 25 I showed Mr Perez and I will show you the transcript

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1 a bit later on. So it is at E1 at 224. Tab 3. This is  
 2 an argument that -- a similar argument that MasterCard  
 3 seems to be making in the present case. Summary of the  
 4 arguments made. So this is under the heading that  
 5 the MMF MIF -- so the MMF is your client as I understand  
 6 it -- the MMF MIF must be set by reference to  
 7 competitive restraints. This is what your client was  
 8 submitting:  
 9 "The OFT fails to recognise that freedom to set the  
 10 MMF MIF ... (Reading to the words)... would put the  
 11 scheme at a severe disadvantage."  
 12 Then somebody else argues that without this freedom  
 13 competition would be distorted, and you get the OFT's  
 14 response:  
 15 "In essence this argument suggests that the cost of  
 16 additional features ... (Reading to the words)... the  
 17 recovery of these costs is necessary."  
 18 Now this is important:  
 19 "On this basis otherwise unlawful conduct would  
 20 become lawful ... (Reading to the words)... the recovery  
 21 of the extraneous costs through the MMF MIF."  
 22 And I promise it will be the last case I will take  
 23 you to, I will take you to the British Airways case, but  
 24 have you -- we will see in a moment Mr Perez was aware  
 25 of this as a reason for -- in other words MasterCard

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1 can't say "I need a MIF to compete with Visa" and Visa  
 2 can't then say "I need a MIF to compete with MasterCard"  
 3 because it all becomes circular. Have you factored this  
 4 in to your counterfactual in your report?  
 5 A. I have explicitly made or recognised or set out that  
 6 there are the two alternative counterfactuals, one in  
 7 which both Visa and MasterCard go down, one in which  
 8 MasterCard goes down and Visa stays up. I'm aware of  
 9 the arguments pro and against. I have set out my  
 10 reasons why I would actually prefer the scenario where  
 11 Visa stays up but those were my reasons. I have set out  
 12 the implications of both scenarios in my report.  
 13 I think it is ultimately -- I think it is up here for  
 14 the Tribunal to come to a view which of those scenarios  
 15 are more relevant for the objective necessity questions  
 16 but equally I would say later on for the damages  
 17 question.  
 18 Q. I promise it will be the last case. If you quickly go  
 19 to the authorities bundle, which is the British Airways  
 20 case. It looks as if it is 12.2, but it is 12.2. It  
 21 just looks as 12.2. It is the very first tab, tab 8A.  
 22 I'm just showing you the passage that the OFT relied on.  
 23 It is not just the OFT's view it is relying on  
 24 established jurisprudence from the European Court.  
 25 I will give you the paragraph number. It is

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1 paragraph 70. The page number is 1499A.23.  
 2 So here there was a complaint, British Airways were  
 3 saying: you are only getting me, what about the others?  
 4 And the General Court says:  
 5 "Whereas in this case the Commission is faced with  
 6 a situation where numerous factors give rise to  
 7 a suspicion of anti-competitive conduct on the part of  
 8 several large undertakings in the same economic sector,  
 9 the Commission is even entitled to concentrate its  
 10 efforts on one of the undertakings concerned while  
 11 inviting the economic operators which have allegedly  
 12 suffered damage as a result of the possibly  
 13 anti-competitive conduct of the other undertakings to  
 14 bring the matter before the national authorities."  
 15 So, again, there in a counterfactual you have  
 16 a situation where if somebody else is acting in the same  
 17 way, they can be sued in damages. Were you aware of --  
 18 Mr Perez was aware of this principle; were you aware of  
 19 this principle when you did your first report?  
 20 A. Sorry, of the principle about a damages claim?  
 21 Q. Yes, that in other words when you are asking yourself  
 22 the question whether Visa would accept the issuers, you  
 23 are asking yourself the question whether issuers would  
 24 apply to be licensees of Visa, whether you accept that  
 25 the retailers would just sit back and do nothing, there

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1 are claims for damages against Visa if they are acting  
 2 in the same anti-competitive way as MasterCard and  
 3 I just am asking you whether you have factored into your  
 4 counterfactual, which is a straight line migration down,  
 5 whether you have factored in this possibility of some  
 6 sort of check on Visa acquiring all this business  
 7 because of a claim for damages?  
 8 A. Again, I have set out both scenarios. I'm aware of the  
 9 reasons why you are in one rather than the other. The  
 10 British Airways -- I'm aware of this principle, that if  
 11 one breaks the law and the other doesn't because the  
 12 other one does it, yes, that is an interesting principle  
 13 to think about in this case. I think now the question  
 14 is about the possibility that when thinking about let's  
 15 say in the situation where MasterCard was forced to  
 16 lower its MIF, whether Visa, rather than being forced by  
 17 that same intervention or the same regulator, whether  
 18 they would do so on the commercial basis or for fear of  
 19 a damages claim later. I think I have considered it and  
 20 I think it is actually one of the reasons why I -- for  
 21 the damages case certainly, for the damages  
 22 counterfactual, why I think that is unlikely, or rather  
 23 the other way round, why I think it is likely that even  
 24 in the relevant claim period, why if MasterCard had gone  
 25 down in that period, Visa would not by itself have gone

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1 down for fear of a damages claim or commercial  
 2 consideration, because what we have actually observed --  
 3 and that's why I think the UK Maestro is such a good  
 4 comparator market in the same period -- there are  
 5 differentials between MIFs and that's beneficial to the  
 6 scheme that can put the higher MIF. I mean that's the  
 7 essence of competition between schemes, that actually if  
 8 they have a higher MIF they can benefit.  
 9 So I think it would be -- it would have been  
 10 speculative of me to say, well, Visa would have gone  
 11 down just because they were facing a damages claim where  
 12 I think commercially it would have been quite attractive  
 13 for them to stay at a high level.  
 14 Q. You don't think then that the possibility of a damages  
 15 claim, the fact that Visa is being investigated, the  
 16 fact as we established with Mr Perez, the Commission  
 17 saying both schemes could be treated equally, what you  
 18 have just said a few moments ago that what applies to  
 19 MasterCard applies to Visa, you don't think that would  
 20 have any check on the migration at all?  
 21 A. I can only comment on what my impressions are but my  
 22 impressions are that that whole period, the period that  
 23 we are talking about was a very murky period with lots  
 24 of uncertainty over what would happen and indeed what  
 25 would be ultimately acceptable level of MIFs. In that

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1 period of uncertainty, I can't see -- schemes would  
 2 change if they were forced to by regulators and if there  
 3 was more certainty and indeed we are now in a new world  
 4 with regulations so it is all clearer, so it is  
 5 a separate world, but in those nine years of the damages  
 6 claim period that we are talking about, I think it was  
 7 a murky period in which it was quite unclear where --  
 8 even what was the right level of MIF, domestic MIF, and  
 9 where each scheme would have ended up. But that's just  
 10 my impression, I can't give an expert opinion on that.  
 11 Q. No, precisely.  
 12 Can we just go to J2 and we will try and finish this  
 13 before lunch.  
 14 I want to go to two more bundles. J2-bundle and  
 15 D3.1. Your second supplemental report at D3.1. Tab 6.  
 16 So at tab 9 of J2, we have the evidence of Mr Perez  
 17 and I will take this quickly because you have  
 18 essentially agreed with what he has said.  
 19 But in page 17 of the transcript, 1120, at the top,  
 20 his evidence is that the two four-party schemes are  
 21 similar. So:  
 22 "Question: In this case, are you aware that  
 23 MasterCard was arguing that the Visa exemption should  
 24 apply to its methodology?  
 25 "Answer: Yes.

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1 "Question: Why should the Visa methodology apply to  
2 MasterCard?  
3 "Answer: Because ... based on cost and therefore  
4 similar."  
5 I tried to get out of him "very similar", but he  
6 just maintained "similar".  
7 If you go to page 18 over the page. Again, it is  
8 a pretty obvious fact. I ask:  
9 "Question: What about just the mechanics of it?  
10 Four-party schemes; do you at least accept that they  
11 operate in a similar way --  
12 "Answer: Yes."  
13 We go on to page 38, which is where I asked him  
14 about a note of a meeting, so his 1141, page 38. There  
15 was a meeting between him and others and  
16 the Commissioner, where the Commission said there would  
17 be no discrimination against MasterCard and Visa.  
18 I asked him about this principle of damages and he  
19 was aware of it. So I'm just setting the scene at the  
20 moment. I think you have accepted everything --  
21 A. Yes.  
22 Q. -- in your own evidence so far.  
23 But then I would like to go to page 54. It starts  
24 at 54 but the relevant bit is at 56, 57. If I give you  
25 the context. At 54 I'm asking Mr Perez why he reduced

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1 the -- (Pause).  
2 MR HOSKINS: This bit was this camera.  
3 MR BREALEY: This bit was, not the fact that they were  
4 similar. That is public knowledge, so thank you, but --  
5 okay. Anyway, so I'm asking him -- this is what the CMA  
6 said, that they had reduced rates in November 2014,  
7 2015.  
8 Then if you go to page 56, I'm asking him why  
9 MasterCard did this -- I am grateful but it is a matter  
10 of public knowledge, CMA website, that MasterCard  
11 reduced its rates. And I'm asking why they did this.  
12 (aside) Do you know whether 56, line 19 is  
13 confidential? It is. So I won't read that out. It was  
14 in camera.  
15 I think I can mention a word, I would ask you to  
16 note the word "perception".  
17 A. Sorry where?  
18 Q. I'm sorry Dr Niels, it is page 1159, page 56, line 19.  
19 A. Yes.  
20 Q. So at line 19 it starts?  
21 "Answer: "So the issuers ..."  
22 Yes? Then it goes on. Then you get "the  
23 perception".  
24 A. Yes.  
25 Q. That is one of the reasons that he is saying that they

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1 reduced. Then over the page at 57 I say:  
2 "Question: "So the greater ... the less risk".  
3 You see that?  
4 A. Yes.  
5 Q.  
6 "Question: That would apply ..."  
7 At 12, as well as to ... And he says ...  
8 Okay?  
9 A. Yes.  
10 MR BREALEY: I'm finding it a bit difficult, but --  
11 MR JUSTICE BARLING: If there's going to be much of this --  
12 MR BREALEY: No there isn't. I would ask you to bear that  
13 in mind and then just go to the last document and  
14 then ...  
15 So that was his evidence and if you go to your  
16 second supplemental report at page 621, this is in the  
17 section 4, the competitive dynamics. This is where you  
18 try and deal with Mr von Hinten-Reed's Australian  
19 experience. So this is dealing with Australia. You  
20 obviously know this?  
21 A. Yes.  
22 Q. One of the questions is, why did Amex not get a greater  
23 market share, yes?  
24 A. Yes.  
25 Q. Bearing in mind what Mr Perez says, at 4.16, this is

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1 paragraph 4.16, 621. This is your own view as to why  
2 Amex did not obtain a greater market share and you say:  
3 "I consider that the constant threat of being  
4 designated could have affected Amex's incentives such  
5 that it did not pursue a strategy to increase its market  
6 share considerably in Australia, as being designated  
7 would have led to its charges being capped in a similar  
8 way to MasterCard and Visa. There was no equivalent  
9 threat of a regulation of Amex in the UK during the  
10 claim period."  
11 But what you are saying here is that the threat of  
12 being designated does affect the card payments  
13 incentives to pursue a strategy to increase market share  
14 and I would suggest to you that that is a commonsense  
15 view and one that equally applies to the Visa  
16 counterfactual -- see what we have just seen -- and that  
17 you should have factored this in to your Visa scenario 1  
18 counterfactual.  
19 A. Well, if I may comment on what the various bits that we  
20 have just seen?  
21 Q. Of course.  
22 A. Also from what Mr Perez was saying.  
23 The way I see it and I'm simplifying perhaps but  
24 what I said earlier, the relevant claim period here was  
25 a murky world. So, yes, the Commission may have been

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1 saying "We will treat you both the same", but still that  
 2 was -- even that wasn't clear whether they actually did  
 3 but it was intra-EEA MIF. For domestic MIF in the UK  
 4 there was no -- it wasn't clear what was going to  
 5 happen, what would be the right level and we had the UK  
 6 Maestro example. That was for most of the claim period.  
 7 We are now in the new world of regulation, where it is  
 8 much clearer, they are all going to be treated the same  
 9 including Amex, in as far as it uses issuers.  
 10 So this current world is a different world and  
 11 I understand Mr Perez's evidence is that yes a few  
 12 things are happening in anticipation of the current  
 13 world but it is still with the current world with  
 14 regulation. The Australian example -- and again there  
 15 are various interesting aspects of that Australian  
 16 example and also why it is different from the UK  
 17 example, but in Australia we are talking here there was  
 18 a regulation in place and there was a mechanism whereby  
 19 the authorities constantly kept an eye on Amex and  
 20 I would say in response to the proposition that that was  
 21 of a different nature because there was already  
 22 a regulation from say Visa fearing that it would be  
 23 treated, or its interchange fees would have to stay the  
 24 same as MasterCard, even if the competition authority  
 25 intervention were only against MasterCard. So I think

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1 you can't entirely compare the two.  
 2 MR JUSTICE BARLING: Is that a good time?  
 3 MR BREALEY: It is.  
 4 MR JUSTICE BARLING: We are still on target?  
 5 MR BREALEY: We are still on target and we will be in  
 6 camera --  
 7 MR JUSTICE BARLING: For the sake of those in court now, the  
 8 likelihood is you are going to ask to be in camera more  
 9 or less straight --  
 10 MR BREALEY: I'm doing the Amex and then the Maestro and all  
 11 that is --  
 12 MR JUSTICE BARLING: All that is in camera. So most of the  
 13 afternoon will be in camera?  
 14 MR BREALEY: That's what I'm thinking.  
 15 MR JUSTICE BARLING: Right. See you at 2 o'clock.  
 16 (1.00 pm)  
 17 (End of open session)  
 18 (The short adjournment)  
 19 (2.00 pm)  
 20 (REDACTED CONFIDENTIAL SESSION)  
 21 (4.00 pm)  
 22  
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