Amended in accordance with the terms of the Order of the Tribunal made on 11 August 2016

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IN THE COMPETITION APPEAL TRIBUNAL

Case Number: 1241/5/7/15 (T)

14 July 2016

Before:

THE HONOURABLE MR JUSTICE BARLING
(Chairman)
PROFESSOR JOHN BEATH OBE
MARCUS SMITH QC

Sitting as a Tribunal in England and Wales

BETWEEN:

SAINSBURY'S SUPERMARKETS LTD

Claimant

-and-

(1) **MASTERCARD INCORPORATED**
(2) **MASTERCARD INTERNATIONAL INCORPORATED**
(3) **MASTERCARD EUROPE SA**

Defendants

Heard at Victoria House on 25-28 January, 2, 3, 5, 8-11, 18, 19, 22, 23, 25, 26, 29 February, 1, 11 and 14-16 March 2016

JUDGMENT

APPEARANCES

Mr Mark Brealey QC, Mr Derek Spitz and Ms Sarah Love (instructed by MdR) appeared on behalf of the Claimant.

Mr Mark Hoskins QC, Mr Matthew Cook and Mr Hugo Leith (instructed by Jones Day) appeared on behalf of the Defendants.

Note: Excisions in this Judgment (marked "[…][✂]") relate to commercially confidential information: Schedule 4, paragraph 1 to the Enterprise Act 2002.

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ANNEXES

Annex 1: Terms and abbreviations used in the Judgment
Annex 2: Overview of UK and EU regulatory decisions

A. Introduction

1. By a claim begun in the Chancery Division of the High Court of Justice and transferred to the Competition Appeal Tribunal by order of Barling J,[1] the Claimant, Sainsbury's Supermarkets Ltd ("Sainsbury's"[2]), claims damages, interest and declaratory relief for infringements of one or more of:

   (1) Chapter I of the Competition Act 1998.

   (2) Article 101 of the Treaty on the Functioning of the European Union ("TFEU").

   (3) Article 53 of the Agreement on the European Economic Area ("EEA Agreement").

2. These provisions are all concerned to prohibit agreements between undertakings, decisions by associations of undertakings or concerted practices which have as their object or effect the prevention, restriction or distortion of competition. The thrust of these provisions is the same – essentially to prohibit agreements (and equivalent arrangements) which distort competition, including cartels and cartelist behaviour – but they vary in their details (in particular as regards their territorial scope and effect). It is appropriate to set out Article 101 TFEU:

> "1 The following shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market, and in particular those which:
>
> (a) directly or indirectly fix purchase or selling prices or any other trading conditions;
>
> (b) limit or control production, markets, technical development or investment;
>
> (c) share markets or sources of supply;

---

[1] See the Ruling of Barling J [2015] EWHC 3472 (Ch), and his Order dated 1 December 2015.

[2] The abbreviations used in this Judgment are set out in Annex 1, which also describes the paragraph in the Judgment where each abbreviation is first used.

(d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

(e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

2 Any agreements or decisions prohibited pursuant to this Article shall be automatically void.

3 The provisions of paragraph 1 may, however, be declared inapplicable in the case of:

- any agreement or category of agreements between undertakings,
- any decision or category of decisions by associations of undertakings,
- any concerted practice or category of concerted practices,

which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

(a) impose on the undertakings concerned restrictions which are not indispensible to the attainment of these objectives;

(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question."

The distinctions between Article 101 TFEU, Chapter I of the Competition Act 1998 and Article 53 of the EEA Agreement do not – on the facts of the present case – appear to us to be material. We note, however, that whilst the Tribunal has jurisdiction to determine alleged breaches of Article 101 TFEU and Chapter I of the Competition Act 1998, it does not have such jurisdiction in relation to alleged infringements of Article 53 of the EEA Agreement. Accordingly, we will generally refer to the provisions of Article 101 TFEU. Save where the contrary is stated, or the context otherwise requires, when we refer to the provisions of Article 101 TFEU, we also intend to refer to the provisions of Chapter I of the Competition Act 1998. We do not refer to Article 53 of the EEA Agreement. To the extent that findings must be made in respect of Article 53 – and we do not, as presently advised, consider that they do – this will be a matter for the High Court in accordance with the Ruling and Order referred to in footnote 1 above. Similarly, although we did not hear argument on the point, it seems to us that any declaratory relief (if any) would also be a matter for the High Court.

3. Instead of repeating the wordy mantra that Article 101(1) TFEU prohibits "agreements between undertakings, decisions by associations of undertakings and concerted practices…which have as their object or effect the prevention, restriction or distortion of competition", we shall refer to "anti-competitive agreements" or the "restriction of competition" as a convenient shorthand.

4. It is Sainsbury's case that the Defendants – MasterCard Incorporated ("MasterCard Inc"), MasterCard International Incorporated ("MasterCard International") and MasterCard Europe SA [3] ("MasterCard Europe"), collectively "MasterCard" – acted unlawfully and in breach of Article 101 TFEU in establishing and implementing certain fees known as "Multilateral Interchange Fees" or "MIFs", which Sainsbury's was required to pay on credit[4] and debit card transactions under MasterCard's payment scheme for credit and debit cards (the "MasterCard Scheme").

5. The outlines of the MasterCard Scheme are considered in the next Section.

B. The MasterCard Scheme

6. The MasterCard Scheme is a world-wide payment scheme managed and represented by MasterCard. The MasterCard Scheme operates as a network, whose licensees are banks or other financial institutions. Essentially, licensees are able to participate in the scheme – assuming they are licensed by MasterCard – as issuing banks ("Issuing Banks") and/or as acquiring banks ("Acquiring Banks"). More specifically:

   (1) Issuing Banks are those banks that have a contractual relationship with the holder of a MasterCard credit or debit card, allowing for the provision of the card to, and use of it by, the cardholder (the "Cardholder").

   (2) Acquiring Banks are those banks that have a contractual relationship with a merchant (the "Merchant") that allows for the acceptance of a

[3] The claim was issued against MasterCard Europe SPRL. MasterCard Europe SPRL became MasterCard Europe SA on 30 June 2015.

[4] Although for certain purposes there are differences between credit cards and charge cards, for the purpose of this judgment, references to credit cards include charge cards.

MasterCard card at that Merchant's point of sale. Card transactions can be accepted in a variety of ways. For the purposes of this Judgment, the two most significant ways are by "chip PIN" and "on-line". Chip PIN transactions occur where the Cardholder is physically present at the Merchant's point of sale, the transaction being validated by the entry by the Customer of a "personal identification number" ("PIN") into the Merchant's card-reading terminal. On-line transactions are transactions that occur over the internet. Along with transactions made by telephone or mail-order, these are referred to as "card not present" ("CNP") transactions.

7. Issuing and Acquiring Banks participate in the MasterCard Scheme through various rules and requirements laid down by MasterCard (the "MasterCard Scheme Rules"). Pursuant to these Rules, Issuing Banks and Acquiring Banks are, as licensees of the MasterCard Scheme, authorised to issue and/or accept MasterCard cards. It should be noted that the MasterCard Scheme Rules are in some cases obligatory (i.e. licensees must abide by them) and in some cases facultative, voluntary or default (i.e. licensee can "contract out" by entering into bilateral agreements or arrangements with other licensees).

8. When a Cardholder makes a purchase from a Merchant using a MasterCard card, the process by which the transaction (that is, the purchase) is completed involves the following steps:

(1) Prior to the transaction taking place:

(i) MasterCard will have licensed the Issuing Bank to issue a card to the Cardholder, and the Issuing Bank will have done so, on terms agreed between the Cardholder and the Issuing Bank.

(ii) MasterCard will have licensed the Acquiring Bank to equip the Merchant with the necessary equipment and authority to process MasterCard card transactions in accordance with the MasterCard Scheme. The agreement between the Acquiring Bank and the Merchant is known as the "Merchant Services Agreement", which term we use in this Judgment.

(2) The Cardholder presents the card issued to him or her by the Issuing Bank in offer of payment to the Merchant. The Merchant, pursuant to the Merchant Services Agreement, transmits information concerning the transaction and the Cardholder's card details to the Acquiring Bank.

(3) The Acquiring Bank transmits information to the Issuing Bank to obtain authority for the transaction to proceed.[5]

(4) Upon the authorisation of the transaction, the Issuing Bank collects the full payment for the transaction from the Cardholder's account with the Issuing Bank (in the case of a debit card transaction) or extends credit to the Cardholder (in the case of a credit card transaction).

(5) The Issuing Bank forwards to the Acquiring Bank the full transaction amount minus a so-called interchange fee (the "Interchange Fee"), which is retained by the Issuing Bank. This is regulated either by the MasterCard Scheme Rules or by specific agreement between the Issuing Bank and the Acquiring Bank.

(6) The Acquiring Bank forwards the transaction amount to the Merchant, after deducting from that amount a charge for its services. Together, the Interchange Fee and the additional charge to the Merchant comprise the "Merchant Service Charge" or "MSC".[6] Payment of the Merchant Service Charge by the Merchant is governed by the Merchant Services Agreement. Thus, the Merchant Service Charge includes:

(i) The Interchange Fee retained by the Issuing Bank.

(ii) A fee charged to the Merchant by the Acquiring Bank for the provision of its services.

[5] This is the general rule. There are cases where the transaction is approved at the Merchant's point of sale without further reference; there are also cases where the transaction is approved by an entity other than the Issuing Bank. The precise details do not matter for the purposes of this Judgment.

[6] In addition, both the Issuing Bank and the Acquiring Bank will pay scheme fees to MasterCard. Quite how these were charged for and accounted for was not a matter on which we were addressed in any detail, and these scheme fees are not a matter of any importance to this Judgment. We do not refer to them further.

Sainsbury's puts its case on the basis that it pays the Interchange Fee through the Merchant Service Charge. Whilst it may be no more than a matter of terminology, we should note that the point is controversial. Paragraph 39(b) of MasterCard's Re-Amended Defence states:

> "In relation to the [Merchant Service Charge], unless the agreement between [Sainsbury's] and its acquirer split out separate elements of the [Merchant Service Charge], it is denied that the [Interchange Fee] forms part of the [Merchant Service Charge]. The [Merchant Service Charge] is simply a single fee which will be the highest fee that the acquirer can negotiate with the merchant, in competition with other acquirers. That fee will often be the same for different types of transaction even though different levels of interchange fee will be payable on those transactions."

(7) One point that was not controversial before us was that the Interchange Fee retained by the Issuing Bank comprised the vast majority (around 90%[7]) of the Merchant Service Charge. It was also not controversial that the cost of the Interchange Fee was borne by the Merchant: this is because – unless the Merchant chose to "surcharge" the Cardholder for paying by card – the Cardholder would pay the same price for the goods or services he or she purchased irrespective of the mode of payment.

9. It must be stressed that this is an extremely high-level description of the manner in which transactions between a Cardholder and a Merchant are processed. It will be necessary, later in this Judgment, to consider aspects of the MasterCard Scheme in greater detail. But, even at the stage of a high-level description, we should note some additional points:

(1) The description in paragraph 8 above assumes that the Issuing Bank and the Acquiring Bank are different entities. It is perfectly possible for the Issuing Bank and the Acquiring Bank to be the same entity, in which case the processes described in paragraph 8 will be different in some respects. In particular, there will be no agreement, because the Issuing Bank and the Acquiring Bank is the same legal person acting in the same capacity.

[7] A good idea of the Interchange Fee element within the Merchant Service Charge can be derived from the memorandum of Mr von Hinten-Reed (Sainsbury's expert economist) dated 10 March 2016.

(2) The description makes no reference to the costs of the Issuing Bank, which may be defrayed by the Interchange Fee. Without, for the present, commenting on or seeking to determine the point, we note what the Re-Amended Defence says in paragraph 46(c):

> "This example does not cover disputes about the transaction, fraud or cardholder default. These situations (and measures taken to prevent/address them) result in a substantial part of the costs of issuers. The interchange fee contributes to these costs…"

(3) The description makes no reference to the timing of transactions. Without, for the present, commenting on or seeking to determine the point, we note what the Re-Amended Defence says in paragraph 46(d):

> "The example also makes no reference to timing. The default scheme rules in relation to the timing of payments by issuers to acquirers provide for same day/next day payment. As a result, if the default rules apply, issuers are required to pay acquirers shortly after transactions take place. However, for credit card transactions, issuers will generally not receive payment from cardholders for at least several weeks, requiring the issuer to fund the transactions until payment. Again the interchange fee contributes to these costs. Meanwhile, because acquirers receive payments shortly after transactions take place, they can pay merchants shortly after transactions take place without incurring any funding costs…"

(4) Finally, the description makes no reference to the so-called "Honour All Cards Rule" or "HACR". If a Merchant wishes to accept a type of MasterCard card, it must accept all cards of that type issued by MasterCard Issuing Banks. A Merchant is permitted to differentiate between types of card: but as regards cards falling within a defined type of card, the Honour All Cards Rule requires a Merchant who wishes to accept such cards to accept <u>all</u> such cards.

10. Because it lies at the heart of Sainsbury's claim, it is necessary to say a little more about the Interchange Fee:

(1) As was described in paragraphs 8(5) and 8(6) above, the Interchange Fee is charged for and retained by the Issuing Bank by agreement with the Acquiring Bank, who passes the cost on to the Merchant, pursuant to the Merchant Service Charge.

(2) The Interchange Fee may either be agreed bilaterally between the Issuing and the Acquiring Banks or, failing that, the default fee established multilaterally by MasterCard pursuant to the MasterCard Scheme Rules is charged. In the latter case, it is a Multilateral Interchange Fee or MIF.

(3) This case concerns the MIFs paid by Sainsbury's as part of the Merchant Service Charge pursuant to the Merchant Services Agreements it entered into with its Acquiring Banks.[8]

(4) MIFs can have different territorial scopes. Thus:

(i) MasterCard may set what is known as an "intra-EEA MIF" in respect of transactions where a card issued in one EEA state is used at a Merchant whose outlet is based in a different EEA state, and the relevant Issuing and Acquiring Banks have not negotiated a bilateral Interchange Fee.

(ii) There is also a MIF applicable (in the absence of a bilateral arrangement) where a card is used at a Merchant situated in a different global region (outside the EEA) from the Issuing Bank or *vice versa* – for example, where a US tourist uses his or her card issued in the US to buy goods in London or where a UK tourist uses his or her card issued in the UK to buy goods in New York. This is sometimes known as the "International MIF".

(iii) MasterCard may set what is known as a "domestic MIF" in respect of transactions where a card is used to pay a Merchant who is situated in the same country as the relevant Issuing Bank, and the Issuing and Acquiring Banks have not negotiated a bilateral Interchange Fee.

[8] As is described more fully below, Sainsbury's in fact had contractual relations with several Acquiring Banks.

(iv) In the absence of a domestic MIF for a specific state, the intra-EEA MIF may operate as a default for that particular state. This case centres on the MIFs within the United Kingdom – the so-called "UK MIF". There was, at all material times, a UK MIF, and so the intra-EEA MIF is not something that it is necessary to consider in this Judgment. How the UK MIF came to be set in this case is considered in greater detail below.

11. With that introduction to the MasterCard Scheme, the next Section briefly identifies and describes the issues arising between the parties.

C. The Issues Between the Parties

(1) Sainsbury's Claim

12. Sainsbury's claims damages for breach of Chapter I of the Competition Act 1998 and/or Article 101 TFEU by reason of the level at which the UK MIF was set for MasterCard cards.

13. Essentially, by its Amended Particulars of Claim, Sainsbury's contends that:

(1) The setting of the UK MIF was a decision by an association of undertakings and/or agreement and/or concerted practice of (amongst others) MasterCard done pursuant to the MasterCard Scheme Rules.

(2) That decision/agreement/concerted practice had and continues to have as its object and/or effect the appreciable prevention, restriction or distortion of competition between Acquiring Banks in the UK. As to this, Sainsbury's:

(i) Defines the relevant product market affected by the UK MIF as the market for acquiring payment card transactions in the UK.

(ii) Defines the relevant geographic market as the UK.

(iii) Asserts that the UK MIF distorts competition between Acquiring Banks in the UK by inflating the base on which Acquiring Banks set charges to Merchants, thereby setting a

"floor" to the Merchant Service Charge. In short, it is contended that, in the absence of the UK MIF, the Merchant Service Charge charged to Merchants by Acquiring Banks in the UK would be lower, because the level of the Interchange Fee would be lower.

(3) The UK MIF set has affected, and continues to affect, trade within the UK, the EU and EEA to an appreciable extent.

(4) The damages recoverable for this (alleged) breach of statutory duty are to be calculated by reference to either:

(i) The overcharge, reflecting the difference between the UK MIF paid by Sainsbury's as part of the Merchant Service Charge and the Interchange Fee that could lawfully have been set ("overcharge damages"); or

(ii) If and in so far as the alleged overcharge is shown to have been "passed on" by Sainsbury's to its customers, and to be irrecoverable in law as a result, the extent to which Sainsbury's lost profits on lost sales because of the unlawful UK MIF ("lost sales damages").

These two bases for calculating damages need to be considered separately.

(5) As regards overcharge damages:

(i) Sainsbury's starting point is that the UK MIF should have been calculated by reference to a test known as and referred to herein as the "Merchant Indifference Test" or "MIT". The nature of that test is considered further below.

(ii) This, according to Sainsbury's, would result in a substantially lower UK MIF, which would be capable of being exempted pursuant to Article 101(3) TFEU and would therefore not be unlawful.

(iii) Sainsbury's overcharge damages are, in essence, the difference between the UK MIF Sainsbury's says it actually paid and the maximum it should have paid for each transaction entered into by Sainsbury's over the course of the claim period.

(6) As regards lost sales damages, Sainsbury's pleadings do not contain more than the bare assertion (in paragraph 50 of the Amended Particulars of Claim) that "the measure of Sainsbury's damages is lost profits on lost sales". As indicated above, this head of claim is only relied upon by Sainsbury's if and to the extent that MasterCard succeeds in its defence of "pass-on". That issue is hotly contested and we have heard a good deal of evidence on it, to which we will refer in due course.

(7) In addition, Sainsbury's claimed exemplary damages from MasterCard, as well as interest on either a compounded or (in the alternative) simple basis. In the event, Sainsbury's claim to exemplary damages was abandoned in its written closing submissions, and we do not consider this further in this Judgment.[9]

(8) Like pass-on, Sainsbury's claim for interest was also hotly contested between the parties, in particular as regards the basis upon which interest should be calculated. We will refer to this debate in due course.

14. In support of its claim, Sainsbury's relies upon a decision of the Commission of the European Union addressed to MasterCard and dated 19 December 2007 (the "Commission Decision"). That Decision was in relation to the intra-EEA MIF, and not the UK MIF that is the subject of these proceedings. In essence, the Commission Decision was that the intra-EEA MIF set by MasterCard pursuant to the MasterCard Scheme infringed Article 101 TFEU (then Article 81 of the EC Treaty) and Article 53 EEA Agreement.

[9] §12(i) of Sainsbury's Written Closing Submissions dated 9 March 2016 ("Sainsbury's Closing") states that "Sainsbury's does not maintain its claim for exemplary damages".

15. The Commission Decision was appealed by MasterCard to the General Court of the European Union, which dismissed MasterCard's appeal: Case T-111/08, *MasterCard v European Commission* [2012] 5 CMLR 5. MasterCard then appealed to the Court of Justice of the European Union, which also dismissed MasterCard's appeal: Case 382/12, *MasterCard v European Commission* [2014] 5 CMLR 23. The Commission Decision therefore stands. The Court of Justice's decision makes a number of important statements of the law, to which we will have occasion to refer in this Judgment.

16. Sainsbury's initial position was that the Commission Decision could be "read across" to the present case. In other words, it appeared to contend that the Commission Decision was either binding upon this Tribunal or else of influence in the decision the Tribunal must make. This issue was the subject matter of considerable debate in opening, and Sainsbury's position moved rather closer to that contended for by MasterCard.

(2) MasterCard's Defence

17. By its Re-Amended Defence, MasterCard raises a number of points in answer to Sainsbury's claim. Taking them broadly in the order considered in this Judgment (rather than the order in which they are pleaded), these points are as follows:

    (1) *The effect and significance of the Commission Decision.* As regards the Commission Decision, MasterCard notes "that the Commission Decision did not relate to or even consider the UK MIF and only related to the EEA MIF in force between 1992 and 19 December 2007" (paragraph 6 of the Re-Amended Defence). It is, accordingly, denied by MasterCard that there is to be any "read across" of the Commission Decision, given the different factual circumstances of this case. MasterCard contends that Sainsbury's claim "is a stand-alone action and [Sainsbury's] is required to prove each element of its claim" (paragraph 65(b)(iv) of the Re-Amended Defence).

    (2) *No infringement of Chapter I of the Competition Act 1998 and/or Article 101 TFEU.* A number of points fall under this head:

(i) *Market definition.* MasterCard takes issue with Sainsbury's definition of the product market, but not the geographical market. Paragraph 68(b) of the Re-Amended Defence provides:

> "In relation to relevant product market, MasterCard denies that it is correct to look at the UK MIF solely in the context of the acquiring market (as defined). The UK MIF also has a direct effect on the issuing market i.e. the market for transactions on MasterCard payment cards as between cardholders and issuers and the market for the issuing of MasterCard payment cards."

(ii) *No association of undertakings.* For reasons pleaded in the Re-Amended Defence, MasterCard contends that it ceased to be an association of undertakings after June 2009, alternatively in June 2010, alternatively after April 2014. If this is right, then to the extent that Sainsbury's claims are based on decisions of associations of undertakings, Sainsbury's claims will fail in respect of transactions after these (alternative) dates.

(iii) *No agreement or concerted practice between undertakings.* MasterCard denies that the UK MIFs were established, set or imposed pursuant to an agreement and/or concerted practice between undertakings.

(iv) *No restriction of competition.* MasterCard contends that even if – which is denied – the establishment of UK MIFs constituted agreements between undertakings, decisions by associations of undertakings and/or concerted practices, these did not have as either their object or their effect the prevention, restriction or distortion of competition.

(v) *Objective necessity.* MasterCard contends that "it was objectively necessary and proportionate to have a UK MIF in order for the MasterCard Scheme to operate in the United Kingdom" (paragraph 13 of the Re-Amended Defence).

(vi) *Appreciability.* MasterCard puts Sainsbury's to proof that any restriction of competition had an appreciable effect on competition (paragraph 75 of the Re-Amended Defence).

(3) *Illegality.* It is contended by MasterCard that Sainsbury's is part of the same "undertaking" as Sainsbury's Bank plc ("Sainsbury's Bank") and that – assuming MasterCard to be an association of undertakings, and assuming a breach of competition law in relation to the UK MIF (both of which are denied by MasterCard) – Sainsbury's is "a party to that infringement. Consequently, any claim by [Sainsbury's] in relation to that infringement is barred by the principle *ex turpi causa*" (paragraph 4 of the Re-Amended Defence).

(4) *Limitation.* Although on the face of the pleadings it appeared that the question of limitation raised some difficult questions, the Summary of the Parties' Positions on Agreed List of Issues dated 24 November 2015 (the "Agreed List of Issues") established common ground so that it is unnecessary for us to consider and resolve these questions.[10] In summary:

(i) It is common ground that for transactions in England, Wales and Northern Ireland, Sainsbury's claim is limited to the period from 19 December 2006 onwards.

(ii) It is common ground that for transactions in Scotland, Sainsbury's claim is limited to the period from 19 December 2007 onwards.

(iii) We formed the strong impression that it was common ground, or at least not contested by Sainsbury's, that Sainsbury's could not claim in respect of transactions made after the entry into force of the Payment Card Interchange Fee Regulations 2015, S.I. 2015 No.1911 (the "2015 Interchange Fee Regulations") (see paragraph 430 below). The 2015 Interchange Fee

[10] Agreed List of Issues at 1.2. See, however, paragraph 96 below.

Regulations have their genesis in European law and we consider them in greater detail later on in this Judgment. For present purposes, it is simply necessary to note that they came into force on 9 December 2015, and that this date provides a temporal end-point for Sainsbury's claims.

We shall refer to the period commencing 19 December 2006 and ending 9 December 2015 as the "claim period".

(5) *Damages.* MasterCard takes a number of points in relation to the damages claimed by Sainsbury's:

(i) *Pass-on.* If and to the extent that the UK MIF infringed competition law, MasterCard denies that Sainsbury's has suffered any loss to the extent to which any such overcharge was passed-on by Sainsbury's to its customers.

(ii) *Constructive "pass-on".* By this we mean an overcharge that could have been passed on, but was not. If and to the extent that Sainsbury's did not pass on any overcharge, MasterCard contends that it should have done so. Paragraph 82 of the Re-Amended Defence provides:

> "Alternatively, if [Sainsbury's] has not passed on the full amount of the MSC to its customers, it has no claim against MasterCard by reason of its failure to do so, since there was no legal or practical hindrance preventing [Sainsbury's] from passing on the MSC (including any additional element due to excessive interchange fees) to customers, including by surcharging its MasterCard credit and debit card customers, but [Sainsbury's] chose not to do so."

(iii) *Response to Sainsbury's overcharge damages.* As described in paragraph 13(5) above, overcharge damages are in essence based on what Sainsbury's claims to be the excessive part of the UK MIF multiplied by the number of transactions undertaken. MasterCard takes a number of points:

(a) It is denied that Sainsbury's can recover damages in the case of transactions where the relevant interchange fee

(the UK MIF) did not apply, either because the Issuing Bank and the Acquiring Bank were the same or because some other Interchange Fee applied (paragraph 84 of the Re-Amended Defence).

(b) It is said that Sainsbury's cannot, in any event, claim damages for any sum greater than the difference between the UK MIF actually charged and the maximum Interchange Fee that could lawfully have been charged (paragraph 85 of the Re-Amended Defence). In essence, this is a point similar to the principle in contract law that damages are calculated by reference to the minimum lawful contractual performance of the contract-breaker. In this connection, MasterCard make a number of points (which are not specifically enumerated here) as to what the lawful level of the UK MIF might be. The use of the Merchant Indifference Test or MIT as the means of ascertaining what a lawful level might be is not accepted by MasterCard.

(c) Furthermore, MasterCard contends that an assessment of damages based upon overcharge damages is flawed. The Re-Amended Defence provides as follows:

> "94 …the effect of any breach is not properly to be measured by reference to the difference between the interchange fee that was imposed and the interchange fee which could lawfully have been imposed…, since [Sainsbury's] would not have received the same [benefits under the] MasterCard Scheme if the default interchange had been substantially lower or zero.
>
> …
>
> 96 [Sainsbury's] has, therefore, received benefits as a result of the interchange fee which it would not otherwise have obtained and must give credit for the value of these benefits. [MasterCard] will contend that, when credit is given for these benefits, [Sainsbury's] has no claim for damages.

97 Alternatively, if the MasterCard Scheme had operated with no or a lower UK MIF, and was not able to make corresponding changes to other default rules, then the number of transactions to which the zero or lower interchange fee applied would have been substantially lower and potentially zero."

(iv) *Interest.* As we have noted, this was a complex topic, which is considered later on in this Judgment.

D. The Structure of the Judgment

18. This Judgment deals with the following points in the following order:

(1) Section E considers whether this is, as MasterCard contends, properly to be described as a stand-alone action, where Sainsbury's is required to prove each element of its claim or whether that burden on Sainsbury's is alleviated (and, if so, to what degree) by a "read across" of the Commission Decision.

(2) Section F describes the various witnesses and experts who gave evidence before us, and considers certain aspects of weight to be attached to the economic evidence that was adduced before us.

(3) Section G deals in greater detail with the operation of payment systems, with particular emphasis on how they operated in what was agreed to be the relevant geographic market: the UK. This general description expands upon that contained in paragraphs 6 to 10 above, and is relevant as the foundation for much of the analysis that occurs in later sections of this Judgment.

(4) Section H considers whether, as Sainsbury's contends and MasterCard denies, Chapter I of the Competition Act 1998 and/or Article 101(1) TFEU are engaged, in the sense that subject only to the potential application of an exemption under Article 101(3) and/or the equivalent provisions in the Competition Act 1998, there has been an infringement of the prohibitions in those rules. The question of whether there can be an exemption under Article 101(3) and/or the

equivalent provisions in the Competition Act 1998 is considered in Section I below.

(5) Section J considers the question of illegality or *ex turpi causa* described in paragraph 17(3) above. If this defence succeeds, then it is a complete answer to Sainsbury's claim.

(6) Section K considers damages and interest on damages. It proceeds on the assumption that the setting of the UK MIF was an infringement of Article 101 TFEU. Specifically, Section K considers:

(i) The extent – if any – of the unlawful overcharge paid by Sainsbury's.

(ii) The extent to which Sainsbury's has mitigated its loss and/or how much, if any, of the UK MIF paid by Sainsbury's was passed-on by Sainsbury's to its customers. In MasterCard's submissions, these points were inextricably linked. We therefore consider in one place the rules of mitigation, the operation of the pass-on defence in English law and its relationship to principles of quantification and mitigation, how that defence may be affected by applicable principles of EU law, and the extent to which, as a matter of fact, Sainsbury's mitigated its loss and/or passed on the UK MIF to its customers.

(iii) The extent to which Sainsbury's has benefited from an anti-competitively set UK MIF. Obviously, if the setting of the UK MIF was an anti-competitive agreement then – subject to questions of mitigation and pass-on – Sainsbury's will have suffered loss, in the form of the unlawful overcharge described above. However, even in this case, MasterCard contends that Sainsbury's also received benefits, which must be reflected in the assessment of damages. As it emerged, these benefits are said to have arisen in the following way:

(a) Sainsbury's Bank – as a licensee participating in the MasterCard Scheme – was a recipient of the UK MIF which (assuming Sainsbury's claim has succeeded to this point) will have been at a higher level than it should have been.

(b) Some of this higher, but unlawful, Interchange Fee, was spent by Sainsbury's Bank on a "rewards" scheme (the so-called "Nectar Scheme") for *inter alios* customers of Sainsbury's. The purpose of the Nectar Scheme was to encourage the use of Sainsbury's Bank issued credit cards, but also increase spending (via such cards) in Sainsbury's supermarkets.

(c) MasterCard contended that had the Interchange Fee been lower, the "rewards" scheme would have been less generous, and Sainsbury's would have lost out as a result.

(iv) Interest.

(7) Finally, our conclusions and the manner in which we dispose of the matters in issue are set out in Section L.

19. In the course of these proceedings, the parties have raised numerous points and issues in their evidence and submissions. The Tribunal has carefully considered all the evidence and submissions, but if we were expressly to rehearse and deal with each and every individual point and issue raised, this Judgment, which is already lengthy, would be inordinately so. We therefore refer only to so much of the material and arguments relied upon as appears to us to be necessary to explain our conclusions.

E. The Significance of the Commission Decision

20. Payment cards in general, and the MIF in particular, have received a considerable amount of regulatory attention. That attention has, at times, been directed towards Visa (which operates a similar four-party payment card system to the MasterCard Scheme), but also towards the MasterCard Scheme itself. An overview of the various regulatory decisions – both at EU level and in the UK – is provided in Annex 2 hereto.

21. Throughout these proceedings, Sainsbury's has relied upon – and referred extensively to – the investigation leading up to the Commission Decision and the Commission Decision itself,[11] as well as proceedings before the Office of Fair Trading ("the OFT", as it then was)[12] and proceedings in the United States.[13] In its Amended Particulars of Claim, Sainsbury's claims to rely upon the Commission Decision and the views of the OFT in support of its claim.[14] However, neither in its Amended Particulars of Claim, nor in its written opening submissions, did Sainsbury's explain how these matters were relevant in the present proceedings. They were matters which were explored during the course of the trial, in particular during the oral openings of both parties.

22. We shall not consider the detail of these prior regulatory findings in this Section, although we will refer to these findings as appropriate in this Judgment. This Section concerns itself with the extent to which prior regulatory findings are binding on this Tribunal or should have weight in its deliberations. In considering if and if so to what extent we are bound by such regulatory findings, we shall focus principally on the Commission Decision and MasterCard's appeals of that decision to the General Court and the Court of Justice. We do so, because this must represent the high-water mark of Sainsbury's ability to rely on regulatory findings: this was a decision by the Commission directed to MasterCard as addressee, which MasterCard (unsuccessfully) appealed.

[11] Amended Particulars of Claim/§§20-27; §§10, 13-36 of Sainsbury's Written Opening Submissions dated 7 January 2016 ("Sainsbury's Opening").
[12] Sainsbury's Opening/§§37-47.
[13] Amended Particulars of Claim/§§28-31.
[14] Amended Particulars of Claim/§36.

23. This is admittedly not a so-called "follow-on" action. Sainsbury's does not contend that the Commission Decision or any other regulatory decision or judgment can be relied upon as being directly in point and binding as to there being an infringement of competition law by reason of the UK MIF. The Commission Decision relates to a different Interchange Fee (the intra-EEA MIF), applicable to different transactions occurring (for the most part) in a different period of time. It could not provide the basis for a follow-on claim other than in relation to the intra-EEA MIF in the relevant period. That MIF does not form part of this action. Instead Sainsbury's argues, as we have noted, that there is a "read across" from the Commission Decision to the present claim.

24. The claim was commenced in the Chancery Division of the High Court, and was transferred into the Tribunal pursuant to powers which came into force on 1 October 2015, the first time such a transfer has been made. This case is, by virtue of that transfer, the first "stand-alone" case to be heard by the Tribunal.

25. It is common ground that as claimant in a "stand-alone" action, Sainsbury's bears the burden of proving its case (save where that burden shifts to MasterCard, as for instance, in the case of the Article 101(3) TFEU exemption question).

26. In considering the effect of the Commission Decision in this context we must take note of the following:

    (1) The Commission Decision contains conclusions both of fact and of law in relation to the circumstances of the Commission's investigation into the lawfulness of the intra-EEA MIF. That Decision was affirmed in the appeals to the General Court and the Court of Justice.

    (2) Although many of the circumstances and much of the evidence considered by the Commission, and many of the issues of fact and law confronting the Commission, were no doubt similar to (and even, perhaps, in some instances, the same as) those with which we have been concerned in the present case, the fact remains that what was under consideration there was a different MIF applicable to different

transactions carried out in an earlier period than the claim period. We have heard evidence about the UK MIF applicable to domestic (i.e. non-cross-border) transactions in the UK geographic market, whereas the Commission considered evidence about the intra-EEA MIF, applicable in cross-border transactions between EEA States. In those circumstances, it is difficult to see how the Commission's findings of fact, although no doubt of interest, could be in any way binding on us.

(3) The position is different where a finding of EU law or principle is concerned. In relation to decisions of UK courts and tribunals in application of the domestic prohibitions set out in Chapter I and Chapter II (such as the Tribunal is required to make in the present case in respect of Chapter I), section 60 of the Competition Act 1998, provides *inter alia* as follows:

> "(2) At any time when the court determines a question arising under this Part, it must act (so far as is compatible with the provisions of this Part and whether or not it would otherwise be required to do so) with a view to securing that there is no inconsistency between –
>
> (a) the principles applied, and decision reached, by the court in determining that question; and
>
> (b) the principles laid down by the Treaty and the European Court, and any relevant decision of that Court, as applicable at that time in determining any corresponding question arising in Community law.
>
> (3) The court must, in addition, have regard to any relevant decision or statement of the Commission."

(4) Here, the Tribunal is also applying the competition rules in the TFEU. In such circumstances it goes without saying that directly effective/directly applicable EU law will be applied by this Tribunal, as it would be by any UK court or tribunal, pursuant to section 2 of the European Communities Act 1972. In that regard the Tribunal is also required by section 3 of that Act to determine a question as to the meaning or effect of any provision of EU law in accordance with principles laid down by, and any relevant decision of, the Court of Justice or the General Court.

(5) In the light of the above, where a legal conclusion has been expressed by the Court of Justice or the General Court based on facts that are materially indistinguishable from those before this Tribunal, then we consider that conclusion to be binding on this Tribunal. In these proceedings, there is only one such instance – namely the question of whether the setting of a MIF by MasterCard was a decision by an association of undertakings. MasterCard, quite properly, accepted that this holding was binding on it, at least until the factual basis on which that holding was made had materially changed. (As we shall see, MasterCard contends that such changes have occurred.)

(6) Similarly, where the Court of Justice or the General Court pronounces upon a question of EU law or principle, the Tribunal is bound to apply the law or principle in accordance with that pronouncement.

(7) In all other cases, whilst it is right and proper for us to consider the relevant Commission and European Court conclusions, we are not bound by them. The approach that we should take was laid down in the decision of the House of Lords in *Crehan v Inntrepreneur Pub Co (CPC)* [2006] UKHL 38, [2007] 1 AC 333. Lord Bingham stated:

> "11 …Community law prohibits the making by national courts of decisions which contradict decisions of Community institutions on the same subject matter between the same parties, and strongly discourages the making by national courts of decisions which may be inconsistent with decisions which may yet be made by Community institutions on the same subject matter between the same parties. But it does not, as the analysis of the relevant authorities by my noble and learned friend, Lord Hoffmann, shows, go the length of requiring national courts to accept the factual basis of a decision reached by a Community institution when considering an issue arising between different parties in respect of a different subject matter…
>
> 12 The judge had either to accept the Commission's assessment, which (unless required) would have been an abdication of the judicial function, or form his own opinion, giving such weight to the Commission's assessment as in his judgment the evidence merited…".

F. Witnesses and Evidence

(1) Witnesses of Fact

(a) Sainsbury's witnesses

27. We heard evidence from the following witnesses of fact called by Sainsbury's:

(1) *David Brooks.* Mr David Brooks is the head of finance operations at Sainsbury's, a position he has held since September 2010. Before that, from September 2006, he was head of procurement at Sainsbury's. Mr Brooks has been employed by Sainsbury's or by a subsidiary of Sainsbury's since 1989. Mr Brooks gave one witness statement ("Brooks 1"), and was called to give evidence on Day 5 (2 February 2016). He was a frank and straightforward witness. At times, his recollection on matters of detail was a little hazy, but he did his best to assist the Tribunal.

(2) *Hannah Bernard.* Mrs Hannah Bernard was employed by Sainsbury's between 2004 and 2015.[15] She is now employed by Barclays as chief financial officer of personal banking. During her time at Sainsbury's, she was (between July 2007 and December 2014) seconded to work at Sainsbury's Bank. Thereafter, she was, in quick succession, director of customer experience at Sainsbury's and then head of marketing, design and delivery. Mrs Bernard gave one witness statement ("Bernard 1"), and was called to give evidence on Day 6 (3 February 2016). She was an impressive, articulate and clear witness, and gave her evidence forthrightly.

(3) *Terence John Rogers.* Mr Terence John Rogers is the chief financial officer of J Sainsbury plc, the parent company of Sainsbury's. In effect, he also acts as the chief financial officer of Sainsbury's (Day 6/p133). He has held this position since July 2010. He joined the Sainsbury group in November 2005, and was appointed to the

[15] In her evidence (Day 6/p73), Mrs Bernard was not actually sure whether she was contractually employed by Sainsbury's or by the parent company of Sainsbury's, J Sainsbury plc, and so to this extent we are using the words "employed by" a little loosely.

operating board of J Sainsbury plc in July 2008 as property director.[16] He now sits on the operating board in his capacity as chief financial officer, but retaining responsibility for property. In October 2010, he was appointed a non-executive director of Sainsbury's Bank. Mr Rogers gave two statements ("Rogers 1" and "Rogers 2"), and was called to give evidence on Day 6 (3 February 2016). He was principally cross-examined on the costs and budgeting processes of the Sainsbury group, on which he gave his evidence clearly. He was obviously master of his brief. His evidence regarding the relationship between Sainsbury's and Sainsbury's Bank was less satisfactory, in that he was more emphatic about the operational independence of Sainsbury's Bank than the documents and, indeed, the evidence of Sainsbury's other witnesses might permit. In this, he perhaps allowed himself to be a little partisan in pressing the Sainsbury's party "line".

(4) *Michael Coupe.* Mr Michael Coupe is the chief executive officer of J Sainsbury plc, the parent company of Sainsbury's. Mr Coupe served the Sainsbury group in a variety of senior roles commencing in 2004: he was appointed chief executive officer in 2014. Mr Coupe gave one statement ("Coupe 1"), and was called to give evidence on Day 7 (5 February 2016). He gave his evidence calmly and with assurance.

(b) MasterCard's witnesses

28. We heard evidence from the following witnesses of fact called by MasterCard:

(1) *Scott Abrahams.* Mr Scott Abrahams is the group head of acceptance, UK and Ireland at MasterCard Inc. Mr Abrahams was appointed to this role in 2014. Before that, he held a variety of positions at Sainsbury's (between 1995 and 2004), Barclays (between 2004 and 2007) and American Express ("Amex") (between 2007 and 2014). Mr Abrahams gave one statement ("Abrahams 1"), and was called to give evidence

[16] Mr Rogers informed us (Day 6/pp131-132) that the operating board was "effectively the executive committee. It is not the plc board, but it is comprised of all the key management in the business…It is actually also in effect also, as it happens, the board of [Sainsbury's]. In effect it is one and the same thing. It is the executive committee of the business, it is also formally the actual board of directors of [Sainsbury's], which is a subsidiary of J Sainsbury plc".

on Day 7 (5 February 2016). He was an engaging witness, who sought to assist us on costs and pricing processes within Sainsbury's and Sainsbury's relationship with Sainsbury's Bank, as well as wider issues involving payment systems generally. He frankly recognised that his knowledge of Sainsbury's was somewhat out of date (having left the organisation in 2004), and was careful to qualify the extent and depth of his knowledge. He did his best to assist the Tribunal in relation to questions regarding payment systems generally.

(2) *Keith Douglas.* Mr Keith Douglas is the executive vice-president and general manager of MasterCard Inc. Mr Douglas joined MasterCard Inc in 2005. Before that, he had more than ten years' experience in the UK retail banking industry, with over six years' in senior roles in the consumer payment cards business of NatWest and RBS. Mr Douglas gave one statement ("Douglas 1"), and was called to give evidence on Day 8 (8 February 2016). In relation to the industry practice of issuing payment cards, Mr Douglas was authoritative and impressive. He was less so in relation to the significance of the interchange fee and its effect on Maestro – a topic we consider in some detail below – but that was because he had only been involved on the periphery of the debit-card competition between the Visa debit card, the Maestro debit card and the MasterCard debit card. At all times, he did his best to assist the Tribunal.

(3) *Javier Perez.* Mr Javier Perez is the president of MasterCard Europe, a position he has held since March 2006. As such, he is responsible for all of MasterCard's European operations. Mr Perez joined MasterCard in 1996: between 1996 and 2004, he was general manager of the customer division of MasterCard Europe; between 2004 and 2006, he was president of MasterCard's Caribbean and Latin America region. Mr Perez gave one statement ("Perez 1"), and was called to give evidence on Day 9 (9 February 2016). He was a formidable witness, who answered the questions put to him clearly, relevantly and articulately. We found his evidence very pertinent.

(4) *Roberto Tittarelli.* Mr Roberto Tittarelli is employed by MasterCard Europe as global product and solutions regional lead (Europe). Mr Tittarelli joined MasterCard in 1995, and has held a series of increasingly senior positions within MasterCard. Mr Tittarelli gave one statement ("Tittarelli 1"), and was called to give evidence on Day 9 (9 February 2016). We did not find Mr Tittarelli's evidence particularly helpful. Although we have no doubt that he was doing his best to assist the Tribunal, he frequently was unable to explain positions taken and statements made by MasterCard in documents that were put to him, because he had not been involved in the meeting or deliberations recorded in these documents. That, of course, would be entirely understandable, save that Mr Tittarelli had expressed firm views on these very points in Tittarelli 1. Thus, for instance, Mr Tittarelli was appointed by Mr Perez to lead a project known as "Project Forward" which was intended to consider the implications of the pending Commission Decision (Tittarelli 1/§5). Mr Tittarelli devoted a considerable amount of space in his witness statement to explaining the various options that were considered by the Project Forward team (Tittarelli 1/§§12-37), and the recommendations that were made by the team (Tittarelli 1/§§38-43). At Tittarelli 1/§44 he stated:

> "I have been asked whether I consider that a different decision would have been taken with regard to implementation of one or more of the above alternative business models if the direct threat had been to UK domestic interchange (rather than the lower-stake Intra-EEA default interchange fee) from 2006/2007 onwards. I was not involved in consideration of these issues at the beginning of that time period, but based on my knowledge of the business from 2007 onwards, I believe that a different decision would have been taken in that context."

When cross-examined, Mr Tittarelli could not deal with documents discussing the various options being considered by MasterCard, and was unable to substantiate the rather general conclusion he had asserted in Tittarelli 1/§44. In short, whilst readily acknowledging that Mr Tittarelli was doing his best to assist the Tribunal, we found that his oral evidence rather undermined the written evidence in Tittarelli 1.

(5) *Bart Willaert.* Mr Bart Willaert is MasterCard's general manager for France, a position he has held since October 2015. Until this appointment, Mr Willaert had (since 2012) been MasterCard's general manager for the Nordics and Baltics. Prior to that, between 2010 and 2012, Mr Willaert was head of MasterCard's interchange fee team. Prior to joining MasterCard, Mr Willaert held various IT and management consultancy jobs. Mr Willaert gave one statement ("Willaert 1"), and was called to give evidence on Day 10 (10 February 2016). Mr Willaert was a punctilious witness, who gave detailed and precise evidence. He was careful to delineate those areas on which he felt he could (and indeed did) speak with authority, and those areas which were outside his knowledge and experience. We found his evidence very helpful.

(6) *Christian Koboldt.* Mr Christian Koboldt, is a partner at DotEcon Limited, an economic consultancy that he co-founded in 1999. DotEcon Limited and Mr Koboldt had advised MasterCard in relation to interchange fees, in particular in light of the Commission Decision. Although in his previous work for MasterCard, Mr Koboldt had been used by MasterCard as an expert, he was in these proceedings called by MasterCard as a witness of fact, to explain the dealings he had had (when acting for MasterCard) with the Commission, and the work he did for MasterCard in seeking to find a method of computing the intra-EEA MIF in a manner that might satisfy the Commission. In other words, the evidence he gave was of a limited ambit. Within that ambit, Mr Koboldt gave his evidence clearly and fairly. That evidence was given in one statement ("Koboldt 1") and orally on Day 10 (10 February 2016).

(7) *Peter Sidenius.* Mr Peter Sidenius is the chief executive officer of Edgar, Dunn & Company, a global financial services and payments consultancy. Like Mr Koboldt, Mr Sidenius and his company had, in the past, advised MasterCard on various payment service matters including, in particular, levels of interchange fees. Like Mr Koboldt,

Mr Sidenius was undoubtedly an expert in his field, as his evidence to us demonstrated. However, he was called by MasterCard as a witness of fact to explain how, in the past, Edgar, Dunn & Company had assisted MasterCard. This he did with great competence and clarity. His evidence was given in two statements ("Sidenius 1" and "Sidenius 2") and orally on Day 11 (11 February 2016).

(2) Expert Evidence

29. We heard evidence from several experts.

(a) Sainsbury's experts

30. Sainsbury's called two expert economists, Mr Nils von Hinten-Reed and Mr Paul Reynolds, both of the economic consultancy CEG. Mr von Hinten-Reed addressed all expert issues arising, with the exception of interest, which was addressed by Mr Reynolds.

31. Mr von Hinten-Reed provided three expert reports dated 28 August 2015 ("Von Hinten-Reed 1"), 26 October 2015 ("Von Hinten-Reed 2")[17] and 9 February 2016 ("Von Hinten-Reed 3"). Von Hinten-Reed 1 and 2 were both very lengthy documents, the latter written in response to the evidence of MasterCard's experts. We make some general comments about the form and content of the expert reports in paragraphs 36 to 41 below, which we consider apply quite generally to the reports of Mr von Hinten-Reed and Dr Gunnar Niels, MasterCard's principal expert witness. Von Hinten-Reed 3 was much shorter and later in time, and was made in response to the fourth report of Mr Greg Harman, one of the MasterCard experts. In general Mr von Hinten-Reed gave his oral evidence somewhat discursively. He frequently preferred a lengthy and elaborate answer to a short and pertinent one, and on occasions this made his evidence a little difficult to follow. At times we also found him to be overly defensive of the case Sainsbury's was running. Although we consider that he was doing his very best to assist the Tribunal in accordance with the highest standards of experts, for these reasons his evidence was not as helpful as it might have been.

[17] There were two addenda to Von Hinten-Reed 2, dated 23 December 2015 and 9 March 2016.

32. Mr Paul Reynolds provided three expert reports dated 27 August 2015 ("Reynolds 1"), 11 December 2015 ("Reynolds 2") and 22 January 2016 ("Reynolds 3"). All of his reports were confined to the issue of interest, his latter two reports being in response to MasterCard's expert (Mr Harman). Mr Reynolds gave evidence on Day 15 (23 February 2016). Mr Reynolds was a most impressive expert witness: he obviously knew his subject intimately, and gave his evidence forthrightly and clearly. He was especially good at articulating why he, and his opposite number on the MasterCard side, Mr Harman, had reached differing conclusions, thus enabling the Tribunal to understand exactly the points in issue.

(b) MasterCard's experts

33. MasterCard called three experts. The first was Dr Gunnar Niels, an expert economist from the economic consultancy Oxera. Dr Niels provided one main report dated 28 August 2015 ("Niels 1"), followed by two supplemental reports, dated 11 September 2015 and 26 October 2015, which were in response to points raised in reports submitted by Sainsbury's experts. Dr Niels gave evidence on Day 16 (25 February 2016) and Day 17 (26 February 2016). Dr Niels was an obviously highly intelligent and articulate witness, who did his best to assist the Tribunal. However, there were times during his evidence when he was unwilling to make concessions on points when (so we consider) such concessions were obviously due. In our view, this indicated an overly entrenched stance in support of MasterCard's position. On the other hand, this entrenchment on the part of Dr Niels appeared to us (in one instance at least) to be more due to the fact that he had not been shown certain factual material until he was cross-examined.[18]

34. MasterCard's second expert was Mr Greg Harman of FTI Consulting. Mr Harman is an accountant, and he gave evidence on aspects of pass-on and interest. He provided five expert reports, dated 28 August 2015 ("Harman 1"), 23 October 2015 ("Harman 2" and "Harman 3"), 11 January 2016 ("Harman 4") and 17 February 2016 ("Harman 5"). The reason for the multiplicity of

[18] For instance, in relation to certain bilateral negotiations between Sainsbury's and Amex regarding the level of Amex's charges: see paragraph 261(4) below.

reports is that the later reports were in response to evidence from Mr von Hinten-Reed and Mr Reynolds. Mr Harman gave evidence on Day 18 (29 February 2016). Like Mr Reynolds, Mr Harman was a most impressive expert witness: he was obviously a complete master of his subject, and gave his evidence with clarity and authority. Like Mr Reynolds, he enabled the Tribunal to understand exactly what was at issue between himself and Mr Reynolds.

35. MasterCard's third expert was Mr Brian Carroll. Mr Carroll has spent most of his career with the John Lewis Partnership plc, mainly working for Waitrose Ltd. His expert report described how supermarket retailers deal with operating costs that they incur in the course of their business, and how they would be likely to have responded in the face of an hypothetical reduction of c.50% in the level of MSCs in respect of credit card transactions in the mid-2000s. He was briefly cross-examined on Day 19 (1 March 2016), and gave his evidence clearly and forthrightly.

(c) Weight to be Attached to the Economists' Evidence

36. Both Mr von Hinten-Reed and Dr Niels were, as we have said, expert <u>economists</u>. Neither of them is an expert in the field of payment systems, whether generally or specifically in relation to the MasterCard Scheme. Inevitably, they were very dependent upon an accurate account of the factual basis and context within which these complex and sophisticated systems operate.

37. In other words, in contrast with the position normally encountered by an expert witness, their expertise was engaged at one remove: it could only be deployed in relation to substantial and complex factual material about which they were <u>not</u> expert.

38. In these circumstances, it was incumbent upon the parties to ensure that the experts gave their opinions based upon a common – and if possible, agreed – factual base. That did not occur in this case: Mr von Hinten-Reed was confronted, in the course of his cross-examination, with material (albeit in the public domain) which he had never seen before; Dr Niels, similarly, was

confronted with material which – buried in the 60 plus trial bundles – he had not considered. We consider that neither expert can sensibly be criticised for not being aware of this material: it was payment system specific and – as we have said – this was not the expertise of these witnesses. Their expertise involved considering certain material, and providing their economic analysis in relation to it. To the extent that this material was incomplete, or referred to them late, their analysis was liable to be undermined.

39. Equally, neither Mr von Hinten-Reed nor Dr Niels are lawyers. Both were assiduous in attempting to ensure that they steered clear of the (difficult) legal questions that arise in this case. But, as was demonstrated particularly clearly by the cross-examination of Dr Niels, there was, in this case, a strong interplay between the legal principles, and the questions the economists were being asked to answer. Because these points were insufficiently clearly articulated and agreed early, both economists found themselves in difficulties that were not of their making. For instance, Mr von Hinten-Reed was forced to accept that his use of the Merchant Indifference Test left out of account a number of welfare benefits, whose omission (at least to the layman) appeared extremely odd. This is a matter that we consider in paragraph 287 below, but it became clear that Mr von Hinten-Reed's use of the Merchant Indifference Test arose out of a legal assumption as to market definition that he was making, but which he was (since it is a question of law) not defending. Equally, Dr Niels was obliged to explain exactly what legal questions he had addressed in making his economic judgments. Both economists would have benefitted from having, in advance, a clear and agreed formulation of what legal principles they were to follow and what assumptions arising out of these legal principles they were being required to make.

40. The upshot is that we were rather less assisted by the economic evidence than we might have been. For the reasons we have given, this was neither the fault of Mr von Hinten-Reed nor Dr Niels, but the consequence is that we have placed considerably more weight on the contemporary factual material and the evidence of the witnesses of fact than we have on the experts, mainly because this material was insufficiently considered by them.

41. For the future, in cases where significant economic evidence is being adduced by economic experts who lack specific expertise in the particular factual field under consideration, we consider that the parties need to be especially assiduous in ensuring that the economic experts are:

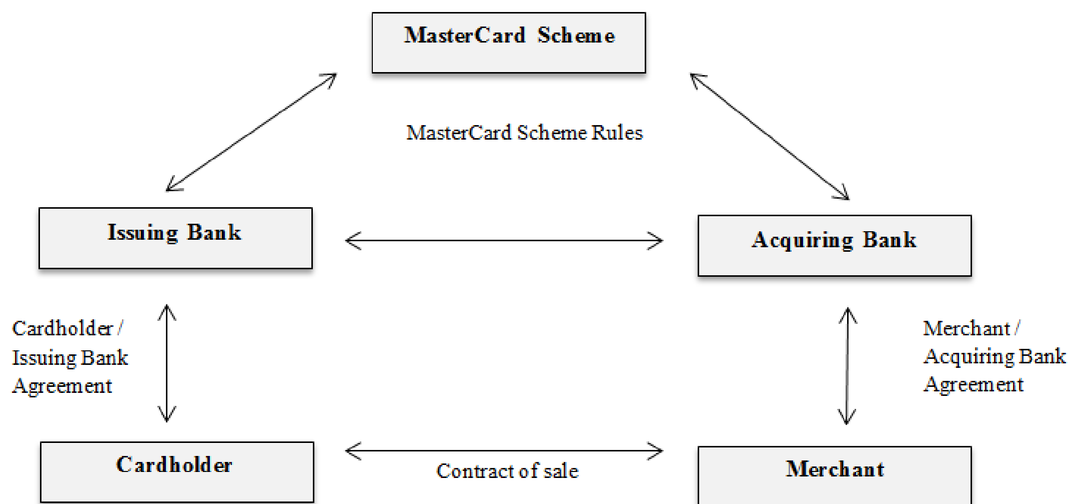
(1) Clearly instructed on the legal principles they are to apply, and in particular any assumptions they are being required to make.

(2) Absolutely clear as to the factual material on which their reports are to be based.

G. The Operation of Payment Systems

(1) The Nature of "Four-Party Systems"

42. The bare bones of the MasterCard Scheme were set out in paragraphs 6 to 10 above. The MasterCard Scheme is an instance of what is commonly known and referred to herein as a "four-party system", which may diagrammatically be represented as follows:



<u>Diagram 1</u>: Representation of a four-party system

43. The system thus operates on a contractual plane as between all parties – Cardholder, Issuing Bank, Acquiring Bank, Merchant (who comprise the four parties to the scheme) and scheme operator. To a considerable extent, therefore, participation is voluntary and a matter of choice. It is important to

understand both the operation of these contracts and the nature and extent to which the parties have freedom of choice in their participation.

(a) Contractual relations as between the scheme operator, the Issuing Bank and the Acquiring Bank

44. The scheme rules operate as between the operator of the scheme, and the Issuing and Acquiring Banks. Obviously, in the case of the MasterCard Scheme, the operator of the scheme is MasterCard, and the relevant rules are the MasterCard Scheme Rules. However, it is worth noting that there is another four-party system – operated by Visa (the "Visa Scheme") – that functions in a broadly similar way.

45. We were shown various versions of the MasterCard Scheme Rules which, unsurprisingly, have gone through a number of versions and revisions over the years. The following features were, however, common over time:[19]

    (1) The MasterCard Scheme Rules refer to "licensees" rather than "members", and that is how we propose to refer to the organisations participating in the scheme. We recognise that, at the inception of the MasterCard Scheme, the term "members" might have been more appropriate, but as the MasterCard Scheme moved towards public ownership, and control of the organisation was taken away from the banks and financial institutions who were originally members,[20] the term licensee becomes more appropriate. In any event, we do not consider that anything turns on this label.

    (2) Essentially, the MasterCard Scheme Rules comprise a series of "standards", "rules" and "manuals" promulgated by MasterCard. As we have noted, these are capable of varying from time-to-time. The MasterCard Scheme Rules also vary somewhat according to jurisdiction.

    (3) An institution may apply to become what the MasterCard Scheme Rules refer to as a "Customer". A Customer is defined as "[a] financial

[19] All quotations from the rules are from the version dated 15 May 2014.
[20] The process is pleaded in Re-Amended Defence/§40.

institution or other entity that has been approved for Participation. A Customer may be a Principal, Association or Affiliate". "Participation" means "[t]he right to participate in Activity granted to a customer by [MasterCard]", and "Activity" refers to "[t]he undertaking of any act that can be lawfully undertaken only pursuant to License by [MasterCard]".

(4) As noted in the preceding sub-paragraph, there are three types of Customer. A "Principal" participates directly in an Activity using Bank Identification Numbers or Issuer Identification Numbers specifically assigned to it by MasterCard. A Principal may sponsor one or more Affiliates: sponsorship enables an Affiliate indirectly to participate in Activities through the Principal. An Association participates directly in Activities, but may not (without specific written consent from MasterCard) issue MasterCard cards or acquire MasterCard transactions.

(5) When a Customer is accepted as such by MasterCard, a contract comes into being between MasterCard and the Customer. Generally speaking, Customers are permitted to participate in competing payment systems. There are various provisions which permit or entitle either MasterCard or the Customer to terminate the agreement between them.

(6) Subject to their terms, the MasterCard Scheme Rules permit Customers to issue MasterCard Cards and/or to acquire MasterCard transactions. The rules contain detailed provisions as to how transactions are to be processed and authorised, the existence of which we simply note. There are specific provisions obliging Customers not to discriminate against any "Merchant" (defined as "[a] retailer, or any other person, firm or corporation that, pursuant to a Merchant Agreement, agrees to accept Cards when properly presented") and to honour all cards of a certain type properly presented. This is the Honour All Cards Rule described in paragraph 9(4) above. As we described, its essential effect is that any MasterCard card of a type accepted by the Merchant must, when properly presented to a

Merchant, be accepted. Unsurprisingly, because Merchants do not directly subscribe to the MasterCard Scheme Rules, the HACR requires further implementation in the agreement between each Acquiring Bank and the Merchants contracting with that Acquiring Bank.[21]

(7) The manner in which MasterCard transactions are settled is laid down in a "Settlement Manual", which we were not shown. No doubt it contains detailed provisions as to aggregation of amounts, set-off and netting. The MasterCard Scheme Rules contain the following high-level description:[22]

> "A Customer that uses the Interchange System for the authorization and clearing of Transactions is required to net settle in accordance with [MasterCard's] settlement Standards. However, an Acquirer and Issuer may, with respect to a particular Transaction, agree to settle directly between themselves pursuant to a bilateral agreement."

The "Interchange System" referred to is the "computer hardware and software operated by and on behalf of [MasterCard] for the routing, processing and settlement of Transactions".[23] A "Transaction" is essentially a transaction processed by an Acquiring Bank, and fed into the Interchange System.[24]

(8) The MasterCard Scheme Rules say this about the Interchange Fee:[25]

> "A Transaction settled between Customers gives rise to the payment of the appropriate interchange fee or service fee, as applicable. [MasterCard] has the right to establish default interchange fees and default service fees (hereafter referred to as "interchange fees", "service fees", or collectively, "fees"), it being understood that all such fees set by MasterCard apply only if there is no applicable bilateral interchange fee or service fee agreement between two Customers in place. The Corporation establishes all fees for Interregional Transactions and Intraregional Transactions, and may establish fees for Intracountry Transactions."

46. Various witnesses sought to assist us as to the numbers of Issuing and Acquiring Banks licensed by MasterCard in the UK. The oral evidence was

[21] See Brooks 1/§11.
[22] See clause 8.2 at p8-1.
[23] See the definition of "Interchange System" at pG-7.
[24] See the definition of "Transaction" at pG-14.
[25] See clause 8.3 at p8-2.

that there were around twenty Acquiring Banks acquiring MasterCard transactions in the UK.[26] As to the number of Issuing Banks, Mr Abrahams considered there to be several thousand issuing MasterCard Cards in the UK,[27] whereas Mr Willaert took the view that there were again around twenty.[28]

47. MasterCard provided us with various figures.[29] As regards Issuing Banks, between 2009 and 2015, the main Issuing Banks issuing MasterCard cards in the UK were Lloyds Bank plc, HSBC Bank plc and the Royal Bank of Scotland plc. Each of these "top 3" banks issued more than 10% of the MasterCard cards in the UK. The remainder of the cards were issued by various banks having a share of less than 10% each. The figures were as follows:

	2009	2010	2011	2012	2013	2014	2015
"Top 3" banks issuing > 10% of MasterCard cards	**68%**	**56%**	**56%**	**48%**	**45%**	**45%**	**43%**
Banks issuing < 10% of MasterCard cards	**32%**	**44%**	**44%**	**52%**	**55%**	**55%**	**56%**

Table 1: Concentration of Issuing Banks

Thus, the share of the issuing market of the "top 3" banks has been declining over time.

48. In light of all of the evidence, we consider the figure of twenty banks issuing MasterCard cards in the UK to be about right as the upper limit: we reject the suggestion that there might be 1000s of banks issuing MasterCard cards in the

[26] Evidence of Mr Abrahams (Day 7/p69). Mr Abrahams somewhat tentatively considered that this figure might be increasing over time. By contrast, Mr Willaert considered 20 to be possible, but on the high side (Day 10/pp68-69).
[27] Evidence of Mr Abrahams (Day 7/p72). This was (as we find) a vast over-statement. It is possible that Mr Abrahams misunderstood the question, and was referring to Issuing Banks worldwide. He later stated that he did not know how many MasterCard licensees there were in the UK, but thought there were "quite a lot" (Day 7/p76).
[28] Evidence of Mr Willaert (Day 10/p69).
[29] MasterCard's response to the Tribunal's information request made on 25 January 2016, provided to the Tribunal on 17 February 2016.

UK. Moreover, although we do not know the precise figures, given that the "top 3" banks account for well-over half the market in 2009, and just under half of the market in 2014, it is likely that the "top 10" Issuing Banks would account for the vast majority of all MasterCard cards issued in the UK.

49. As regards Acquiring Banks, between 2009 and 2015, the main Acquiring Banks in the UK were WorldPay (UK) Ltd, Barclays, GPUK LLP and First Data Europe Ltd. At some point during 2009-2015, each of these "top 4" Acquiring Banks had agreements with over 10% of Merchants in the UK for the acquisition of MasterCard card transactions. Others had a less than 10% share. The figures were as follows[30]:

	2009	2010	2011	2012	2013	2014	2015
"Top 4" banks having agreements with > 10% of Merchants	**84%**	**84%**	**81%**	**90%**	**91%**	**92%**	**92%**
Banks having agreements with < 10% of Merchants	**16%**	**16%**	**19%**	**10%**	**9%**	**8%**	**8%**

Table 2: Concentration of Acquiring Banks

50. Thus, in contrast with Issuing Banks, there has been a concentration of the acquiring market over time, with the "top 4" Acquiring Banks acquiring transactions for 84% of Merchants in 2009, rising to 90% and over in 2012 and subsequent years.

51. In these circumstances, we consider that for there to be twenty Acquiring Banks in the UK would be on the high side – which reflects Mr Willaert's reservations. Obviously, the "top 4" Acquiring Banks account for the vast majority of Merchants, and it seems unlikely that there could be more than ten Acquiring Banks of any significance operating in the UK over the period in question.

[30] *Ibid.*

52. Although long ago, a bank or financial institution might act both as an Issuing Bank and as an Acquiring Bank, the trend has been towards a specialisation, with fewer and fewer institutions offering both services.[31] This is borne out by the information in Tables 1 and 2 above, which show no overlap between the largest Issuing Banks and the largest Acquiring Banks.

53. The evidence was also that either all or else the vast majority of licensees used the Interchange System and paid the UK MIF. In theory – and perhaps in other jurisdictions – there are two ways in which an Issuing Bank and an Acquiring Bank can elect (by bilateral agreement) to move away from this default position:

(1) By exiting the Interchange System altogether, and selecting a different processor for the settlement of payment. Mr Willaert accepted that this was possible and did on occasion occur,[32] although no-one referenced a specific UK example.

(2) By remaining in the Interchange System, but agreeing a bilateral interchange fee different from the MIF. This was not – at least in the UK – a common course of conduct. Indeed, in the UK it was extremely rare.[33] Mr Willaert was asked about this:[34]

Q (Mr Smith)	You mentioned earlier on in your evidence that in some markets bilateral agreements are relatively frequent and in other markets, like the UK, they are less so. Can you help us with what causes bilaterals to be popular in one market but not popular in another? Why is it that – I think Sweden you mentioned – why is it Sweden operates on a basis of bilaterals whereas in the

[31] For example, the evidence of Mr Douglas (Douglas 1/§17) was that during his time at Natwest/RBS (from 1998-2005) (see Douglas 1/§§4-9), Natwest/RBS, like most major card issuers, were also acquiring banks. An overview of the more recent position was provided by Dr Niels, in presenting the market shares of the main merchant acquirers in the UK credit card market in 2014 (Niels 1/§3.33). He noted that several acquirers shown in his Figure 3.4 are now independent from the banks that initially owned them, i.e. they are no longer associated with an issuing business. In particular, "RBS sold Streamline in 2009; HSBC sold its share in a joint venture with Global Payments in 2009; and Western Union sold First Data Merchant solutions in 2006. On the other hand, several acquirers still operate as subsidiaries of a bank: Barclaycard (Barclays), Cardnet (Lloyds TSB) and Elavon Merchant Services (U.S. Bancorp)".

[32] Evidence of Mr Willaert (Day 10/p72).

[33] Evidence of Mr Abrahams (Day 7/pp70-71); evidence of Mr Willaert (Day 10/pp72-73).

[34] Day 10/pp72-73.

UK the evidence we are having is that they are actually very rare?

A (Mr Willaert) I think there is various reasons, I think the historical reasons why the banks in Sweden have agreed to use bilateral. I think there was a bit of the common market practice, and my understanding also was that this was done under, let's say, the support and the supervision of the local competition authorities to complement a bilateral agreement system. Which does not mean that there was no fallback, but they implemented a bilateral system.

In other markets it happens, the customer is told it doesn't need to do so, to set these bilaterals, and it relied on the multilateral interchange fee, because it felt that going to bilaterals would not change the outcome and the multilateral interchange fee was the right level.

But I would say in most of the cases there was a multilateral interchange fee. If you look across Europe, it is the most commonly used.

54. The exceptional case is where – in the case of a given transaction – the Issuing Bank and the Acquiring Bank are the same legal entity. In such a case, although the Issuing/Acquiring Bank could use the Interchange System, it typically would not and would "settle with itself". Such transactions are known as "on us" or "own account" transactions.[35]

55. There are alternatives to four party payment systems. Because these systems provide similar (but by no means identical) services to Cardholders and Merchants, it is appropriate briefly to describe them. The leading proponent of such schemes is Amex, which operates both a "three party system" and a hybrid system which has been described as a "three-and-a-half party system".

56. In a three party system, the operator of the scheme <u>also</u> performs the function of the issuing of cards and the acquiring of transactions. In short, there are <u>no</u> Issuing Banks and <u>no</u> Acquiring Banks. For that reason, there is no need for an interchange system, and no Interchange Fees as such. That said, Amex charges its Merchants a "discount rate", which represents an amount of the purchase

[35] Evidence of Mr Willaert (Day 10/pp74-75).

price paid by the Cardholder that is retained by Amex. To the Merchant, the discount rate appears very similar to the Interchange Fee.[36]

57. A three-party system may diagrammatically be represented as follows:

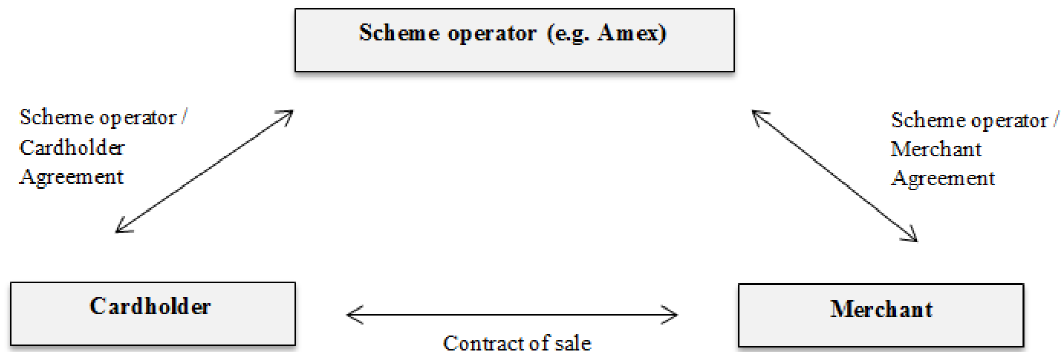


Diagram 2: Representation of a three-party system

58. The distinction between three-party systems and four-party systems is somewhat blurred by the Amex Global Network Services ("Amex GNS") programme, sometimes referred to as a three-and-a-half party system, which was launched in the UK in late 2005. [37] Under Amex's GNS programme, Amex remains the sole acquirer for Amex cards. On the issuing side, as well as itself issuing Amex cards, Amex also licenses other financial institutions to issue Amex cards. Such institutions then issue Amex cards to cardholders alongside or instead of other cards – like Visa or MasterCard cards – giving cardholders greater choice in terms of payment options.[38]

59. Thus, in theory at least, both Issuing Banks and Acquiring Banks have a choice as to which scheme(s) they participate in. It is important to understand the nature of and limits to that choice. That choice is in considerable measure informed by the Issuing Banks' relationship with Cardholders and by the Acquiring Banks' relationship with Merchants.

60. As regards Issuing Banks/Cardholders:

[36] The evidence of Mr Rogers (Day 5/pp.89-92) was that Amex calls it a discount rate rather than an Interchange Fee.
[37] Douglas 1/§19.3 and §56.4, §45 of MasterCard's Written Opening Submissions dated 7 January 2016 ("MasterCard Opening").
[38] MasterCard Opening §45, §47.

(1) It is perfectly possible for an Issuing Bank to issue cards from several schemes. Indeed, some schemes (like the "Duo" scheme[39]) are predicated on the issue of multiple cards. That said, there is a clear difference to be drawn between credit cards and debit cards. Because debit cards – by their nature – are tied to a specific bank account, with one card per account, Issuing Banks are likely to offer a debit card from a single scheme. By contrast, Cardholders can have, and may well want, multiple credit cards. Issuing Banks may cater for this demand by participating in more than one scheme. MasterCard provided us with figures showing that – between 2006 and 2014 – the number of cards (of any type) per Cardholder lay between 2.6 and 2.8.[40]

(2) The evidence before us was that whilst some payment schemes had tried – by way of specific agreement with Issuing Banks – to obtain an exclusive tie, such provisions were rare. There would, however, often be volume commitments and the like. Obviously, for the reason given in the preceding sub-paragraph, such ties would be more important in the case of credit cards (where Issuing Banks do issue cards from multiple schemes) than in the case of debit cards (where Issuing Banks will be inclined to issue from only a single scheme).

(3) In terms of switching between schemes, this is not a straightforward matter. Clearly, there are the costs to the Issuing Bank of joining a new scheme, so as to be able to issue its cards. Even if an Issuing Bank is already party to more than one scheme, there is the not insignificant cost and time lag in switching cards already issued to Cardholders from one scheme to another. An Issuing Bank would not, therefore, undertake the decision to switch from one scheme to another lightly. All things being equal, an Issuing Bank would look at likely future revenue flows when considering switching, weighing these against the costs.

[39] The Duo scheme – an example of a three and a half party system – involves a single Issuing Bank issuing cards from MasterCard and Amex.
[40] See footnote 29.

61. As regards Acquiring Banks/Merchants, the position is rather different:

(1) Although a Merchant can pick or choose between Acquiring Banks, and even select some services from one Acquiring Bank and some from others, the fact is that (at least, as the market presently stands) if a Merchant accepts payment by Visa, it will also want to accept payment by MasterCard and *vice versa*. Indeed, in the UK, it is striking that of the Merchants accepting payment by MasterCard, 100% also accept payment by Visa.[41] The addition of other – less pervasive – schemes (like Amex) will depend more on whether the individual Merchant considers this additional payment option to be attractive to its customers.

(2) Clearly, a rational Acquiring Bank will want to be able to acquire transactions of all schemes, so as to offer Merchants a full range. Inevitably, this must have an effect on an Acquiring Bank's inclination to enter into a payment scheme: an Acquiring Bank would be strongly inclined to participate in as many payment schemes as it could.

(3) That said, it would still be in the interests of an Acquiring Bank to negotiate or seek to negotiate better rates with an Issuing Bank. Even though Acquiring Banks pass all of the Interchange Fees retained by Issuing Banks on to their Merchants via the Merchant Service Charge, it is clear that the Merchants consider the UK MIF to be too high.[42] We return to this question later on in this Judgment. For now, we simply note that it would, undoubtedly, have given an Acquiring Bank during the claim period a significant competitive edge to negotiate a better Interchange Fee, so as to be able to differentiate itself within the Merchant market. It was Mr Willaert's evidence that although the pressure for lower Interchange Fees was communicated to MasterCard by Acquiring Banks, no Acquiring Bank sought to negotiate a special deal with MasterCard, nor would MasterCard have been inclined to

[41] *Ibid.*
[42] See paragraph 196(4) below.

conclude such a deal.[43] In other words, whilst MasterCard was perfectly prepared to have a MIF that differentiated according to card type or transaction type,[44] it was not prepared to differentiate according to Merchant or Acquiring Bank.

(4) In essence, this meant that a lower price could only be negotiated through a bilateral agreement between an Acquiring Bank and one or more Issuing Banks – and this does not seem to have occurred in the UK (as has been described).

(5) The upshot is that Acquiring Banks did not and do not compete on the level of the Interchange Fee incorporated into the Merchant Service Charge. They could, of course, differentiate themselves according to the (proportionately very much smaller) price of that element of the Merchant Service Charge reflecting the charge for their own services, and according to the nature and quality of the services they in fact provided to Merchants.[45]

(b) Contractual relations as between the Cardholder and the Issuing Bank

62. There is a contractual relationship between the Cardholder and the Issuing Bank with whom the Cardholder has contracted. We were not shown the terms of such contracts, but clearly these agreements would have to regulate the manner in which the Issuing Bank could take money from the Cardholder's account for the payment of goods and services (in the case of debit cards) and the manner in which credit was extended to Cardholders – and how that debt had to be repaid – in the case of credit cards.

63. As mentioned earlier, many Cardholders have multiple Cards, not necessarily all issued by the same Issuing Bank. A Cardholder would typically only have a single debit card, to go with his or her single current account, but might well have multiple credit cards.

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[43] Evidence of Mr Willaert (Day 10/pp81-83).
[44] As will be seen, MasterCard issued a number of different card types, each attracting a different MIF. Similarly, MasterCard's MIFs differentiated according to whether a transaction was e.g. a chip PIN transaction or online transaction.
[45] As to this, see the evidence of Mr Willaert (Day 10/pp80-81).

64. It is necessary to explore why this might be. On one level, certainly for the MasterCard and Visa Schemes, the cards basically operate in the same way within the payment scheme: they provide the key to accessing these payment systems. The problem with this essential similarity is that it makes it very difficult for Issuing Banks to differentiate themselves:

(1) Obviously, an Issuing Bank can offer access to several schemes. Beyond that, however, because of the HACR, in terms of access to the payment system, one Visa card is like another Visa card and one MasterCard like another MasterCard.

(2) Beyond offering access to several schemes, Issuing Banks can really only differentiate themselves by:

(i) Becoming increasingly generous in terms of the people they offer cards to and the terms on which the cards are offered (e.g. bigger limits or "tied" overdrafts).

(ii) Competing on interest (in the case of credit cards).

(iii) Improving the "frills" or "rewards" offered to Cardholders. One example of such rewards is the Nectar Scheme described in paragraph 18(6)(iii)(b) above.

(iv) Making the card a "status" symbol, as some "premium" cards seek to do.

65. Some of these factors will drive Cardholders or potential Cardholders to choose one Issuing Bank over another. That is very likely to be true of debit cards, since they are tied to a current account. It is less likely to be true of credit cards, for Cardholders are not, in the case of credit cards, <u>obliged</u> to choose <u>between</u> Cards (although, of course, they can do so). In the case of credit cards, a Cardholder can simply augment his or her portfolio of cards. The key will then, for Issuing Banks and the schemes they participate in, lie in usage (i.e. which card the Cardholder <u>chooses</u> to use), and it is for that reason that many "reward" schemes reward not the acquisition of a card, but its use.

(c) Contractual relations as between the Merchant and the Acquiring Bank

66. There is a contractual relationship between the Merchant and the Acquiring Bank with whom the Merchant has contracted, in the form of the Merchant Services Agreement. As we have noted, whilst an Acquiring Bank will seek to participate in the widest range of payment systems so as to be able to offer Merchants the widest choice, Merchants may not necessarily choose to contract with a single Acquiring Bank:[46]

Q (Mr Smith)	Can a merchant choose, if it wants to, to use multiple acquiring banks for its transactions?
A (Mr Willaert)	Absolutely. A merchant can choose to say "I want – for my MasterCard transaction – I want to use this acquiring bank, for my Maestro transaction I want this bank, for my Visa cards I want to get a better deal with a different acquirer". So they can fully choose which acquirer they use.
Q (Mr Smith)	How finely can that division be sliced? You have divided it quite logically between different payment schemes. So you might have an acquirer, as you say, for Visa and an acquirer for MasterCard. Can one differentiate between debit and credit cards?
A (Mr Willaert)	Yes. For instance, and I made the example of Maestro and MasterCard, the merchant can make a specific agreement with one acquirer to only process one brand of product. That can happen, yes.
Q (Mr Smith)	But presumably there has to be some sort of agreement between the merchant and his various acquirers --
A (Mr Willaert)	Typically, they have multiple agreements, to decide on which product they process. Some merchants even have multiple acquirers for multiple products just to allow to not be dependent on one acquiring bank.

67. It was Mr Brooks' evidence that Sainsbury's itself used several Acquiring Banks.[47]

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[46] Day 10/pp77-78.
[47] Brooks 1/§§26-28.

(d) Contractual relations as between the Cardholder and the Merchant

68. There is a contract between the Cardholder and the Merchant. That agreement will concern the sale and purchase of the goods or services sold by the Merchant and purchased by the Cardholder. As part of this agreement, the Cardholder will offer to pay by debit or credit card, and the Merchant will agree to accept payment in this form.

69. It is – self-evidently – a necessary condition for this to take place that not only the Cardholder have a debit or a credit card and the Merchant have an agreement with an Acquiring Bank, but that the Cardholder's Issuing Bank and the Merchant's Acquiring Bank subscribe to the rules of the same scheme. Unless this has occurred, no matter how willing Cardholder and Merchant are to effect and accept payment by card, the transaction will not go forward.

(2) "Two-Sided Platforms"

70. It is uncontroversial that the MasterCard Scheme is – like all payment systems – what is commonly referred to by economists as a "two-sided platform".[48] The essence of a two-sided platform, as its name implies, is that "the platform brings together two types of user. In payment card schemes, these are the consumers who carry the card in their wallet (cardholders), and the retailers and other types of merchant who accept the card for payment (merchants). There are many other examples of two-sided platforms: TV channels, newspapers and websites bringing together viewers/readers and advertisers; PC operating systems bringing together users and developers/programmers; dating agencies bringing together men and women".[49]

71. There is an essential relationship between the two types of user: "the more users there are on one side, the more attractive the platform is to the other side. The more consumers with a MasterCard in their wallet, the more attractive it is for retailers to accept MasterCard, and vice versa".[50] A good example of a two-sided platform is the *Metro* newspaper, which is free of charge to readers

[48] Niels 1/§2.5.
[49] Niels 1/§2.7.
[50] Niels 1/§2.7.

(so as to maximise readership), thus making it attractive to the other group of users – advertisers – who will be prepared to pay more for advertising space the greater the size of the readership. There is a dynamic between the two groups of users (readers and advertisers), which causes one group (the advertisers) to pay more if the other group (the readers) is larger. That dynamic exists, even though there is no formal (legal) relationship between the readers and the advertisers.

(3) Necessary Legal Co-Operation Between the Two User Groups

72. In an article published in 1983 in the *Journal of Law and Economics*,[51] Professor William Baxter noted that payment systems – which he defined as including card systems like the MasterCard Scheme[52] – involved a degree of co-operation between cardholder and merchant not necessarily found in other two-sided markets. He put the point like this:[53]

> "The mechanics of transactional services require that for every transaction in which a purchaser becomes a maker of a check, there must be one – and precisely one – transaction in which a merchant becomes a payee; similarly, each use of a credit card by a card holder must be matched by precisely one act of acceptance of the card…by a merchant.
>
> This identity in the type of transactional service used by the merchant and purchaser in a given exchange introduces a constraint not normally found in markets for private goods and reflects the interdependence in the marginal valuations between merchants and purchasers. Because the mechanics of transactional services require the acceptance of a particular payment mechanism by *both* the merchant and the purchaser to effect any given purchase, the marginal valuation of a transactional service by one party to the purchase is contingent on the acceptability of this form of service by the other party."

73. The point is an obvious, but important, one: without co-operation between Cardholder and Merchant, there can be no purchase. And that co-operation implies a co-operation between the Issuing Bank (with whom the Cardholder has contracted) and the Acquiring Bank (with whom the Merchant has contracted). Unless there is such co-operation between the Issuing and

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[51] Baxter, "Bank Interchange of Transactional Paper: Legal and Economic Perspectives", (1983) 26 *Journal of Law and Economics* 541 ("Baxter 1983").

[52] Professor Baxter's definition of payment systems was in fact significantly wider, extending to cheques (or "checks") as well as cards: Baxter 1983 at pp541-542. Nothing turns on this for present purposes.

[53] Baxter 1983 at 544.

Acquiring Banks – by which we mean a form of legal agreement along the lines described above – the transaction will not go ahead.

74. It is important to note that this is not a feature of all two-sided platforms. To return to the example of the *Metro* newspaper, although there is undoubtedly a dynamic between the two groups of users (readers and advertisers), there is no need for the type of formal (legal) co-operation that must exist in the case of payment systems for the two groups to get what they want.

75. Although there is no reason why an Interchange Fee could not move from the Issuing Bank to the Acquiring Bank, in the UK it has been the Acquiring Bank that has paid an Interchange Fee to the Issuing Bank (in the form of a permitted deduction, as described at paragraph 8(5) above). We explore the cost-driven reasons for this below, but for the present our description follows the reality – that it is the Issuing Bank that receives an Interchange Fee.

76. The Interchange Fee self-evidently sets the price that is paid by the Merchant via the Acquiring Bank and the sum that is received by the Issuing Bank, which may or may not be passed on to the Cardholder. In short, the price represented by the Interchange Fee is relevant to both Issuing Banks and Acquiring Banks. It represents the pivot between the two user groups in this two-sided market.

(4) Payments and Charges

77. Where a Cardholder pays for a good or service using a MasterCard card with a Merchant, a chain of operations takes place. Using the card-reading technology that an Acquiring Bank will have equipped a Merchant with,[54] the transaction is either approved or not approved. If approved, it is fed into the MasterCard settlement system – the Interchange System – and a stream of payments is made by the Issuing Bank to the Acquiring Bank. Essentially:

(1) The Issuing Bank will debit the Cardholder. Either the Cardholder's current account will be debited (if the card is a debit card) or else the

[54] We are assuming that the Cardholder is present for the transaction, and validates using chip PIN.

liability of the Cardholder to the Issuing Bank will be increased (if the card is a credit card) by the amount of the transaction.

(2) The Issuing Bank will remit to the Acquiring Bank (generally speaking, using the Interchange System) the face value of the transaction less any Interchange Fee (whether default or specifically agreed).

(3) The Acquiring Bank will remit to the Merchant the amount received from the Issuing Bank less its own additional charges.

78. We consider further the rates and amounts of Interchange Fee actually paid by Sainsbury's over the claim period below.

(5) Different Types of Card

79. Although it is natural to consider only the simple dichotomy between debit and credit cards, the volume of different card products, in the UK market at least, is far greater than this. Both on the debit card and – to an even greater extent – on the credit card side, a range of products was offered by payment schemes like MasterCard and Visa and issued by Issuing Banks, ranging from "no frills" or "entry level" cards to "premium" cards, which offered far more than entry level cards in terms of ancillary "benefits" or "rewards".

80. The evidence before us was that there are many different interchange fees. These fees vary according as to the location of the transaction (e.g. intra-UK or cross-border), the manner in which the transaction is effected (e.g. "in-shop", on-line, via an ATM) and/or the nature of the card being used. In his witness statement, Mr Brooks said:[55]

> "13 Debit and credit cards carry different MIFs. Generally, MIFs for credit cards are ad valorem (a percentage of the transaction) and for debit cards they are expressed in pence per transaction. There are broadly three different types of credit cards: consumer, corporate and business. Corporate credit cards and business credit cards sound like similar products but they are actually very different. Corporate credit cards are for employees of businesses, whereas business credit cards are for anyone with a business, for example a sole trader.

[55] Brooks 1/§§13-14.

14. Furthermore, the MIFs charged vary in relation to the location of the card issuer, resulting in domestic (e.g. UK), EEA and regional transaction rates. On top of all this, [Sainsbury's] is charged different MIFs dependent on the type of merchant point of sale, such as in-store and online. Different combinations of these variables result in about 206 different MIFs for [Sainsbury's] total portfolio of card transactions. When trying to validate if a specific MIF is correct, we have to trust our Acquirers because there is no simple way to check that they have applied the correct MIF to each transaction, as this requires knowledge of what interchange rate has been allocated to which type of card i.e. the Issuer Identification Number ("IIN") of six digits for each card, which is confidential information not shared with [Sainsbury's].

81. Mr Brooks had this to say about different cards attracting different MIFs:[56]

"17 The development that has really affected all retailers over the last six years is MasterCard's move to what is known as a "Premium" card, branded as a "World" card. This is a card that attracts a much higher MIF. I believe the MIF on a World card is 1.25% of the transaction value, as opposed to a current average MasterCard fee of about 0.83% across all the different MIF rates we pay. These are only the MIF fees, not the full MSC. Premium cards made up an average of 38.4% of all MasterCard charges (costs) at Sainsbury's in 2014/15…MasterCard sets the rules concerning what sort of customers can hold a World card. I believe the current rules are that a customer must spend more than £9,000 a year on the card and also that the issuing bank ("Issuer") must reward the customer with at least 1% of the annual spend."

(6) The HACR

82. The nature of the HACR was described in paragraphs 9(4) and 45(6) above. Although the Honour All Cards Rule is simply stated, in practice it is a rule that applies to certain classes of card and not to all "MasterCard" branded cards, whatever their type.[57] Certain types of card fall under a particular grouping or "umbrella": the HACR applies to the card types in this grouping.

H. Infringement of Chapter I of the Competition Act 1998 and/or Article 101 TFEU

(1) Matters in Issue

83. This Section considers the question of whether Article 101(1) TFEU has *prima facie* been infringed, as Sainsbury's contends. It is, as here, sometimes convenient to use the words "infringe" or "infringement" when discussing whether there is a restriction within the meaning of Article 101(1) TFEU; we

[56] Brooks 1/§17.
[57] Evidence of Mr Willaert (Day 10/pp78-80).

are, of course, conscious that the existence of an infringement will depend also upon whether an exemption under Article 101(3) TFEU is applicable in respect of any restriction found to exist. The question of whether any restriction of competition (if any) can be justified under the Article 101(3) TFEU exception is separately considered in Section I below.

84. There are a number of points of dispute between the parties, which are considered and resolved in the course of this Section:

(1) *Decision by an association of undertakings and/or an agreement and/or concerted practice.* Sainsbury's contends that the setting of the UK MIF was a decision by an association of undertakings and/or an agreement and/or concerted practice of (amongst others) MasterCard, made pursuant to the MasterCard Scheme Rules. Save that MasterCard accepts that in relation to the period prior to 19 December 2007, the Commission's Decision that it is an association of undertakings is binding, this contention is otherwise denied by MasterCard. We consider whether the setting of the UK MIF was by way of an agreement, decision or concerted practice in Section H(2) below.

(2) *Restriction of competition by object.* Sainsbury's contends that the object of the setting of the UK MIF was the appreciable restriction of competition between Acquiring Banks in the UK. This is denied by MasterCard. The restriction of competition by object is considered in Section H(3) below.

(3) *Restriction of competition by effect.* As to this:

(i) Sainsbury's contends that the effect of the setting of the UK MIF was the appreciable restriction of competition between Acquiring Banks in the UK.

(ii) This was denied by MasterCard on essentially two broad grounds:

(a) MasterCard contended that even if the setting of the UK MIF had an anti-competitive effect, the UK MIF was objectively necessary for the operation of the MasterCard Scheme, so as not to fall within Article 101(1) TFEU.

(b) MasterCard contended that the setting of the UK MIF in any event did not have an anti-competitive effect.

(iii) There was very little common ground between the parties. Essentially, the parties agreed *(i)* that the relevant provision – whose anti-competitive effect needed to be tested – was the setting of the UK MIF; and *(ii)* that the relevant geographic market, for the purposes of testing the effect of the UK MIF, was that of the UK. Apart from this very limited agreement, the parties were in substantial disagreement on pretty much everything else.

(iv) We approach the question of restriction by effect in the following way:

(a) First, we consider in Section H(4) the analytical approach we must follow in determining whether the setting of the UK MIF had an anti-competitive effect and whether the UK MIF was objectively necessary to the operation of the MasterCard Scheme.

(b) Thereafter, we consider in Section H(5) whether there has been an appreciable restriction of competition and in Section H(6) whether the UK MIF can properly be regarded as objectively necessary to the operation of the MasterCard Scheme.

(2) Agreement, Decision or Concerted Practice

(a) Introduction

85. Sainsbury's alleges that the setting of the UK MIF was a decision or series of decisions of MasterCard as an association of undertakings.[58] In the alternative, Sainsbury's alleges that the setting of the UK MIF was an agreement or agreements between undertakings or a concerted practice or practices between undertakings,[59] the agreement or concerted practice being between MasterCard and its licensees.[60]

86. MasterCard:

    (1) Denies that the setting of the UK MIF was an agreement or agreements between undertakings or a concerted practice or practices between undertakings.[61]

    (2) Accepts that in relation to the period prior to 19 December 2007, it is bound by the Commission Decision (upheld by the General Court and the Court of Justice) that it is an association of undertakings.[62] As we have indicated in paragraph 26(5) above, we consider this admission to be correct.

    (3) Contends that the Commission Decision is not binding after 19 December 2007 and that, on various dates thereafter, there were certain material changes of fact so as to entitle this Tribunal to re-visit the question of whether MasterCard was an association of undertakings. Paragraph 13 of the Re-Amended Defence states that "the Defendants ceased to be an association of undertakings in June 2009 (or alternatively June 2010 or April 2014)". The various facts and matters on the basis of which MasterCard asserts the significance of the June 2009, June 2010 and April 2014 dates are spelt out in

[58] Amended Particulars of Claim/§§37 and 38B.
[59] Amended Particulars of Claim/§38B.
[60] Amended Particulars of Claim/§39.
[61] Re-Amended Defence/§67A.
[62] Re-Amended Defence/§40(a).

paragraph 40 of the Re-Amended Defence. Mr Cook, junior counsel for MasterCard, put the point as follows (Day 4/p129):

> "The starting point, MasterCard acknowledges, it has to acknowledge, it doesn't agree with it, that it was an association of undertakings until 19 December 2007, because that's the period covered by the Commission Decision, and that was upheld.
>
> We also accept, as a matter of logic, even though we are not formally bound to, that that finding is one the Tribunal is going to follow, any court would follow, and unless and until there has been a sufficient change that the Commission's reasoning as approved by the Court of Justice is no longer applicable.
>
> What we say is that sufficient changes had taken place by June 2009 that we were no longer an association of undertakings after that date. We advanced, as you will have seen, a sort of cascade of dates. We say we have made a certain number of changes, that is good enough. If not, we have made some more, some more, and we get to today and say we are certainly not an association of undertakings."

Mr Cook is clearly right in regard to the period between 19 December 2007 and June 2009.[63] It is clear, and we so find, that MasterCard was an association of undertakings within the meaning of Article 101 TFEU for (at least) that period, as well as the period before 19 December 2007.

(b) Overlapping concepts

87. In Case C-49/92P, *Anic Partecipazioni*, [1999] ECR 1-4125, the Court of Justice said that "agreements", "decisions by associations of undertakings" and "concerted practices" were overlapping concepts. They are "intended to catch forms of collusion having the same nature and are only distinguishable from each other by their intensity and the forms in which they manifest themselves" (at paragraph 131). At paragraph 108, the Court of Justice noted:

> "The list in Article [101(1) TFEU] is intended to apply to all collusion between undertakings, whatever form it takes. There is continuity between the cases listed. The only essential thing is the distinction between independent conduct, which is allowed, and collusion, which is not, regardless of any distinction between types of collusion."

[63] The point was repeated in Appendix D to MasterCard's Written Closing Submissions dated 8 March 2016 ("MasterCard Closing").

88. Thus, an “agreement” can also be a “decision” and an “informal agreement” may also be a “concerted practice”.[64] As Sainsbury’s noted in paragraph 62 of its written opening submissions, the point of overlapping concepts “is to cover all types of arrangements by which undertakings mutually accept a limitation of their freedom of action instead of independently determining their future conduct on the market”.

(c) An “agreement”

89. In Case T-41/96, *Bayer v Commission*, [2000] ECR II-3383, the General Court stated that the concept of an agreement between undertakings “centres around the existence of a concurrence of wills between at least two parties, the form in which it is manifested being unimportant so long as it constitutes the faithful expression of the parties’ intention” (at paragraph 69).

90. As Whish & Bailey note,[65] “[a] legal contract of course qualifies as an agreement”. The MasterCard Scheme Rules undoubtedly amount to a legal contract between MasterCard and the various parties licensed pursuant to those rules,[66] and so to an “agreement between undertakings”.

91. MasterCard nevertheless disputed that the alleged restriction of competition (the UK MIF) amounted to an “agreement”. Paragraph 67A of the Re-Amended Defence provides:

> “…it is denied that the UK MIF was and remains the result of an agreement and/or concerted practice between undertakings. It is denied that it is correct to describe MasterCard Issuing Banks and Acquiring Banks as acquiescing in MasterCard setting the UK MIF by virtue of their participation in the MasterCard Scheme and their agreement to the MasterCard Scheme Rules for the reasons set out in paragraph 66b above”.

92. Paragraph 66b provides:

> “It is denied that it is correct to describe MasterCard Issuing Banks and Acquiring Banks as acquiescing in the Scheme Rules. Any party which wants a licence to act as a MasterCard Issuer and/or Acquirer is required to enter into a bilateral contract with

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[64] See, in general, Rose & Bailey, Bellamy & Child, *European Union Law of Competition*, 7th ed (2013) (“Bellamy & Child”) at paragraph 2.032 *ff*.

[65] Whish & Bailey, *Competition Law*, 8th ed (2015) (“Whish & Bailey 2015”) at p104.

[66] Although the governing law is not English law, this is clearly a case of a “network” of contracts between MasterCard, Issuing Banks and Acquiring Banks, of the sort considered (in the context of sporting events) in *Clarke v Earl of Dunraven, The Satanita*, [1897] 1 AC 59.

MasterCard, which will require it to comply with the MasterCard Scheme Rules. In relation to interchange, this will require the party to use MasterCard's default interchange rates for transactions with other parties unless there is a bilateral agreement with that party."

In the course of written and oral submissions, MasterCard did not expand or elaborate upon those contentions.

93. We do not accept this characterisation of the agreements entered into by MasterCard licensees with MasterCard and the relationship of those agreements with the MasterCard Scheme Rules. The MasterCard Scheme Rules are absolutely clear: although not obliged to use the Interchange System, if they do so, Issuing Banks and Acquiring Banks are obliged "to net settle in accordance with [MasterCard's] settlement Standards".[67] As part of such a net settlement process, Issuing Banks are entitled to be paid the appropriate Interchange Fee, which applies unless there is a bilateral agreement.[68] It is obvious that the agreement by which a party becomes licensee of the MasterCard Scheme involves the creation of rights and obligations between licensees *inter se* in particular as regards the payment of the Interchange Fee.

94. Although Acquiring Bank licensees and Issuing Bank licensees have the freedom to negotiate bilateral Interchange Fees, where no bilateral agreement is sought or made, licensees positively agree to be bound by the MIF stated by MasterCard. It is on this basis that the Issuing Bank is permitted to deduct from the money it takes from its customer (the Cardholder) and passes to the Acquiring Bank the amount of the UK MIF. This is certainly "acquiescence" in the MasterCard Scheme Rules: indeed, we would go further – there is, in our view, positive agreement on the part of all parties (MasterCard and the licensees) that MasterCard would set the default UK MIF which, absent bilateral agreement, the Acquiring Bank licensees would be obliged to pay and Issuing Bank licensees entitled to receive.

[67] See paragraph 45(7) above.
[68] See paragraph 45(8) above.

95. In conclusion, we find that the setting of the UK MIF was an agreement or agreements between undertakings, the agreement being between MasterCard and its licensees.

(d) Concerted practice/decision by an association of undertakings

96. Given the conclusion we have reached regarding an agreement between undertakings, in our view it is not necessary to consider whether or to what extent there was also a concerted practice during the claim period. Nor, subject to one point, is it necessary for us to decide whether there was also a decision by an association of undertakings in any period after June 2009.[69] It was conceded, and we have found, that there was such a decision until at least June 2009 when the first change of circumstances relied upon by MasterCard occurred: see paragraph 86(3) above. The one qualification to this relates to MasterCard's pleaded case, and is as follows:

(1) In paragraph 12A of its Re-Amended Defence, MasterCard contends that Sainsbury's claim, to the extent that it is based on an agreement and/or a concerted practice, is time-barred in respect of the period prior to 24 July 2009 for transactions in England and Wales, and in respect of the period prior to 24 July 2010 for transactions in Scotland.

(2) That contention appears to be based on a consent order made in the High Court dated 24 July 2015, pursuant to an agreement by MasterCard that Sainsbury's be given permission to amend its Particulars of Claim to plead *inter alia* an agreement and/or a concerted practice (in addition to a decision by an association of undertakings, as originally pleaded) on the basis that "the doctrine of relation-back shall not apply to these amendments, with the relevant date for limitation purposes being the date of this Order". The consent order goes on, in essence, to spell out that for the purposes of the amended aspects of the claim the limitation period would run back from 24 July 2015 for six years (namely to 24 July 2009) in respect of

[69] We have found that the setting of the UK MIF was a decision by an association of undertakings from the beginning of the claim period until at least June 2009, as well as an agreement between undertakings throughout the claim period. However, for convenience we refer hereafter in this Judgment only to "agreement".

England and Wales transactions and five years (namely to 24 July 2010) in respect of the Scottish elements of the claim.

(3) It is not clear to what extent, if at all, this limitation aspect of MasterCard's pleaded case has been pursued. As far as we can tell, there is no discussion of it in MasterCard's written closings, nor is it identified as an issue in the Agreed List of Issues. Furthermore, in the course of oral submissions, the Tribunal expressly raised with MasterCard's counsel the question of an agreement/concerted practice as alternatives to a decision by an association of undertakings. The following exchange took place on Day 4/pp147-149:

Q (The Chairman)	The only thing is, is it all a bit academic? I mean you are all linked together by the banks, by these licence agreements via the rules, why does it matter whether you are an association of undertakings or you have just got a set of agreements that make provision for these things or even a concerted practice? Are you going to say much about that at this stage?
A (Mr Cook)	Sir, to be fair, we had not planned to say a great deal in relation to the argument about agreement to concerted practice. We don't admit it. It is a matter that my learned friend will have to prove and establish to you. We do consider factually the analysis of the association of undertakings is wrong; MasterCard is not acting on behalf of anybody else, it is an individual. If my learned friend persuades you that the agreement point is sufficient then --
Q (The Chairman)	Do[n't] we have to deal with it though? It is just a mechanism, isn't it, for coordination and there is no issue that you are coordinated because that's what rules are for, so why does it matter? It is a genuine question.
A (Mr Cook)	Sir, it does matter to MasterCard whether you say we are an association of undertakings. It matters in the context of, to be honest, the level of fines that might be imposed in the circumstances if we are to be treated as acting on behalf of all the banks and their turnover is brought within it. That is a point -- MasterCard challenges the idea that we are part of an

association of undertakings. We don't make any admissions in relation to any other parts of the analysis. My learned friend will have to satisfy you that the concerted practice or agreement point arises. We don't factually make any points in relation to that beyond what we said here, which says MasterCard is not acting on behalf of the banks, it is making its own unilateral decision now not because the banks are telling it to do so. So we do very much challenge the association of undertakings point and we are not making any admissions in relation to the rest of the analysis.

Q (The Chairman) Thank you very much.

No mention was made at that stage of the limitation point, nor was it the subject of submissions at any time. Similarly, the terms of the consent order were at no stage drawn to our attention so far as we are aware.

(4) This is perhaps unsurprising, given that at best its only impact could be to reduce the period in respect of which Sainsbury's can recover damages by approximately one month (for England and Wales transactions) namely the period from sometime in June 2009 to 24 July 2009, and thirteen months (for Scottish transactions) namely the period from sometime in June 2009 to 24 July 2010. We are not in a position to identify what the corresponding amounts of damages would be, but it is likely that they would be *de minimis* in relation to the claim as a whole. In those circumstances the parties ought to be able to resolve any issue relating to those periods by agreement and we invite them to do so.

(5) If it were necessary for us to consider this matter further (which would be likely to involve disproportionate expense in the light of the amounts involved) we would need to hear full argument from the parties. Aspects that would need to be covered would include the effect of the consent order (and the circumstances in which such an order can be varied) in the context of amendments to Sainsbury's pleading which, on a provisional view only, do not appear to add a new

cause of action, and which in any event appear to arise out of the same or substantially the same facts as the originally pleaded claim, for the purposes of CPR 17.4. On that basis one would normally have expected full relation-back to the time the proceedings were issued. Submissions and/or evidence might also be needed to deal with the position in relation to the Scottish law of limitation.

(3) Restriction of Competition by Object

97. Although it formed a part of its pleaded case,[70] Sainsbury's did not place very much emphasis on the UK MIF being an anti-competitive agreement by object. Restriction of competition by object was not mentioned in Sainsbury's written opening, nor in its oral opening, nor in its written closing. When pressed during the course of his oral closing submissions, Mr Brealey QC on behalf of Sainsbury's made clear that Sainsbury's was contending that the UK MIF was a restriction of competition by object, although he did so unenthusiastically:[71]

Q (The Chairman) There is another point; is it your argument – I know it is on the pleadings, but I wasn't sure to what extent you were pursuing it, are you saying this is a restriction by object?

A (Mr Brealey) No. I mean, it is not on the pleadings and we have not run the case, but it is pretty close to it, and the reason it is pretty close to it is because it has been said to be a restriction by effect for so many years that at some point you have to say, "Well, is it a restriction by object?"

I hear sniggering but that is actually how object restrictions are identified. So if you go to the [Article 101 TFEU] guidelines, you know, why is there an object infringement? Because price-fixing is, by its very nature – we have decided it so many times that it is an obvious restriction. That is why price-fixing agreements tend to have as their object a distortion of competition, because of previous case law. And I would say we are not far off an object infringement.

Q (Mr Smith) Well, Mr Brealey, I think you do plead that it is an infringement by object. You have said very little about it in your submissions; that is why we are a little puzzled.

[70] Amended Particulars of Claim/§39.
[71] Day 20/pp31-32.

Q (The Chairman)	We have got to work out whether we have to decide it. At some point we need to know if it is part of your case.
A (Mr Brealey)	If you are pushing me, then I would say it was an object infringement.
Q (The Chairman)	It is?
A (Mr Brealey)	Yes.
Q (The Chairman)	An object restriction?
A (Mr Brealey)	I am not, at this stage, going to say that it is not. I have just said it is an extremely close thing. They have had – 2002, supplemental statement of objections prior to that. I think the Tribunal would be perfectly entitled, in all consciousness, to say "Enough is enough. You know, both Visa and MasterCard have lost every single time". They have got a new statement of objections; again, it is a restriction… I haven't emphasised it because we say that it is clear that it is a restriction by effect, but I certainly couldn't stand up here and say "It's not a restriction by object".

98. Thus, Sainsbury's case on object was that:

(1) The UK MIF was, in essence, a price-fixing agreement;

(2) Various regulators (notably the Commission, in relation to the intra-EEA MIFs and the OFT in relation to the UK MIF) had found these to be anti-competitive agreements "by effect". There have, of course, been multiple investigations and decisions in this area. We set out below those that are the most significant in terms of the conclusions reached and their timing (i.e. the extent to which they pre-date the claim period):

(i) The Visa II Decision (24 July 2002), which concerned the Visa intra-EEA MIF, stated in Recital (73) that "[t]he MIF in the Visa system amounts to an appreciable restriction of competition within the meaning of Article [101(1) TFEU] and Article 53(1) of the EEA Agreement". The Commission had stated in Recital (69) that a MIF in a four-party payment system

is not a restriction by object if its aim is to increase the stability and efficiency of operation of that system, and indirectly to strengthen competition between payment systems by thus allowing four-party systems to compete more effectively with three-party systems.

(ii) The OFT Decision (6 September 2005), which concerned the MasterCard UK MIF (referred to as the "MMF MIF"), stated at paragraph 390:

> "Although it has not made this finding, the OFT considers that the MMF MIF agreement could be characterised as a price-fixing agreement which has as its object the restriction of competition in the wholesale and acquiring markets. This characterisation is possible because the collective price restriction, in practice, results in a collectively agreed interchange fee (i.e. the MMF MIF) which issuers charge acquirers. In practice, therefore, the Parties are not determining independently their own pricing policies vis-à-vis each other. The freedom to determine independently one's own pricing policies can be regarded as *"the essence of the competitive process"*. Accordingly, the MMF MIF agreement could be characterised as an *"obvious restriction of competition"*".

It is unclear why – having made this statement – the OFT did not follow through and conclude that there was an object restriction in this case. The OFT did, after a lengthy analysis, conclude that the UK MIF was a restriction of competition by effect.[72] We bear in mind, however, that the OFT Decision was set aside by this Tribunal on 10 July 2006.[73]

(iii) The Commission Decision (19 December 2007) concluded, again after lengthy analysis, that the MasterCard intra-EEA MIF "restricts competition between acquiring banks by inflating the base on which acquiring banks set charges to merchants and thereby sets a floor under the merchant fee. In the absence of the multilateral interchange fee the prices set by acquiring banks would be lower to the benefit of merchants and

[72] See paragraph 512 of the OFT Decision.
[73] *MasterCard UK Members Forum Limited and Others v Office of Fair Trading* [2006] CAT 14.

subsequent purchasers."[74] The Commission had earlier in the Decision (Recital 407) determined that it was "not necessary to reach a definite conclusion" on the question of whether the infringement was "by object" given its view that a restriction by effect could be clearly established.

99. MasterCard contended that in light of the case-law – in particular, the decision of the Court of Justice in Case C-67/13P, *Groupement des cartes bancaires (CB) v Commission* [2015] 5 CMLR 22 – "[i]t is obvious from even a cursory appraisal of the expert economic evidence in this case, both written and oral, that the MasterCard UK MIFs could not possibly be regarded "by their very nature" as being harmful to competition".[75]

100. We begin with a consideration of the law:

(1) Ever since the decision in Case 56/65, *Société Technique Minière v Maschinenbau Ulm* [1966] ECR 235 at 249, it has been clear that the words "object or effect" in Article 101(1) TFEU are to be read disjunctively. Where an agreement has as its object the restriction of competition, it is unnecessary to prove that it will produce anti-competitive effects: only if it is not clear that the object of an agreement is to restrict competition is it necessary to consider whether it might have the effect of doing so. [76]

(2) As Whish and Bailey note, what constitutes a restriction of competition by object remains a controversial topic, "a concept that, after more than 50 years of EU competition law, continues to be hotly debated".[77] For a period, it appeared that the legal threshold for an object restriction was becoming lower – in that it was becoming easier to establish restriction of competition by object.[78] That trend appears to have been halted, and perhaps reversed, by the Court of Justice's decision in *Cartes Bancaires* (emphasis added):

[74] See Recital 664 of the Commission Decision.
[75] MasterCard Closing/§189.
[76] Whish & Bailey 2015 at p123.
[77] *Ibid.*
[78] Whish & Bailey 2015 at pp125-126.

“48 It must be recalled that, to come within the prohibition laid down in [Article 101(1) TFEU], an agreement, a decision by an association of undertakings or a concerted practice must have “as [its] object or effect” the prevention, restriction or distortion of competition in the internal market.

49 In that regard, it is apparent from the Court’s case law that certain types of coordination between undertakings reveal a sufficient degree of harm to competition that it may be found that there is no need to examine their effects…

50 That case law arises from the fact that certain types of coordination between undertakings can be regarded, by their very nature, as being harmful to the proper functioning of normal competition…

51 Consequently, it is established that certain collusive behaviour, such as that leading to horizontal price-fixing by cartels, may be considered so likely to have negative effects, in particular on the price, quantity or quality of the goods and services, that it may be considered redundant, for the purposes of applying [Article 101(1) TFEU], to prove that they have actual effects on the market…Experience shows that such behaviour leads to falls in production and price increases, resulting in poor allocation of resources to the detriment, in particular, of consumers.

52 Where the analysis of a type of coordination between undertakings does not reveal a sufficient degree of harm to competition, the effects of the coordination should, on the other hand, be considered and, for it to be caught by the prohibition, it is necessary to find that factors are present which show that competition has in fact been prevented, restricted or distorted to an appreciable extent…

53 According to the case law of the Court, in order to determine whether an agreement between undertakings or a decision by an association of undertakings reveals a sufficient degree of harm to competition that it may be considered a restriction of competition “by object” within the meaning of [Article 101(1) TFEU], regard must be had to the content of its provisions, its objectives and the economic and legal context of which it forms a part. When determining that context, it is also necessary to take into consideration the nature of the goods or services affected, as well as the real conditions of the functioning and structure of the market or markets in question…

54 In addition, although the parties’ intention is not a necessary factor in determining whether an agreement between undertakings is restrictive, there is nothing prohibiting the competition authorities, the national courts or the Courts of the European Union from taking that factor into account…

55 In the present case, it must be noted that, when the General Court defined in the judgment under appeal the relevant legal criteria to be taken into account in order to ascertain whether there was, in the present case, a restriction of competition by “object” within the meaning of [Article 101(1) TFEU], it reasoned as follows, in paragraphs 124 and 125 of that judgment:

> "124 According to the case law, the types of agreement covered by [Article 101(1)(a) to (e) TFEU] do not constitute an exhaustive list of prohibited collusion and, accordingly, the concept of infringement by object should not be given a strict interpretation…
>
> 125 In order to assess the anti-competitive nature of an agreement or a decision by an association of undertakings, regard must be had *inter alia* to the content of its provisions, its objectives and the economic and legal context of which it forms a part. In that regard, it is sufficient that the agreement or the decision of an association of undertakings has the potential to have a negative impact on competition. In other words, the agreement or decision must simply be capable in the particular case, having regard to the specific legal and economic context, of preventing, restricting or distorting competition within the common market. It is not necessary for there to be actual prevention, restriction or distortion of competition or a direct link between [that agreement or decision] and consumer prices. In addition, although the parties' intention is not a necessary factor in determining whether an agreement is restrictive, there is nothing prohibiting the Commission or the Community judicature from taking it into account…"

56 It must be held that, in so reasoning, the General Court in part failed to have regard to the case-law of the Court of Justice and, therefore, erred in law with regard to the definition of the relevant legal criteria in order to assess whether there was a restriction of competition by "object" within the meaning of [Article 101(1) TFEU].

57 First, in paragraph 125 of the judgment under appeal, when the General Court defined the concept of the restriction of competition "by object" within the meaning of that provision, <u>it did not refer to the settled case law of the Court of Justice mentioned in paragraphs 49 to 52 of the present judgment, thereby failing to have regard to the fact that the essential legal criterion for ascertaining whether coordination between undertakings involves such a restriction of competition "by object" is the finding that such coordination reveals in itself a sufficient degree of harm to competition</u>.

58 Secondly, in the light of that case law, the General Court erred in finding, in paragraph 124 of the judgment under appeal, and then in paragraph 146 of that judgment, that the concept of restriction of competition by "object" must not be interpreted "restrictively". The concept of restriction of competition "by object" can be applied only to certain types of coordination between undertakings which reveal <u>a sufficient degree of harm to competition that it may be found that there is no need to examine their effects</u>, otherwise the Commission would be exempted from the obligation to prove the actual effects on the market of agreements which are in no way established to be, by their very nature, harmful to the proper functioning of normal competition. The fact that the types of agreements covered by [Article 101(1) TFEU] do not constitute an exhaustive list of prohibited collusion is, in that regard, irrelevant."

101. It is clear that the essential criterion for discerning a restriction on competition "by object" is that the agreement by its very nature reveals a sufficient degree of harm to competition, so as to obviate any need for an effects-based examination. Although the basic test – "a sufficient degree of harm to competition" – is not further defined, the following points can be made:

(1) Certain types of agreement can be said to be – by their very nature – likely to be anti-competitive. Their anti-competitive effect can be presumed. In this, it may be said that object restrictions bear a passing similarity to *per se* illegal agreements under the US Sherman Act 1890. In the case of a *per se* infringement, it is not open to the parties to the agreement to argue that it does not restrict competition: it belongs to a category of agreement that is by law regarded as restrictive of competition.[79]

(2) Given that a finding of object restriction obviates the need for a consideration of the anti-competitive effects of an agreement, there is a symbiosis between restriction by object and restriction by effect. Restriction by object should not be used as a means of avoiding a difficult investigation of anti-competitive effects. In short, the harm to competition that might be expected in the case of an object restriction needs to be clear-cut and pronounced without an examination of the effects.

(3) Whilst the whole point of an object restriction is to avoid the need for an effects investigation, it is clear (not least from paragraph 53 of *Cartes Bancaires*) that the anti-competitive restriction needs to be seen and considered in context,[80] and that the intentions of the parties can be a relevant factor.[81]

102. With this, we turn to the allegedly anti-competitive agreement in this case, the agreement setting the UK MIF. It is our conclusion that this agreement is not a

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[79] It is important not to push the analogy too far. "Object" restrictions can be saved by Article 101(3) TFEU; "*per se*" restrictions are irredeemable – there is no equivalent of Article 101(3) TFEU in US law.

[80] See paragraph 53 of *Cartes Bancaires*.

[81] See paragraph 54 of *Cartes Bancaires*.

restriction of competition "by object". We have reached this conclusion for the following reasons:

(1) First, although it is fair to say that the UK MIF is an agreement fixing a price, and that such provisions might be said to have a presumptive anti-competitive effect, it must be borne in mind that the UK MIF is a default provision. Under the MasterCard Scheme Rules, it was at all times open to Issuing and Acquiring Banks to agree a different Interchange Fee. That, in our judgment, has a diluting effect on the extent to which anti-competitive consequences can be presumed. Of course, we appreciate that the ability on the part of Issuing and Acquiring Banks to depart from the UK MIF by way of bilateral agreement may have been more illusory than real. But that is not a matter on which we can reach a conclusion without considering the effects of the UK MIF.

(2) Secondly, given that after voluminous factual and expert evidence in writing, oral evidence over fifteen days and much submission from two very able legal teams, the issue of whether the UK MIF was, or was not, anti-competitive was very much at large, we do not think that it can be said that the anti-competitive nature of this agreement was either clear-cut or pronounced without an examination of the effects. It is also worth bearing in mind that price-fixing cartels (the classic "by object" restriction) are almost invariably secret. The MasterCard Scheme Rules, including the provisions regarding the MIF, are not secret. They are extant in every relevant licence agreement and the MIFs (as well as the Scheme Rules) are published by MasterCard on its website.[82]

(3) Thirdly, we do consider that it is important to examine why MasterCard was setting a MIF. The evidence on this was as follows:

[82] Willaert 1/§21.

(i) MasterCard did not derive any direct financial benefit from the MIF – Interchange Fees are paid to Issuing Banks, not to MasterCard.

(ii) In his witness statement, Mr Willaert gave evidence on how – in general terms – a MIF was set:[83]

> "17 To assess and set interchange fees, the interchange fee team researches the relevant payment market looking at market trends and evolution. If necessary, it will request a cost study from an independent consultant to analyse the costs incurred in relation to a particular product (this may look at either the full costs or, where the majority of costs are incurred by one party, just the costs of this party as a convenient proxy for total costs). When conducting the analysis the team would consider the impact of the proposal on all parties in the transaction process. The team then develops a proposal which is put before the interchange fee review body (the European Interchange Committee or EIC). Proposals are submitted to the EIC in a document referred to as a "pre-read"…
>
> 18 My personal involvement in the preparation of proposals varied depending on the complexity and importance of the proposal. The more complex or significant a proposal was, the more I would be involved. I was, however, responsible for overseeing all proposals made when I was Head of the Interchange Fee Team.
>
> 19 Once the proposal is finalised, in the form of a pre-read, this is then reviewed by the legal department and, if approved, presented to the EIC. The EIC consists of representatives from all sides of the MasterCard business including Products, Customer Relations, Implementation, Acceptance, Legal and Global Interchange. It would also include the country manager/divisional president relevant to the proposal being made so he can explain the potential impact of the proposal upon both acquirers and issuers and their customers and raise any market specific concerns. Only MasterCard employees are part of the EIC.
>
> 20 The aim of the review process is to ensure that MasterCard understands the potential impact upon all parties and can make a decision taking this into account. Pre-reads are sent to the EIC ahead of the meeting enabling them to review the proposal and raise questions if they had any. As Head of the Interchange Fee Team, presenting the proposals to the EIC would be my responsibility.
>
> 21 A proposal would generally be subject to discussion at the EIC. Only when there are no outstanding questions and all

[83] Willaert 1.

members of the EIC are happy with the proposal will it be endorsed…and a memorandum summarising the proposal sent to the President of International Markets for approval…Once approved by the President the change will be announced (published) in an interchange bulletin…on MasterCard online for customers and published on the MasterCard public website when the rates become effective so merchants can consult them. The rate change is usually implemented and effective about 3 months from the date of announcements to customers.

22 MasterCard takes a strategic approach to setting interchange fees…It takes into account the cost data relevant to the particular MasterCard product under review, the level of rates set by MasterCard's competition in this respect (particularly Visa and Amex) and any relevant payment scheme objectives which are relevant to this (such as the introduction of new technologies, innovation, the need to fight fraud)…

…

24 …there are multiple factors which are considered when setting interchange fees: cost data, competition, market conditions such as sensitivity to cardholder fees and merchant service charges, payment scheme objectives and innovation. In particular, MasterCard must balance the competing interests and desires of cardholders, issuers, acquirers and merchants. For example, on one side, MasterCard needs to assess and have reference to the level of issuer costs incurred dealing with card use (a large proportion of which arise from the other rules in the Scheme, such as whether the transaction has to be paid or can be charged back in the event of fraud) and costs for attracting card holders – too low a fallback interchange fee and there will be no incentive for issuers to win cardholders or encourage card use; on the other side, interchange fees consider the value that merchants derive from card acceptance and cannot be too high or merchants will either discourage the use of payment cards or simply won't accept them. Merchant resistance, therefore, prevents MasterCard setting excessive merchant service charges and interchange fees."

(iii) In his oral evidence, Mr Willaert was also asked about the manner in which MIFs were set. In response to questions from Mr Brealey, he said:[84]

Q (Mr Brealey)	Mr Willaert, there are thousands of documents in this case and, forgive me, but one document seems to be missing and that is the precise calculation by the interchange fee team of the

[84] Day 10/pp21-22

UK MIF.

Can you assist the Tribunal with why that is?

A (Mr Willaert) I cannot answer on the specific document because I was not -

Q (Mr Brealey) It is not annexed to your statement for example?

A (Mr Willaert) No, exactly. So I would say that, and I think what you are hinting at is, is there one precise formula where you magically pump in all the information and the interchange comes out? No. An interchange is a balancing mechanism and you need to take various inputs into account to set the right level of interchange.

There are other examples, for example if the Central Bank sets an interest rate, they are also using a mechanism in the market to balance. So it does not necessarily require one specific formula.

So this, typically where you are balancing two different market sides, it does not mean necessarily there is a specific formula for saying "This is now the right level of interchange."

(iv) In response to a question from Professor Beath:[85]

Q (Prof Beath) …I'm still trying to get to grips with what goes on in your team's mind as you are generating this MIF, because the way you describe it you have some hard information…Then you also have soft information, which is all this stuff about, you know, what the market is like and so on.

Now, when you bring these things together you have to have a baseline to start from. So is the baseline the cost information and you then have a judgmental factor? Because, you know, thinking about the Bank of England MPC process that's exactly what it would be. There is hard data on the economy, and then you think about expectations and things of that sort.

Is that actually the way your team ends up with

[85] Day 10/pp28-30.

"This is today's MIF"?

A (Mr Willaert)	It is a very good question. I'll try to explain it. So I would say – in the first objective I would say that the product that you put in the market, let me assume that we would be setting the rate for a new product from MasterCard that would be launched, of course the first objective would be to ensure that the product is competitive in the market. So that is the first objective. Then what you would do is you would look at the cost information –
Q (Prof Beath)	But if it didn't cover the costs. I mean, if to be competitive it didn't cover the costs, would you simply withdraw the product?
A (Mr Willaert)	So if you would, let's say, need to set an interchange would be higher than the costs in order to be competitive, then I think no. So you could still go ahead. But, for instance, let me make a concrete example. The premium product. We get a study from Edgar Dunn that says the cost in the market on average is 100 basis points on average. Then we want to compete with Amex. So we say, well, Amex gives the issuers on average, let's say, 160 [basis points]. So, if I'm going to launch a product at 100, it is never going to be able to compete, no issuer in the market will launch this. So I can actually make – set an interchange rate which is competitive with Amex, say I put it at 140 because Amex has a different acceptance. So we look at 140 as a competitive rate, but then I would look at the overall costs in the market and then make an estimate how much of these products will be issued in the market. And I will look at the total costs in the market of all MasterCard products for merchants: standard products, premium products. And the average of that, I would try to ensure that that is below the cost level, so that on average the merchant does not necessarily have an increase, or will not be above the cost. But that does allow me within this average to set some products at the higher rate to compete and some at the lower level.

It is thus clear that in terms of the level at which it was set, the MIF was no ordinary price-fixing agreement. MasterCard sought to set a considered

default Interchange Fee, reflecting multiple factors and diverse interests. In particular, it was Mr Willaert's evidence, which we accept, that MasterCard sought to balance the competing interests of Issuing Banks/Cardholders and Acquiring Banks/Merchants, as well as taking account of the competitiveness of MasterCard cards with its rival schemes, Visa and Amex. Given this approach, and given what MasterCard contended were the potentially devastating consequences of a mismatch between its Interchange Fees and those of its rivals, we consider that it cannot be said that the MIF demonstrates of its very nature a sufficient degree of harm to competition so as to amount to a restriction "by object".

(4) Restriction of Competition by Effect: the Correct Analytical Approach

(a) Introduction

103. For the reasons given in Section H(2) above, we have found that the setting of the UK MIF by MasterCard was an agreement between undertakings. However, for the reasons given in Section H(3) above, we do not find that the UK MIF was a restriction of competition "by object".

104. The next question that arises is whether that agreement had the effect of preventing, restricting or distorting competition. There is no dispute that the geographic market in the present case is the UK, and we do not consider this aspect of market definition further. There is also no dispute that it is the anti-competitive effect of the setting of the UK MIF that we are considering.

105. The manner in which it is determined whether a given provision constitutes a restriction of competition "by effect" is – in general terms – well-understood. Extensive analysis of an agreement in its market context is required. In order to do this:

(1) Having identified the relevant agreement or provision said to constitute a restriction on competition (an uncontroversial issue in this case), it is necessary to identify the market in which the effect of that agreement or provision is to be gauged.

(2) Once that has been done, a theory of harm must be articulated. In a regulatory case, that is done by the competition authority; in a private action, it is the claimant, here Sainsbury's.

(3) The allegedly harmful effect is then assessed by reference to what the position would have been in the absence of the allegedly infringing agreement or provision. This "counterfactual hypothesis" imagines what the market would have been like absent the infringing agreement or provision. In this way, it can be determined whether the provision or agreement is indeed restrictive of competition.

106. From the very outset, there was a dispute between the parties as to the market in which the effect of the UK MIF was to be gauged. This was largely because of the fact that the MasterCard Scheme is – as we have described in paragraph 70 above – a two-sided platform.

107. Sainsbury's case was that the relevant market was to be defined as the market for acquiring payment card transactions in the UK.

108. MasterCard's response to this was a nuanced one. Although Sainsbury's – particularly in Von Hinten-Reed 2 and in the oral opening of Mr Brealey – complained that MasterCard had failed properly to engage on the question of the relevant product market, MasterCard's position was that more than one product market was engaged because the MasterCard Scheme was a two-sided platform. MasterCard contended that the agreement to set the UK MIF was objectively necessary and/or did not have the effect of restricting competition when viewed in the context of the several markets engaged – namely, in particular, the acquiring market and the issuing market.

109. It is, therefore, necessary to determine what is the correct analytical approach when considering a restriction of competition by effect in a case such as this.

(b) Effect of preventing, restricting or distorting competition: the law

110. In Case T-328/03, *O2 (Germany) GmbH & Co OHG v Commission*, [2006] 5 CMLR 5, the General Court considered the manner in which it was to be

tested whether a given provision had the effect of preventing, restricting or distorting competition.

111. The General Court held:

> "66. In order to assess whether an agreement is compatible with the common market in the light of the prohibition laid down in [Article 101(1) TFEU], it is necessary to examine the economic and legal context in which the agreement was concluded…, its object, its effects, and whether it affects intra-Community trade taking into account in particular the economic context in which the undertakings operate, the products or services covered by the agreement, and the structure of the market concerned and the actual conditions in which it functions…
>
> 67. That method of analysis is of general application and is not confined to a category of agreements…
>
> 68. Moreover, in a case such as this, where it is accepted that the agreement does not have as its object a restriction of competition, the effects of the agreement should be considered and for it to be caught by the prohibition it is necessary to find that those factors are present which show that competition has in fact been prevented or restricted or distorted to an appreciable extent. The competition in question must be understood within the actual context in which it would occur in the absence of the agreement in dispute; the interference with competition may in particular be doubted if the agreement seems really necessary for the penetration of a new area by an undertaking…
>
> 69. Such a method of analysis, as regards in particular the taking into account of the competition situation that would exist in the absence of the agreement, does not amount to carrying out an assessment of the pro- and anti-competitive effects of the agreement and thus to applying a rule of reason, which the Community judicature has not deemed to have its place under [Article 101(1) TFEU]…"

112. The correct approach is best considered in stages:

(1) The only question being considered is the question of whether the agreement in question – here the agreement to set a UK MIF – has the effect of preventing, restricting or distorting competition. There is no question of balancing pro- or anti-competitive effects and saying that certain anti-competitive effects are out-weighed by countervailing pro-competitive effects. That is the province of Article 101(3) TFEU. In short, if an agreement has the effect of restricting competition, then (subject, of course, to the question of objective necessity considered in Section H(6) below and the question of appreciability considered in Section H(5) below) the Article 101(1) TFEU prohibition bites.

(2) Whether a given agreement has anti-competitive effects needs to be considered in the actual economic context in which the agreement operates. It is necessary to identify those factors which show that competition has in fact been prevented or restricted or distorted.

(3) Whether there are such anti-competitive effects is determined by assessing what the competition situation would be in the absence of the agreement.

113. This involves a counterfactual hypothesis, as was confirmed in paragraph 71 of the General Court's judgment in *O2*:

> "The examination required in the light of [Article 101(1) TFEU] consists essentially in taking account of the impact of the agreement on existing and potential competition…and the competition situation in the absence of the agreement…, those two factors being intrinsically linked."

114. In *MasterCard*, the Court of Justice considered the counterfactual in the specific context of MIFs. One of the intervening parties (Royal Bank of Scotland plc ("RBS")) suggested that the Commission had, in the Commission Decision, "erred in law in its assessment of the existence of a restrictive effect on competition" (at paragraph 127). The Court of Justice summarised the argument as follows (at paragraph 128):

> "…in assessing whether a decision has a restrictive effect on competition, the Commission should have considered what the actual 'counterfactual hypothesis' would have been in the absence of the MIF. By not penalising that omission…and by thus relying solely on the economic viability of the prohibition of *ex post* pricing rather than on any consideration of the likelihood of such a prohibition actually being adopted, the General Court erred in law by confusing the legal conditions for objective necessity and those for effects on competition."[86]

115. It will be necessary to consider the so-called "prohibition of *ex post* pricing" in considerably greater detail. For the present, it is simply necessary to note that the Court of Justice was considering whether the MasterCard Scheme, as a payment system, could work without a MIF, provided there was a prohibition on *ex post* pricing. The point being made by RBS was that when considering whether the primary operation or activity (the payment system) was <u>impossible</u> to carry on (instead of merely more difficult or less profitable)

[86] The point is made again in *MasterCard* at paragraph 168.

without a MIF, different criteria applied to the appropriate counterfactual than when considering whether there was a restriction on competition.

116. Pausing there, it is easy to see why this should be the case: the question of whether it is impossible to carry on a primary operation or activity without a particular term, is very different from the question of whether that term is restrictive of competition, which invokes an inquiry as to the nature of competition in the relevant market absent the restriction in question.

117. The Court of Justice agreed with RBS:

> "161. As regards RBS's criticism, summarised in paragraph 128 of that judgment, that, in assessing whether a decision has a restrictive effect on competition, the Commission should have considered what the actual 'counterfactual hypothesis' would have been in the absence of the MIF, it should be noted that the Court of Justice has repeatedly held that in order to determine whether an agreement is to be considered to be prohibited by reason of the distortion of competition which is its effect, the competition in question should be assessed within the actual context in which it would occur in the absence of the agreement in dispute…
>
> 162. Nevertheless, it is apparent in particular from paragraph 132 of the judgment under appeal that, in order to assess the competitive effects of the MIF, the General Court relied on 'the premiss of a MasterCard system operating without a MIF – solely on the basis of a rule prohibiting *ex post* pricing', that is to say, on the same 'counterfactual hypothesis' it applied in order to examine whether the MIF could be regarded as an ancillary restriction as referred to in paragraphs 89 and 90 of the present judgment, in relation to the MasterCard payment system.
>
> 163. As is apparent from paragraph 108 of the present judgment, the same 'counterfactual hypothesis' is not necessarily appropriate to conceptually distinct issues. Where it is a matter of establishing whether the MIF have restrictive effects on competition, the question whether, without those fees, but by the effect of prohibiting *ex post* pricing, an open payment system such as the MasterCard system could remain viable is not, in itself, decisive.
>
> 164. By contrast, the Court should, to that end, assess the impact of the setting of the MIF on the parameters of competition, such as the price, the quantity and quality of the goods or services. Accordingly, it is necessary, in accordance with the settled case-law referred to in paragraph 161 of the present judgment, to assess the competition in question within the actual context in which it would occur in the absence of those fees.
>
> 165. In that regard, the Court of Justice has already had occasion to point out that, when appraising the effects of coordination between undertakings in the light of [Article 101(1) TFEU], it is necessary to take into consideration the actual context in which the relevant coordination arrangements are situated, in particular the economic and legal context in which the undertakings concerned operate, the nature of the goods or services affected, as well as the

real conditions of the functioning and the structure of the market or markets in question…

166. It follows from this that the scenario envisaged on the basis of the hypothesis that the coordination arrangements in question are absent must be realistic. From that perspective, it is permissible, where appropriate, to take account of the likely developments that would occur on the market in the absence of those arrangements.

167. In the present case, however, the General Court did not in any way address the likelihood, or even plausibility, of the prohibition of *ex post* pricing if there were no MIF, in the context of its analysis of the restrictive effects of those fees. In particular, it did not…address the issue as to how – taking into account in particular the obligations to which merchants and acquiring banks are subject under the Honour All Cards Rule, which is not the subject of the decision at issue – the issuing banks could be encouraged, in the absence of MIF, to refrain from demanding fees for the settlement of bank card transactions.

118. Thus, the counterfactual hypothesis to be constructed when assessing whether there has been a restriction on competition is different from that to be constructed when assessing whether there has been an ancillary restraint.

119. "Market definition" is an important tool when considering whether there has been an appreciable restriction on competition. In the well-known case of Case 23/67, *Brasserie de Haecht v Wilkin*, [1967] ECR 407, the Court of Justice said:

"…it would be pointless to consider an agreement, decision or practice by reason of its effects if those effects were to be taken distinct from the market in which they are seen to operate and could only be examined apart from the body of effects, whether convergent or not, surrounding their implementation. Thus in order to examine whether it is caught by Article [101(1)] an agreement cannot be examined in isolation from the above context, that is, from the factual or legal circumstances causing it to prevent, restrict or distort competition. The existence of similar contracts may be taken into consideration for this objective to the extent to which the general body of contracts of this type is capable of restricting the freedom of trade.[87]

120. Ordinarily, when considering whether there has been an appreciable restriction on competition, it is only necessary to define a single market and to consider the (anti-) competitive effects of an alleged restriction in that market.

121. Payment systems are – as we have described – a two-sided platform, and the question arises as to whether this makes a difference in terms of the markets

[87] At p. 415.

that need to be defined and considered. This question was considered by the Court of Justice in *MasterCard.*

122. *MasterCard*, it will be recalled, was an appeal from the General Court to the Court of Justice. The decision of the General Court was criticised by Lloyds Banking Group (one of the parties intervening, "LBG") for failing "to recognise the importance of constraints from other payment systems and the relevance of the two-sided nature of the system, which, according to the General Court, are relevant only in the context of [Article 101(3) TFEU]. In LBG's submission, in order to rule that the Commission had demonstrated to the requisite legal standard that there was a restriction of competition, the General Court had to be satisfied that the Commission had considered the alleged restriction of competition in its proper context".[88]

123. The Court of Justice rejected the criticism of the General Court that it had failed to recognise the importance of constraints from other systems in paragraph 176 of its decision. The Court of Justice agreed that such constraints were important, but held that the General Court had paid due regard to them.

124. As regards the question of two-sided markets, the Court of Justice concluded that these <u>could</u> be relevant to an assessment of restriction of competition:

> "177. As regards the argument, also referred to in paragraph 140 of the present judgment, by which LBG accuses the General Court of having ruled the two-sided nature of the system to be relevant only in the context of [Article 101(3) TFEU], it should be borne in mind that, as is apparent from paragraph 161 of the present judgment and as LBG, moreover, has submitted, the General Court was obliged to satisfy itself that the Commission had examined the alleged restriction of competition within its actual context. In order to determine whether coordination between undertakings must be considered to be prohibited by reason of the distortion of competition which it creates, it is necessary, according to the case-law referred to in paragraph 165 of the present judgment, to take into account any factor that is relevant, having regard, in particular, to the nature of the services concerned, as well as the real conditions of the functioning and the structure of the markets, in relation to the economic or legal context in which that coordination occurs, regardless of whether or not such a factor concerns the relevant market."

125. The legal conclusion of the Court of Justice was, therefore, clear. The two-sidedness of a platform, and the fact that multiple markets could be in play,

[88] At paragraph 140.

might well be relevant factors when considering whether there had been an appreciable restriction on competition. In the end, for the reasons given in paragraphs 178 to 181, and which are not material for present purposes, the Court of Justice nevertheless affirmed the General Court's decision on this point.

(5) Did the Setting of the UK MIF Have the Effect of Appreciably Restricting Competition?

(a) The starting point: the allegedly anti-competitive provision

126. The provision which Sainsbury's alleges to be restrictive of competition is the UK MIF. As we have described, this is a default rate, set by MasterCard, and agreed by all parties licensed to the MasterCard Scheme pursuant to the MasterCard Scheme Rules.

127. It was common ground between the parties that it was the effect of this provision that needed to be considered. We approach the question in the following way:

(1) First, we identify the relevant market or markets in which the allegedly anti-competitive effect of this provision is to be tested.

(2) Secondly, we set out Sainsbury's theory of harm.

(3) Thirdly, we test that theory in the context of the market or markets we have defined as relevant on the basis of a hypothesis that the UK MIF is absent.

(b) The relevant market or markets

(i) Potentially relevant markets

128. In order to assess whether there is a distortion of competition, it is necessary to begin by defining the relevant market or markets. There was no disagreement between the parties as to the definition of potentially relevant product markets. Essentially, there are three:

(1) In the Visa I Decision, the Commission said this about the markets in which payment systems operate:

> "(34) Two types of competition relevant to payment cards can be distinguished. The first is between different payment systems/networks (different payment card schemes/networks and possibly means of payment other than cards), while the second is between financial institutions (usually banks) for card-related activities (essentially issuing of cards to individuals and 'acquiring' of card payments from merchants). The former of these two types of competition is conventionally termed 'system/network market' or 'upstream market', while the latter is conventionally termed 'intra-system or downstream market'. On the intra-system markets, within each payment system (Visa, for example), financial institutions compete with each other to issue cards bearing that brand or to acquire merchants accepting that card.
>
> (35) All these types of competition are affected by the Visa rules. Firstly, they affect the competitive position of Visa with regard to other payment systems. Secondly, they affect competition between banks within the Visa system in so far as they lay down certain standard terms and conditions for issuing or acquiring contracts, thus preventing banks from differentiating themselves from other banks by offering different terms and conditions…
>
> (36) For a payment card to be widely used, it must be accepted by large numbers of merchants, and then cardholders must choose to use that card among the different cards they hold and which are accepted by the merchants in question. Demand from both merchants and cardholders must therefore be analysed in order to determine the correct definition of the system market. This demand is interrelated: even if a card is free to cardholders, it will not be used unless accepted by merchants, and vice versa."

(2) The Visa II Decision adopted a similar description,[89] but added the following detail regarding the intra-system or downstream markets:

> "(45) As for the intra-system markets, on the issuing side, banks and other Visa card issuers compete with each other to issue Visa cards to individuals, and to persuade their cardholders to use those Visa cards rather than any other cards that those individuals may hold. A Visa card is usually (but not invariably) linked to a bank account, but is not normally a bundled product, which would be inevitably included in a package with a bank account. A Visa card can therefore be considered as a distinct product. On the acquiring side, Visa acquirers (which may be banks or entities owned by banks) sign merchants for all of the services necessary for the merchant to accept Visa cards: these normally include providing authorisation, processing, crediting merchants' accounts, software and technical backup services, clearing

[89] See the Visa II decision/§§(43)-(45).

and settlement with the issuing bank. A merchant does not need to hold his principal bank account with his Visa acquirer."

(3) The Commission Decision also accepted the analysis in the Visa I and II Decisions.[90] Indeed, in paragraph 279 of its Decision, the Commission explicitly distinguished three markets – "an upstream "system/network market" and downstream "issuing" and "acquiring" markets".

129. We agree with this analysis, which was not disputed by the parties. Payment systems undoubtedly operate in three related markets:

(1) The market between payment systems.

(2) The "issuing" market.

(3) The "acquiring" market.

(ii) The relevant market or markets

The contentions of the parties

130. What was in dispute between the parties was whether – as Sainsbury's contended – only the acquiring market was relevant or whether – as MasterCard contended – all three were. Sainsbury's position requires no further elucidation. MasterCard's position is described in Niels 1:

"3.13 …the Commission Decision distinguishes between three categories of product market.

- The market for payment cards – this is the market in which payment card schemes compete with each other and with other payment methods such as cash, cheques and online payment systems – 'inter-system' competition. In my opinion, it is not material for the present purposes whether other payment methods provide a sufficiently strong competitive constraint on payment cards to be included in the same market; nor is it material whether or not the payment card market is split further between debit and credit cards.
- The acquiring market – this is the market in which acquirers compete with each other for the custom of merchants. This is a form of 'intra-system' competition (although acquirers from different schemes may also compete with each other, so there is an element of inter-system competition). The Commission left open the questions of whether the market should be

[90] See Commission Decision/§§278*ff.*

further divided between debit and credit card acquiring, and whether acquiring for MasterCard is separate from acquiring for other schemes.

- The issuing market – similarly, this is the market in which issuers compete with each other for cardholders; another form of 'intra-system' competition. Issuers from different schemes will also compete with each other, so this also involves inter-system competition.

…

3.15 …the restriction of competition that was identified in the Commission Decision of 2007 in relation to the intra-EEA MIF referred to the acquiring market only. This is the market in which the intra-EEA MIF was seen as creating an artificial cost base that was common for all MasterCard acquirers, representing a restriction of price competition between acquiring banks.

3.16 However, to understand the economic context and effects of the UK MIF, I consider that one also has to take into account the other two markets – i.e. the market for payment cards more broadly, and the issuer market. This is because any change in one market will have inevitable knock-on effects in the other two markets, given the two-sided nature of payment card platforms and feedback effects between the two sides. In my analysis of restriction of competition in this section…all three markets play a role in specific parts of the analysis."

Obviously, this was not accepted by Sainsbury's. Sainsbury's contended that the approach of the Commission in the Commission Decision – which, as Dr Niels rightly said, considered the acquiring market to be the only relevant one[91] – should be followed.

The Commission's approach

131. In paragraph 307 of the Commission Decision, the Commission stated:

"The supply and demand side analyses show that card acquiring services are neither sufficiently substitutable with cash and cheque related services, nor with bank giro-, nor with direct debit services. The Commission therefore retains as relevant product market for assessing the MIF the market for acquiring payment card transactions. It can be left open whether this market can be further sub-divided into credit card acquiring and debit card acquiring or whether acquiring for MasterCard products is a product market on its own."

132. The Commission's analysis of the supply side of the acquiring market is particularly instructive of its approach:

"283 …acquirers provide a wide range of services, which are of a technical and of a financial nature. Their customers are merchants wishing to accept payment cards. The product characteristics of acquiring services are fundamentally different from those of issuing services. Pricing of acquiring services is

[91] Commission Decision/§316.

structurally different from the pricing of issuing services, since it is based on a fee paid for each transaction, whereas cardholders typically pay annual fees.

284 The differences in product characteristics and of the competitive dynamics in providing acquiring services as opposed to providing issuing services further illustrate that the approach of amalgamating all these distinct services into one single *"MasterCard payment service"* for the purpose of defining the relevant market is inappropriate to grasp the complexity of market reality in this industry.

285 The product characteristics of card acquiring services are also wholly different from the services that suppliers provide to merchants in respect of acceptance of cash and cheque. Cash collectors, for example, can hardly switch to acquiring merchants for card acceptance and vice-versa. Cash collection requires high security transports and involves the risk of robbery, whereas card acquiring requires sophisticated IT equipment, involves financial risks such as unrecoverable charge back losses linked to merchant default."

133. The earlier (6 September 2005) OFT Decision took a similar approach to the Commission. Like the Commission, the OFT identified three markets.[92] When it came to considering the relevant product market, the OFT considered that the key test was that "[t]he relevant product market comprises all those products which are regarded as reasonably interchangeable by reason of the product's characteristics, price or intended purpose".[93] This led the OFT to focus on the acquiring market. The OFT considered whether the fact that payment systems were a two-sided platform affected the analysis, and considered that it did not:

"162 The OFT notes that ultimate demand for credit and charge card transactions is two-sided, from merchants on one side and from cardholders on the other side. The OFT has explicitly considered the competitive constraints that may result from merchant and cardholder behaviour. However, the OFT does not accept the view of the Parties that the presence of two-sided demand makes it necessary to consider a single relevant market based upon the card scheme as a whole. The relevant market(s) in cases of two-sided demand will depend upon the nature of the restriction in question and the economic conditions that apply in the market(s).

163 The OFT notes that previous cases dealing with situations of two-sided demand have led to the definition of separate relevant markets on one or both sides of the demand for a product. For example, in *Aberdeen Journals* the Competition Appeal Tribunal upheld the OFT's market definition which focused on the relevant product market for advertising space in local newspapers. In *Carlton/Granada*, separate relevant product markets were defined for advertising and broadcasting activities. As a result, the OFT does

[92] OFT decision/§149.
[93] OFT decision/§152.

> not accept that the presence of two-sided demand requires that the market be defined in relation to the card scheme as a whole but takes the view instead that careful consideration must be given to each level of demand.
>
> 164 The OFT considers that, in addition to the wholesale services…, it is also appropriate to examine separate relevant markets on each of the two sides of demand: the acquiring and issuing markets. Accordingly, as the starting point for market definition, the OFT considers the supply of three groups of services: those supplied at the wholesale level between issuers and acquirers; those supplied by acquirers to merchants; and those supplied by issuers to cardholders."

Our conclusion

134. Both the Commission and the OFT apparently approached the assessment of whether the MIF had anti-competitive effects on the basis that ultimately only one of the three related markets (namely the acquiring market) was "relevant" when it came to assessing the existence and extent of such effects (see paragraph 284 of the Commission Decision, quoted in paragraph 132 above and paragraphs 162-163 of the OFT Decision, quoted in paragraph 133 above).

135. The Court of Justice's decision in *MasterCard* shows that such an approach may be unduly restrictive. When considering whether an activity is to be considered distortive of competition, it is necessary "to take into account any factor that is relevant, having regard, in particular, to the nature of the services concerned, as well as the real conditions of the functioning and the structure of the markets, in relation to the economic or legal context in which that coordination occurs, regardless of whether or not such a factor concerns the relevant market" (paragraph 177 of *MasterCard*, quoted in paragraph 124 above). Where there are several markets that are inter-connected, that very inter-connection, in our view, is a matter that needs to be taken into account. By focusing exclusively on a specific market, there is a danger of failing to have regard to a whole series of relevant factors arising out of the connections between these three markets.

136. Indeed, as the Commission's analysis in the Visa I and Visa II Decisions shows (see paragraph 128 above), there is, in the case of two-sided platforms, a close and inevitable connection between the markets lying either side of the platform – the platform being the payment system, and markets lying on either

side being, respectively, the acquiring and issuing market. That nexus is made particularly clear by virtue of the fact that the very transaction that the payment system is intended to facilitate (namely the payment for the goods or services the subject of the underlying transaction) cannot occur without contractual cooperation between the issuing and acquiring banks (for the reasons given in paragraphs 73 to 77 above). The MIF, in short, is a default price in two markets – the issuing market and the acquiring market. It is not possible to have one MIF in the issuing market, and a different MIF in the acquiring market.[94]

137. Accordingly, we cannot accept Sainsbury's contention that the analysis of anti-competitive effect must be confined to the acquiring market. We define at least three relevant markets and – essentially for the reasons given by Dr Niels in paragraphs 3.13 to 3.16 of Niels 1 – consider that actual and potential anti-competitive effects need be considered in relation to all three markets, as well as in the inter-relationship between those markets. For that is the actual economic context in which the UK MIF operates.

(c) Theory of harm

138. As we have noted, the provision which Sainsbury's alleges to be restrictive of competition is the UK MIF. The harm which that provision is alleged to cause is stated by Sainsbury's in paragraph 39 of its Amended Particulars of Claim to be as follows:

> "39.3 The UK MIF distorts competition between Acquiring Banks in the UK by inflating the base on which Acquiring Banks set charges to merchants and thereby setting a floor under the MSC.
>
> 39.4 In the absence of the UK MIF, the MSC charged to merchants by Acquiring Banks in the UK would be lower as the level of any Interchange fee would be lower."

139. Unsurprisingly, Sainsbury's theory of harm focused on the effect of the UK MIF in the acquiring market. However, for the reasons we have given, we consider that it is necessary to consider the effect of the UK MIF not only in the acquiring market, but also in the issuing market and in the market between payment systems.

[94] See the exchange with Mr Brealey on Day 20/pp49-53; Day 21/pp22-40.

(d) The counterfactual hypothesis

(i) The flow of monies

140. To recap, the Interchange Fee is an amount retained by an Issuing Bank when making a payment to an Acquiring Bank pursuant to a transaction performed between the Cardholder and the Merchant. The Acquiring Bank will transfer the money it receives from the Issuing Bank to the Merchant less a further amount representing the Acquiring Bank's charges. In effect, therefore, if a Merchant sells a product for £10 to the Cardholder, the Cardholder will indeed pay £10 (either his or her account will immediately be debited or he or she will have credit extended to him or her by the Issuing Bank which he or she will ultimately have to repay), but (assuming – and we stress these are examples only – an Interchange Fee of 0.7% and an Acquirer fee of 0.1%), the Issuing Bank will retain 7p, the Acquiring Bank will receive £9.93, will itself deduct 1p, and the Merchant will receive £9.92.

(ii) No MIF

141. Absent bilateral agreement, the Interchange Fee is set by default. We consider that the starting point for the counterfactual hypothesis must be that no default of any kind would be set by MasterCard.

142. In terms of the process by way of which money moves from the Cardholder to the Merchant:

(1) The Cardholder's payment obligations to the Issuing Bank and the Acquiring Bank's obligations to the Merchant will not be contained in the MasterCard Scheme Rules, but in the agreements between Cardholder/Issuing Bank and Acquiring Bank/Merchant respectively.

(2) The obligations as between Issuing Bank and Acquiring Bank are contained in MasterCard Scheme Rules, which were considered in paragraph 45 above. On the conclusion of a transaction between the Cardholder and the Merchant, a "settlement obligation" arises as between the Issuing Bank and the Acquiring Bank. The banks will be obliged to settle in accordance with the relevant MasterCard standards

(which we have not seen, and which no doubt contain provisions regarding netting and set-off).

(3) What is clear, however, is that the Issuing Bank will only be allowed to make deductions from the settlement obligation that have been contractually agreed (see clause 8.2 of the current MasterCard Scheme Rules).

(4) One such permitted deduction is the MIF, which applies unless an applicable bilateral interchange fee is in place (see clause 8.3 of the current MasterCard Scheme Rules). On the counterfactual hypothesis, there is no MIF and, unless a bilateral arrangement is put in place, the Issuing Bank will not be permitted to make any deduction – at least by way of Interchange Fee – from the settlement obligation it owes to the Acquiring Bank.

143. We therefore conclude that, absent a bilateral agreement, there is no permitted Interchange Fee that the Issuing Bank may deduct, and that in effect the Interchange Fee will (absent agreement to the contrary) be zero.

144. That was Mr Willaert's view:[95]

Q (Mr Smith)	So let's suppose that a cardholder goes into a shop in London, using his MasterCard, and purchases a product for a certain consideration. Obviously the transaction is processed using the merchant's equipment, the card-reading equipment, and I will come back to that if I may. But let us assume the transaction is authorised and goes through. In terms of the money flow, the money is taken from the cardholder, either from his current account if it is a debit card or by way of the extension of credit from the issuing bank to the cardholder if it is a credit card. So assuming no bilateral agreement as to interchange, at this point the issuing bank will pass money over to the acquiring bank -
A (Mr Willaert)	Correct.
Q (Mr Smith)	- but it will hold on to the MIF?

[95] Day 10/pp65-68.

A (Mr Willaert) That is correct, yes.

…

Q (Mr Smith) And the acquiring bank then deducts a further amount, representing the cost of its services to the merchant?

A (Mr Willaert) That is correct.

Q (Mr Smith) And passes what one could call the net net amount to the merchant?

A (Mr Willaert) That is correct.

…

Q (Mr Smith) Now, going back to this chain of payments, I presume that there is a dovetailing of the provisions in the MasterCard scheme with the arrangements at either end of the scheme, in other words with the issuing bank to the cardholder and the acquiring bank and the merchant, authorising these deductions?

And just to expand on that before you answer. Looking at the relationship between the merchant and the acquiring bank, the agreement between those two entities will define what the acquiring bank is allowed to deduct, and that's the merchant service charge?

A (Mr Willaert) The acquiring banks make their commercial agreement with the merchant, absolutely.

Q (Mr Smith) Equally, at the other end, when you look at the relationship between the issuing bank and the cardholder, there will be some form of provision whereby the cardholder agrees that his account, whether it is his current account or his credit account with the bank, can be debited with the amount of the transaction?

A (Mr Willaert) Correct.

Q (Mr Smith) And would I be right in thinking that in terms of the deductions that, say, the issuing bank can make when paying the acquiring bank, it is only entitled to make agreed deductions, it can't make the deductions that it feels on any one day [entitled] to make?

A (Mr Willaert) Absolutely.

Q (Mr Smith) These are stipulated?

A (Mr Willaert)	Absolutely, that is my understanding.
Q (Mr Smith)	So the only deduction that an issuing bank can make is either the MIF, or if there is a bilateral agreement, the amounts stipulated in the bilateral agreement?
A (Mr Willaert)	Correct.

145. In its written closing, MasterCard flirted with the notion that Issuing Banks – in the counterfactual hypothesis where no default Interchange Fee of any kind would be set by MasterCard – would have the right to resort to "self-help", by deducting from the amounts remitted to the Acquiring Banks what the Issuing Bank considered it was owed.[96] When making his closing submissions, Mr Hoskins QC on behalf of MasterCard suggested instead that this was a very difficult question of construction, but accepted that if there was a "free-for-all", this would clearly create problems "because nobody – that scheme would not be viable. Let me take that. A free-for-all would not be viable, because nobody would sign up to that scheme if you were left with, for example, *quantum valebat* type issues. That is unworkable".[97]

146. Mr Hoskins is clearly right about the unworkability of a free-for-all – but we consider that the MasterCard Scheme Rules are such that absent a bilateral agreement, there is no permitted Interchange Fee that the Issuing Bank may deduct, and that in effect the Interchange Fee will (absent agreement to the contrary) be zero.

(iii) A rule against "ex post" pricing?

147. MasterCard has, in the past, suggested that absent a MIF, Acquiring Banks would be at the mercy of Issuing Banks. The point is most clearly made in paragraph 553 of the Commission Decision:

> "MasterCard argues that acquiring banks in open payment card systems would be *"at the mercy of issuers"*, because without a MIF that applies by default in the absence of bilaterally agreed interchange fees the scheme's issuing banks would be in a position to deduct unilaterally any interchange fee they wish. Acquiring banks could not then prevent issuing banks from retaining excessive interchange fees as acquirers are bound under MasterCard's HACR to process all card transactions properly presented

[96] MasterCard Closing/§§131-133.
[97] Day 22/p51.

to them. Based on an opinion of its expert MasterCard concludes that due to the HACR there must be *some kind* of arrangement which sets out the terms and conditions under which issuers and acquirers agree to provide payment services to cardholders and merchants. The MIF is such arrangement and without the MIF it would be impossible to sustain the HACR."

148. The Commission's solution to this suggested difficulty – which was described as the "hold-up" argument – was to import into the counterfactual hypothesis an additional network rule "less restrictive of competition" than the MIF. This is the so-called prohibition on *ex post* pricing. Paragraph 554 of the Commission Decision states:

> "That argument [i.e. the argument contained in paragraph 553, set out above] cannot be accepted…the possibility that some issuing banks might hold up acquirers who are bound by the HACR could be solved by a network rule that is less restrictive of competition than MasterCard's current solution that, by default, a certain level of interchange fee applies. The alternative solution would be a rule that imposes a prohibition on ex-post pricing on the banks in the absence of a bilateral agreement between them. The rule would oblige the creditor bank to accept any payment validly entered into the system by the debtor bank while prohibiting each bank from charging the other bank in the absence of a bilateral agreement on the level of such charges. That solution to "protect" acquirers if issuers should indeed abuse their power under an HACR is less restrictive of competition than a MIF as it does not set a minimum price level on either side of the scheme."

149. We doubt whether any such rule is required for the reasons discussed above. We do not consider that it would be open to an Issuing Bank simply to deduct from its settlement obligation any amount that it saw fit. Indeed, it is significant that the Commission described this in paragraph 554 of its Decision as an "abuse", and that is exactly what it would be. According to the MasterCard Scheme Rules, a deduction from the settlement obligation must be authorised – and if it is not authorised, it cannot be made.

150. Indeed, although we were not shown the terms of the agreements between the Cardholder and the Issuing Bank, we consider it most unlikely that the Issuing Bank, *quoad* its customer the Cardholder, would be entitled to take the customer's money (whether as a debit to the current account or as an extension of credit) without properly accounting for it.

151. In short, whilst an *ex post* pricing rule might be desirable to put matters beyond argument, it would be no more than a clarification of what we consider the existing position to be. The Honour All Cards Rule could be

maintained in a non-MIF counterfactual world without having to import such an additional rule. Absent a bilateral agreement between the Issuing Bank and the Acquiring Bank, no deduction representing a charge for interchange would be permissible in the no-MIF or zero MIF world. In effect, unless agreed otherwise, taking our hypothetical example of a £10 transaction between the Cardholder and the Merchant, all of the £10 would be taken from the Cardholder and paid to the Acquiring Bank by the Issuing Bank.

(iv) Options available to Issuing Banks in the counterfactual world

152. Thus, in a counterfactual world where no UK MIF could be set by MasterCard, Issuing Banks would not simply be able to retain such amounts as they saw fit, and pay the balance to the Acquiring Bank. Absent an agreed Interchange Fee, no deduction could be made by them at all.

153. In these circumstances, Issuing Banks would have four alternatives or options:

(1) *Option 1.* Negotiate bilateral interchange fees with each Acquiring Bank participating in the MasterCard Scheme in the UK.

(2) *Option 2.* Accept participation in the MasterCard Scheme without any payments by way of Interchange Fee from their Acquiring Bank counterparties.

(3) *Option 3.* Participate in an alternative settlement system, other than the interchange operated by MasterCard. This, of course, could only be done with agreement of Acquiring Bank counterparties.

(4) *Option 4.* Leave the MasterCard Scheme altogether in the UK, and either join the Visa Scheme or (if already a licensee under the Visa Scheme) abandon the issue of MasterCard cards to Cardholders and issue only Visa cards in the UK.

154. Before us, MasterCard contended that Option 4 (leave the MasterCard Scheme) was the most likely outcome and should inform the counterfactual hypothesis. As we have described, although there is a cost to joining a new card payment scheme – in terms of setting up the infrastructure necessary to

process the transactions using that scheme and in issuing new cards to Cardholders – these costs are not prohibitive. Indeed, many Issuing Banks already participate in multiple payment schemes.

155. MasterCard's argument was that faced with a scheme paying no UK MIF (MasterCard) and a similar scheme paying a materially higher MIF (Visa or perhaps Amex), there would be a dramatic shift of Issuing Banks away from the MasterCard Scheme to a rival scheme so that the MasterCard Scheme would not merely be damaged, but utterly destroyed.

156. Sainsbury's answer to this argument was that it was unreal and implausible to suggest that MasterCard would be subject to a no-UK MIF rule in the counterfactual world, whilst Visa was free to set whatever UK MIF it pleased. Sainsbury's contended that in the counterfactual world the no-UK MIF rule should apply not merely to MasterCard but also to Visa and to any other similar scheme.

157. To this, MasterCard responded that Sainsbury's was misapplying the test laid down in *MasterCard*: the counterfactual hypothesis had to be based upon the likely developments that would occur on the market in the absence of the offending provision – namely, the MasterCard UK MIF.

158. Before considering MasterCard's contention that Option 4 (leave the MasterCard Scheme) with the consequent collapse of the Scheme was the most likely outcome and therefore should inform the counterfactual hypothesis, it is necessary to consider two questions:

(1) First, whether, in the counterfactual world, it is necessary to assume that Visa would have been in exactly the same position as MasterCard in terms of the constraints on its ability to set a UK MIF or whether as a matter of fact Visa would have been subject to such constraints?

(2) Secondly, assuming Visa was not so constrained in the counterfactual world, would there be a dramatic shift of Issuing Banks away from the MasterCard Scheme to Visa so that the MasterCard Scheme would not merely be damaged, but utterly destroyed, or would there be put in

place bilaterally agreed fees, which would prevent or minimise that damage or destruction?

We consider these questions first, before turning to the question of whether Option 4 (leave the MasterCard Scheme) is indeed the outcome that should inform the counterfactual hypothesis.

(v) Should Visa's Interchange Fees be assumed to be the same as MasterCard's on the counterfactual hypothesis?

159. In our judgment, MasterCard is right and Sainsbury's wrong as to the manner in which the counterfactual hypothesis is to be constructed:

(1) The agreement whose anti-competitive effect we are testing is the agreement described in paragraph 84(3)(iii) above, namely the agreement between MasterCard and its licensees to have a default UK MIF.

(2) We stress that we are testing the anti-competitive effect of this agreement. It would be wholly wrong for us to enter upon this inquiry presuming the default UK MIF to be anti-competitive. The whole point of the counterfactual exercise we are undertaking is to provide an analytical framework whereby the effect of an agreement can be tested by hypothesising its absence.

(3) That being the case, it would be wrong in principle to make any presumption as to the constraints on rivals to MasterCard, like Visa, that is not rooted or based on fact.

160. We reject, therefore, any suggestion that Visa's Interchange Fees should be presumed, in the counterfactual world, to be the same as MasterCard's.

161. The next question is what would Visa actually have done in the counterfactual world, if MasterCard's effective UK MIF was zero? Although Mr Brealey sought to persuade us that regulatory pressures would cause the Visa MIF to match MasterCard's Interchange Fee, such that there would be no difference between the two, we do not consider that this is plausible. What is to be postulated for the purpose of the counterfactual is not that the MasterCard UK

MIF has been eliminated (or reduced to zero) by regulatory constraint (which might plausibly be said to apply to both MasterCard and Visa), but that MasterCard has simply decided to do so, for example as a result of pressure from large merchants. To assume that it has occurred through regulatory pressure or constraint would be, once again, to assume that which the counterfactual exercise is designed to test.

162. In any event, the fact is that throughout the claim period – and before – both the Visa and MasterCard Schemes have come under the regulatory scrutiny of the Commission (in relation to intra-EEA MIFs) and the OFT (in relation to UK MIFs). There have, on occasions, been decisions against one of Visa or MasterCard (notably the Visa II Decision, the OFT Decision, and the Commission Decision), but the regulators have pursued Visa and MasterCard separately, and not jointly. Visa and MasterCard have responded, not by voluntarily following what the other has been constrained to do, but by acting independently.

163. In conclusion, we consider that, in the counterfactual world, faced with a unilateral elimination of the UK MIF by MasterCard, Visa would have acted in its own best interests, and all other things being equal would have maintained its MIF at as close to its then level as it felt it could achieve. We doubt very much whether Visa would have increased its MIF – there would have been no good reason to do so, and the real disadvantage that this might well excite regulator interest or merchant activism or both – but Visa would have sought to take advantage of MasterCard's position by maintaining the differential between MasterCard's Interchange Fee and that of Visa for as long as commercially possible.

164. Accordingly, the next question is what would happen if the MasterCard UK MIF was zero, with the Visa UK MIF at a materially higher level. In these circumstances would – as MasterCard suggest – there be a dramatic shift by Issuing Banks away from MasterCard and towards (most probably) Visa.

(vi) A move to Visa if Visa's MIF was substantially higher than MasterCard's?

165. Mr Perez gave compelling evidence as to the thought processes of Issuing Banks in such circumstances. Mr Perez was asked by Mr Brealey why MasterCard had reduced the MIF on its premium card rates before it was legally obliged to by the 2015 Interchange Fee Regulations – indeed, before the EU Regulation giving rise to it - Regulation (EU) 2015/751 of the European Parliament and of the Council of 29 April 2015 on interchange fees for card-based payment transactions (the "EU Interchange Fee Regulation") - had even been agreed:[98]

Q (Mr Brealey) …My question is: why would you do this before there was a legal obligation to do so? If you were so concerned about losing market share to American Express, which I take it to be the Duo, rather than the standard offering, why would you do it before you were legally obliged to?

A (Mr Perez) So, it is important to understand in our business the issuers make decisions based on not only – when there is a negative differential, if the perception is that the differential is going to stay there for a long time, that obviously means a lot of money.

If the perception is that the differential is going to be there for a short period of time, then it is less money, simply because it is less time in which they are going to be disadvantaged if they stay with MasterCard instead of Amex.

So – and the reason for that is that there is a cost to migrate, so you need to get rid of the MasterCard cards, you need to re-issue an Amex card, you need to communicate with your clients, and so on and so forth.

So the issuers are always evaluating what is the cost of conversion, versus what is the benefit of conversion. So the reason why we could do this at the time is because the perception in the market, and I would say more than a perception, it was that the Commission was indeed going to reduce pricing, and there was going to be a level playing field, as it did actually happen.

Therefore, the risk of an immediate conversion from MasterCard to Amex was a lot lower because the perception of the market was this ain't – even if there is a differential right now, it is not going to last very long. And that's why we took that decision and there was some risk involved, yes.

Q (Mr Brealey) So the greater the perception of the level playing field, the less

[98] Day 9/pp55-57.

risk there is that you will lose business?

A (Mr Perez) Yes.

Q (Mr Brealey) That would apply to Amex as it would to Visa.

A (Mr Perez) It would, yes.

166. It is worth bearing in mind that MasterCard's decision to reduce its premium rates was made on 28 October 2014;[99] and although the EU Interchange Fee Regulation was anticipated, it was only adopted by the European Parliament and by the Council on 29 April 2015. The 2015 Interchange Fee Regulations did not come into force until 9 December 2015.

167. We do not, therefore, consider that the fact that Visa's MIF was much higher than MasterCard's would provoke an immediate shift by Issuing Banks away from the MasterCard Scheme towards the Visa Scheme. Rather, Issuing Banks would take a mature and considered view. We consider that, all other matters remaining unchanged (and we stress this qualification), a much higher Visa MIF, which was perceived as likely to remain in place for a substantial period, would be a factor that could provoke a shift of Issuing Banks away from MasterCard and towards Visa. We consider the effect on Issuing Banks of a mismatch between the Interchange Fees charged by one scheme and those charged by another in greater detail below.

(vii) Is Option 4 (leave the MasterCard Scheme) the outcome that should inform the counterfactual hypothesis?

168. Sainsbury's claim is for damages from 19 December 2006 (taking the earliest date, for transactions in England, Wales and Northern Ireland) until 9 December 2015[100]. These dates provide the temporal limits for the counterfactual hypothesis we are considering and constitute what we call the claim period.

169. Assuming that the no UK MIF rule was firmly established and in place on the start date for this period (19 December 2006), we must consider the factors

[99] See the 116th Europe Interchange Committee Decisions document dated 28 October 2014.
[100] See paragraph 430 below.

that would have played on Issuing Banks as rational profit-seeking firms in deciding whether or not to move away from MasterCard to (probably) Visa.

170. Those factors would have been:

(1) The cost of changing card "brand".

(2) The perception as to the direction of competition/regulatory intervention as regards payment schemes other than MasterCard and – closely related to this – what would actually have happened to the Visa UK MIF.

(3) The cost of, and likely outcome of, bilateral negotiations with Acquiring Banks regarding the interchange.

171. We consider these various factors in turn below.

The costs of changing card "brand"

172. Mr Perez explained very clearly the costs associated with changing from one card "brand" to another, including migrating customers from one brand to another. They are sufficiently high to give Issuing Banks pause for thought, but not so high as to deter an Issuing Bank from moving from one scheme to another if – over time – the revenue in-flow from higher Interchange Fees would appear to make a shift worthwhile.

Perception as to the direction of competition/regulatory intervention and the Visa UK MIF

173. We considered this in paragraphs 159 to 164 above, and have concluded that Visa's Interchange Fee would (assuming no other change) be materially higher than that of MasterCard for as long as Visa felt it possible to maintain the difference.

Options apart from Option 4

174. All other things remaining equal, if MasterCard's UK MIF was (as we assume) set at zero and Visa's UK MIF remained unchanged (as well as the rates of other schemes) – that is, at a level materially above that of MasterCard – there would be an incentive bearing on Issuing Banks to cause them to move

away from the MasterCard Scheme and towards other schemes, principally Visa and Amex. We accept that the difference in Interchange Fees could be sufficiently great so that if it was perceived as likely to persist, Issuing Banks would drift away from the MasterCard Scheme until the MasterCard Scheme had practically no participating Issuing Banks, and so that (as a consequence) Merchants would no longer consider it worth their while accepting MasterCard cards. As a result, the demand for the acquisition of MasterCard transactions would also fall, and Acquiring Banks would also cease to participate in the MasterCard Scheme. In short, the MasterCard Scheme might – given these assumptions – collapse. This was MasterCard's contention, and we consider it further below.

175. However, we consider it entirely wrong to assume that Issuing Banks would directly implement Option 4 (leave the MasterCard Scheme altogether) without considering any of the other options articulated in paragraph 153 above. We consider it most unlikely that a rational Issuing Bank would incur the costs of leaving the MasterCard Scheme before considering the viability of other options, given the costs of shifting from one scheme to another.

176. Option 2 (accept participation in the MasterCard Scheme without receiving any payments from Acquiring Banks) would only be accepted by Issuing Banks if they considered that the differential between the MasterCard UK MIF (zero) and the UK MIFs offered through other schemes (materially higher than zero) would last for so short a period as to make it not worth incurring the costs of changing scheme. We do not consider that this would be the likely perception of Issuing Banks in the counterfactual hypothesis: accordingly, we consider that it is unlikely that a rational Issuing Bank would regard Option 2 as a particularly attractive option.

177. Equally, Option 3 (participate in an alternative settlement system other than the MasterCard interchange system) would not be attractive to Issuing Banks. All participants in the MasterCard Scheme appear to have considered the interchange settlement system a satisfactory one, and it was the uncontested evidence of Mr Willaert that using an alternative system – whilst possible – had no particular advantages and so was not done. The fact is that a rational

Issuing Bank would not seek to negotiate with Acquiring Banks an entirely new settlement system, when the only matter at issue was the level of the Interchange Fee between Issuing and Acquiring Banks.

178. In short, we consider that, before incurring the cost of leaving the MasterCard Scheme and issuing non-MasterCard cards, Issuing Banks would seek to negotiate a bilateral Interchange Fee with Acquiring Banks in relation to MasterCard transactions. It is that alternative that we now proceed to consider.

(viii) Option 1 (negotiate bilateral interchange fees) as an alternative to Option 4 (leave the MasterCard Scheme)

<u>Is Option 1 an option that is open to the Tribunal to consider?</u>

179. In the course of his closing submissions, Mr Hoskins firmly put the point that it was not open to the Tribunal to find that the Issuing Banks would have concluded bilateral agreements with the Acquiring Banks.[101] The reason, he said, that this finding was not one open to the Tribunal to make, was because such a conclusion could not be supported by the evidence; and that it was not permissible for the Tribunal to reach a conclusion that did not have a basis or foundation in the evidence.

180. Essentially, we agree with Mr Hoskins' reasoning, but not with his conclusion. Of course, our determination must be based on the evidence. However, we query Mr Hoskins' description of this question as a factual one.[102] The

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[101] See, for example, Day 22/pp37-40.

[102] Mr Hoskins appeared to label it so on Day 23/p39. By contrast, when cross-examining Mr von Hinten-Reed, Mr Hoskins clearly (and correctly) accepted that this was not the case. On Day 12/pp62-63, Mr Hoskins had the following exchange with Mr von Hinten-Reed:

Q (Mr Hoskins)	But I'm asking you to assume that throughout the period of the claim, Visa maintains its MIF at the actual level it had during the period of the claim. It is a hypothetical. It is not your counterfactual. But do you accept that MasterCard's ability to compete would have been materially restricted in those circumstances? It must follow from what you said before, if that helps, but you answer the question.
A (Mr von Hinten-Reed)	Yes.

On Day 13/pp54-55, when Mr Hoskins was putting a series of hypothetical questions to Mr von Hinten-Reed, the following exchange occurred:

A (Mr von Hinten-Reed)	The problem here is we are speculating.
Q (Mr Hoskins)	Of course we are, it is a counterfactual. That's why we are here, I'm sorry.

question what would have happened in the counterfactual world is a necessarily hypothetical question, and not a factual one. However, we entirely agree that it is our duty to apply the law as we have described it in Section H(4) above. In particular, our counterfactual hypothesis must be in accordance with the requirements laid down by the Court of Justice in *MasterCard*.[103] We agree that these requirements require us to have regard to the evidence, albeit that, at the end of the day, the process we are engaged in is one of evidentially based speculation. No amount of factual enquiry can ever conclusively tell us what would have happened on the counterfactual hypothesis.

181. It is therefore necessary for us to review the factual evidence regarding bilateral agreements. That review will not be confined to the expert economists. Indeed, for the reasons we have given in paragraphs 36 to 41 above, on this point the evidence in the contemporary documents and the evidence of the factual witnesses probably has even more weight than that given by economists who – however eminent – were not expert in the payment systems market(s).

Is it realistic to suppose that bilateral agreements could or would have been concluded?

182. Absent a UK MIF, by definition the only way an Interchange Fee could be paid by Acquiring Banks to Issuing Banks would be by way of bilateral agreement. Indeed, as we have said, the MasterCard Scheme Rules expressly envisage that licensees of MasterCard could agree an Interchange Fee, the MIF being, by definition, a default Interchange Fee used in the absence of such agreement. We do not consider that this ability to ignore the default fee was intended by MasterCard as anything other than a genuine option, available to all licensees.

183. In some markets, bilateral agreements between Issuing Banks and Acquiring Banks are relatively common, for example, in Sweden.[104] The UK is not such a market – the evidence before us was that there were no bilateral agreements

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Mr Hoskins was quite right. Although of course our analysis of the counterfactual work must be rooted in the evidence, it is ultimately a speculative exercise.

[103] See the passage quoted at paragraph 117 above, in particular paragraphs 164 to 166 of the decision of the Court of Justice.

[104] Evidence of Mr Willaert Day 10/pp. 10-11, p. 73.

in the UK at all,[105] although there had been some in the past (for example, Maestro/Switch operated on this basis). Mr Willaert was asked about this, in a passage quoted at paragraph 53(2) above.[106] In essence, Mr Willaert's explanation was not that bilateral agreements could not be concluded, but that in most cases, most parties used the MIF because "going to bilaterals would not change the outcome". In short, Mr Willaert's evidence was that any attempt to negotiate a bilateral Interchange Fee would result in a fee the same as the MIF, with the result that the parties would simply waste time and costs in negotiating a deal that brought them nothing extra. Given Mr Willaert's evidence as to how the MIF was set, his evidence is not surprising: we will revert to the question of whether the MIF was out of line with what might bilaterally have been agreed in the absence of any MIF later on in this Judgment. For the moment, we would simply note that the implication of Mr Willaert's evidence was that if there was no MIF, licensees of MasterCard would negotiate and conclude a bilateral Interchange Fee, because this would make a real difference.

184. Indeed, Mr Willaert said so, earlier in his oral evidence:[107]

> "Within the market domestically in the UK, if there is a limited number of participants, issuers, acquirers, I think indeed it is possible that those issuers and acquirers would be able to agree amongst themselves about what is the level of interchange that both parties seem to need to make the system work. That is domestically set.
>
> Of course, it is impossible for every single acquirer and issuer in the UK market to do this across the world with all transactions. On a limited scale it is possible. Just to clarify, that possibility exists and there's nothing stopping in MasterCard rules for issuers and acquirers in the UK market to do that."

This case, of course, concerns the UK MIF: as is clear from Tables 1 and 2 above, the concentration of Issuing and Acquiring Banks in the UK issuing and acquiring markets is such that substantially all UK domestic MasterCard transactions could be caught by relatively few bilateral agreements.

[105] Evidence of Mr Abrahams Day 7/pp.70-71 ("I have a sense that there aren't any"), Sainsbury's Closing/§8 ("Indeed, in these proceedings, no evidence has been provided by MasterCard of any bilateral agreement in the UK").
[106] Day 10/pp72-73.
[107] Day 10/p12.

185. Mr Douglas was of the same view. In Douglas 1/§67, he considered various alternative business structures open to MasterCard, one of which was bilateral agreements:

> "Alternatively, MasterCard would have had to persuade its issuers and acquirers to enter into bilateral agreements setting bespoke interchange fees to apply to the transactions between them. I believe that a sufficient number of bilateral agreements could have been entered into to deal with this given the limited number of major issuers and acquirers in the UK market. Certainly, bilateral agreements were not unknown in the UK market – Maestro had operated on this basis until MasterCard took over its rate setting in 2009…".

186. Turning to the expert economists, the position that both adopted in their reports was that bilateral agreements setting Interchange Fees could have been concluded. Mr von Hinten-Reed stated:[108]

> "532 In the absence of a MIF, the interchange fee would be agreed by bilateral negotiation, and it would be this bilaterally agreed fee that each acquirer would incorporate into its MSC.
>
> 533 In a series of bilateral negotiations, no acquirer knows what interchange fee any other acquirer would agree with each issuer. Any given acquirer will be concerned that if it agrees to too high a fee, it would risk being undercut by, and lose business to, an acquirer who agrees a lower fee and who is then able to offer a lower MSC. Since every acquirer would be looking over its shoulder at every other acquirer, this uncertainty would lead to downward pressure on interchange fees, with the result that all acquirers would set low fees."

187. Thus, according to these paragraphs, Mr von Hinten-Reed saw no difficulty in bilateral Interchange Fees being concluded. However, earlier on in the same report, Mr von Hinten-Reed stated:[109]

> "Both a prohibition on *ex-post* pricing and the abolition of the HACR would involve bilateral negotiations between issuers and acquirers. <u>These could potentially be costly and would yield little, if any, gain for issuers</u>."

Mr von Hinten-Reed was asked as to the basis for his conclusion in this (underlined) second sentence.[110] It turned out, that the reason for this conclusion was an unstated assumption that – in the counterfactual world – the range of fees that could constitute a bilaterally agreed Interchange Fee lay between 0% (the price that would obtain absent bilateral agreement) and

[108] Von Hinten-Reed 1.
[109] Von Hinten-Reed 1/§419 (emphasis added).
[110] Day 13/pp73-76.

0.15% (which was the benefit to the Merchant of using cards calculated by Mr von Hinten-Reed):[111]

Q (Mr Smith)	So I don't quite understand why you are saying that there is little gain for issuers because the whole reason for an issuer entering into a bilateral negotiation would be to shift the interchange up.
A (Mr von Hinten-Reed)	Yes, to get some of that 0.15 over to their cardholders. So the question is, if the costs of negotiation are large, then you eat into that money that you are shifting from the merchant over to the other side.
Q (Mr Smith)	Right, so the reason you are saying, in paragraph 419, that it would yield little is because of your opinion that the range for negotiation of the interchange fee is up to 0.15%?
A (Mr von Hinten-Reed)	It could, yes.
Q (Mr Smith)	But no -
A (Mr von Hinten-Reed)	I don't know where we lie on that continuum, okay? Whether it is 0, 0.05 – up to 0.15, I don't know.
Q (Mr Smith)	But what you are saying, I think, is that the 0.15 represents the maximum?
A (Mr von Hinten-Reed)	Yes, sir.
Q (Mr Smith)	In other words, the room for negotiation between issuer and acquirer is between 0 interchange and 0.15?
A (Mr von Hinten-Reed)	Exactly, and in the alternative world where you are not thinking about the default MIF, you are thinking about – you then have a negotiation. If you have the HACR, you have the ex post pricing rule, then that's the range of negotiation value.
Q (Mr Smith)	Just to be absolutely clear, your 0.15 derives from the MIT-MIF?
A (Mr von Hinten-Reed)	Yes, but I'm deriving the – I'm using the methodology to derive the value of transaction benefits. I'm not saying it is because it is – don't confuse it with the default MIF.

[111] Day 13/pp75-76.

188. The "MIT-MIF" is shorthand for an interchange fee based upon the Merchant Indifference Test. It will be necessary to consider this test in greater detail when considering "exemptible" MIFs. In summary, the Merchant Indifference Test seeks to measure the cost-benefit to Merchants of using cards instead of cash in payment for their goods or services. It was Mr von Hinten-Reed's evidence that accepting payment by card would cost 0.15% per transaction less than accepting payment in cash, and (as can be seen from the exchange above) that that figure would represent the upper limit that would inform a Merchant's negotiation (through the Acquiring Banks) of a bilateral Interchange Fee.

189. The problem with this is that the MIT is a theoretical economic construct, and not a measure that was used by Merchants during the claim period or at all.[112] We consider that in deciding what to pay, Merchants would be far more practical: they would consider what value they attached to card payment schemes, and they would try to keep their costs as low as possible.

190. Mr Coupe made quite clear that Sainsbury's would adopt an entirely pragmatic approach to reducing its cost base:[113]

Q (Mr Smith) Mr Coupe, could I ask you one question? Can I ask you to assume a world where there are no MIFs, so no multilateral interchange fees, and the world operates only on bilateral fees agreed between issuing banks and acquiring banks. Now, Sainsbury's obviously is a major merchant vis-à-vis its acquirers. I wonder if you could just walk us through hypothetically how you see Sainsbury's dealing with its acquiring banks in negotiating the merchant service charge that it would be paying in this hypothetical bilateral world?

A (Mr Coupe) It is quite difficult to imagine that scenario but like any other aspect of our cost base we would start with the idea – the underlying idea of negotiating the best possible price from the supply – the sources available to us and we would use whatever negotiating leverage we could create in order to reduce the costs, to reduce the prices that we were charged and then we would – if we were successful, we would have a pot of money and we would then consider where we would apply that pot of money

[112] Von Hinten-Reed 2/§472 "Determining the proper classification of costs for the MIT-MIF calculation is a challenging task. It requires a different type of thinking about costs than typically done by merchant's finance departments."
[113] Day 7/pp13-14.

> and we may choose to spend it on better quality, better service, better ranges, different services to offer, lower prices or indeed pass the money back in an ideal world to our shareholders in the form of profit.

191. We do not accept the suggestion that, in the counterfactual world, Merchants (through Acquirers) would negotiate price by reference to the MIT, which is an entirely theoretical construct. We are quite sure that no Merchant would cause to have calculated and would rely upon a MIT in these circumstances.

192. In his reports, Dr Niels also accepted that in the counterfactual world, bilateral Interchange Fees would be concluded. However, he considered that these bilateral Interchange Fees would be higher than the UK MIF actually set by MasterCard:[114]

> "I conclude that the UK MIF should not be considered a restriction of competition. In a proper counterfactual without a default MIF, there would have been bilateral terms of dealing including interchange fee arrangements between acquiring and issuing banks; as a result, the costs borne by acquirers would have been higher than those under the current structure including the UK MIF (which is a default fall-back rate) as follows from commonly accepted economic theory."

193. Dr Niels had two reasons for concluding that in the counterfactual world, the bilaterally agreed Interchange Fee would be higher than the actual UK MIF:

(1) First, there would be the transaction costs of concluding a bilateral Interchange Fee.[115]

(2) Secondly, the combination of the HACR and Dr Niels' reading of the MasterCard Scheme Rules would permit Issuing Banks to hold Acquiring Banks to ransom, by deducting whatever Interchange Fee they (the Issuing Banks) saw fit.[116] This, of course, is the "hold-up" argument we considered, and rejected, in paragraphs 147 to 151. For the reasons we have given, we do not consider that the MasterCard Scheme Rules would permit "hold-up" and, in any event, we consider

[114] Niels 1/§1.25.

[115] See, for example, Niels 1/§2.53.

[116] Niels 1/§3.60; Day 16/p90: "In those negotiations, the logic is that an acquirer – with the honour all cards rule, which is another important aspect of a four-party scheme – with the honour all cards rule, once the payment has been made at the merchant and that merchant's acquiring bank then has no option but to clear the payment with the issuing bank. It is at that stage that each issuing bank has a degree of market power, of monopoly power. It is perhaps the equivalent of the holder of a patent that you can't go round."

that any such outcome would be precluded in the counterfactual hypothesis, because it would render the scheme unviable.

194. In the course of Dr Niels' evidence, we put to him the counterfactual hypothesis articulated here, namely that without a UK MIF, the Interchange Fee would be 0% unless a higher Interchange Fee was agreed by bilateral negotiation. Dr Niels' view was that in this case, Merchants (through Acquirers) would insist on paying nothing. In short, they would eschew all bilateral negotiations, and would insist upon paying nothing to Issuing Banks for their participation in a scheme that they nevertheless regarded as beneficial.[117] Dr Niels' view was that the short-term interests of individual Acquiring Banks/Merchants would always trump the medium or long-term benefit to these Acquiring Banks/Merchants of paying an Interchange Fee:[118]

> "So there is this zero default. The default interchange fee is zero so you can't charge. I'm still struggling a little bit with that one, what the benefits of that would be. But let's say if that were the rule, I do still think that the individual acquirer would – in individual negotiation – because the zero is there for grabs. That is the default. No effort required. I do not think any acquirer individually would be so generous as to think to the greater good of everyone for the survival of the scheme."

195. Dr Niels accepted that in certain cases, sophisticated undertakings might take a longer view and (for instance) positively incur costs in the short term in order to ensure that, over time, their supply chain was not subject to a monopoly:[119]

Q (Mr Smith)	…looking at our hypothetical undertaking, how keen would it be to ensure that it maintained multiple sources of supply so that it would have competition in its own supply chain, those supplying services or goods to it, so as not to be exposed to having a single monopoly provider?
A (Dr Niels)	Yes. Yes, I think that can certainly be a relevant consideration. It likes to have competition and to the extent that for example some supermarkets, actually this is a concept called sponsored entry. Some supermarkets, if they feel there isn't enough competition, for example we saw this in the merger of two bottling companies who were making own-brand soft drinks for supermarkets, we saw there are examples where Tesco sponsored a new entrant so as to keep their supplier market competitive. I don't think it will

[117] Day 16/pp91-99.
[118] Day 16/pp98-99.
[119] Day 17/pp131-132.

happen always and sometimes it is also not in the control of that company."

Dr Niels did not, however, think that this would be much of a relevant consideration in the counterfactual hypothesis being considered here,[120] and he was adamant that if the "default" MIF was effectively zero, there would be no negotiation of positive bilateral Interchange Fees because the Merchants would insist on a short-term costs benefit even if this meant a drift away from the MasterCard Scheme by participating Issuing Banks such that the Scheme ultimately collapsed, leaving Merchants at the mercy of other payment schemes with positive MIFs.

196. We are not convinced by this evidence. We consider that the circumstances would favour the conclusion of a bilateral agreement or agreements between Issuing and Acquiring Banks to pay a positive Interchange Fee:[121]

(1) In the first place, in the absence of a UK MIF, MasterCard would do whatever it lawfully could to make bilateral agreements easy to conclude. That is because – for the reasons given above – the continued viability of the MasterCard Scheme would depend on the conclusion of such bilateral agreements.

(2) Although, in form, any bilateral agreement would be between the Issuing Banks and the Acquiring Banks, in fact the attitude of Merchants would be critical. This is because the Acquiring Banks have (in the "real" world) passed the entirety of the UK MIF on to Merchants, and there is no reason to suppose that this would not occur in the "counterfactual" world.

(3) It is clear that Merchants attach considerable value to the MasterCard Scheme: as we have noted, all Merchants participating in the Visa Scheme also participate in the MasterCard Scheme, and (in the "real" world) pay the UK MIF, rather than departing from the MasterCard

[120] Day 17/pp133-134.
[121] We should say that we did seek to raise and debate these hypothetical questions during the course of Mr Hoskins' oral closing (Day 22/pp76-86). Somewhat inconsistently with his question of Mr von Hinten-Reed (see footnote 102 above), Mr Hoskins declined to engage, because "it is evidential and it wouldn't be appropriate for me…".

Scheme. Given that the Merchants would be paying the Visa MIF (and would continue to do so in the counterfactual world), we consider that Merchants would use the opportunity offered by bilateral interchange agreements to negotiate the Interchange Fee down. In particular, we consider that Merchants – certainly the large Merchants (like Sainsbury's) that would have most influence on Acquiring Banks – would:

(i) Understand the importance of keeping by far the most significant rival payment scheme in operation: a Visa monopoly would be undesirable.

(ii) See the opportunity of negotiating down their cost base and – ideally – forcing a similar reduction in the Visa UK MIF.

We reject as entirely improbable the notion that Merchants, faced with these commercial realities, would seek to avoid paying an Interchange Fee altogether: as we have explained, in the counterfactual world, Merchants would not be able to avoid the Visa UK MIF, and their objective would be simply to reduce the Interchange Fee for MasterCard.

(4) We also consider that Acquiring Banks would – in this counterfactual world – take this opportunity of differentiating themselves. As matters stand – in the real world – Acquiring Banks are the parties who are bound by the MIF and are contractually obliged to pay it, but they pass the MIF on 100% to the Merchants, who pay the MIF as part of the MSC. For the reasons we have discussed, in the real world, Acquiring Banks and Merchants both adopt a passive role in relation to the level of the MIF. They may grumble at its level – but they do not negotiate, either between themselves (i.e. as between Merchant/Acquiring Bank) or with the Issuing Banks or (for that matter) with MasterCard.[122]

[122] See, for example, the evidence of Mr Rogers (Day 6/pp117-118 and 120) (referring to the Budget 2011/12 Retail Controlled Costs Star Chamber document dated 11 February 2011): "… that's put pressure on our overall costs in relation to card processing fees. It is not something that we would discuss particularly at length because there is not a great deal that we can do about it…So what this

However, in a counterfactual world where the effective MIF was zero, that situation would obviously change. Most significantly, Issuing Banks would (as we have described) be keen to agree an Interchange Fee at a level higher than zero, and would be open to discussions with the Acquiring Banks and their Merchants. At the same time, as a means of bringing the Acquiring Banks/Merchants to the negotiating table, Issuing Banks could (before departing the MasterCard Scheme altogether) raise the issue of scaling back some of the benefits or features of the MasterCard Scheme.

(5) We do not consider – for the reasons given above – that either the Acquiring Banks or the Merchants would intransigently insist on maintaining a zero Interchange Fee. We consider that both Acquiring Banks and Merchants would be conscious of the risk that – if the Interchange Fee remained at zero for a significant amount of time, with other schemes offering significantly higher rates – Issuing Banks would abandon the MasterCard Scheme, and that both Acquiring Banks and Merchants would be left with a market dominated by Visa and American Express. In other words, both Acquiring Banks and Merchants would have an interest in ensuring the continued existence of the MasterCard Scheme. Equally, we consider that Merchants would be keen on retaining the Scheme in much its present form: in other words, we consider that a threat by Issuers to scale back some of the benefits or features of the MasterCard Scheme would also have some traction.

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highlights is that we faced an increased cost due to card processing fees as a result of mix, which we can't do anything about whatsoever … I don't recall ever having a discussion on interchange fees in a star chamber process because it is just not something that there's anything we can do about…". Mr Hoskins (Day 23/p.88) described this evidence as having "…an air of fatalism. What he says is we can't do anything about it. So what they do is rather than looking towards doing something by going to MasterCard and Visa saying hang on a minute, this won't do, they actually turn to their own business and say what can we do to mitigate the problem that we have". Referring to a document dated 13 February 2013 and entitled the Budget 2013/14 Retail Controlled Costs Star Chamber document, Mr Rogers stated (Day 6/pp.124-125): "…if …there were more premium cards being used than we had anticipated, then that would represent a risk to the budget. It is merely a point of fact. There is not anything that we can do about it." Mr Hoskins' take on this evidence (Day 23/p.90) was that "Again, it is a fatalism point. Retailers faced with increased MIFs that they don't like don't then go to the acquirers or go to Visa and MasterCard and say do something about it. They take it as a given and they then go and deal with it within their own business".

(6) Merchants would not, however, be prepared to pay whatever Issuing Banks demanded. We consider that Merchants would seek to achieve a lower price than Visa's UK MIF. In other words, we agree with Mr von Hinten-Reed that there would be a downward pressure on Interchange Fees. Quite how much lower the bilaterally agreed Interchange Fee would be is a matter we consider below.

(7) We do consider that Acquiring Banks would take the opportunity of a bilateral negotiation with the Issuing Banks to differentiate themselves in the Acquiring Market. In the real, as opposed to the counterfactual, world, Acquiring Banks have great difficulty in differentiating their service, because they cannot compete on price. The Interchange Fee comprises the vast majority of the Merchant Service Charge (well in excess of 90%[123]), and so the most that Acquiring Banks can do is compete on services, which are inevitably (given the nature of the MasterCard Scheme) very similar. The evidence of Mr Willaert was as follows:[124]

Q (Mr Smith)	Going back to this question, then, of differentiation. How is it that an acquiring bank can improve its position vis-à-vis merchants to provide a better service? What can it do?
A (Mr Willaert)	I'm not an acquiring bank so…Typically, they would compete on service, they would compete on the type of terminals they provide, technology they provide, maintenance they provide. Of course, they will also compete on the pricing that they provide to their merchants, and to give you an example, you have got merchants with a presence across multiple countries. So they will try to put in place reporting, they will try to put in place infrastructure that the same merchant, who goes across multiple countries, can deploy. So they have a bit of common infrastructure as a merchant. So it depends a bit on the merchant segment, I would say. Some merchants it might be very local support. Some merchants they might provide an advice service, like loyalty solutions, like fraud solutions, to detect, service. Others might be more central support.

[123] See, for example, footnote 7 above.
[124] Day 10/pp80-81.

> So there is all the services that acquirers typically provided to merchants.

(8) For example, at present, transactions processed through the MasterCard Scheme are paid for on a "per-transaction" basis, the only difference being whether the rate is a "flat" rate (e.g. 2p per transaction) or an "*ad valorem* rate" (e.g. 0.5% according to transaction value). As Mr Hoskins accepted,[125] very little thought appears to have gone into charging structures, and the fact that debit card transactions are generally paid for at a flat rate and credit card transactions at an *ad valorem* rate may be little more than historical happenstance.

(9) We consider that this might well change in the counterfactual world. Freed from MIF, in the counterfactual world, the opportunity for Acquiring Banks to differentiate themselves would present itself in a manner that it does not in the real world. Each Acquiring Bank would be likely to look to negotiate pricing structures with Issuing Banks that it could use to attract Merchants to use its – as opposed to some other Acquiring Bank's – services.

(10) In short, Acquiring Banks would seek to agree with Issuing Banks pricing structures that would combine a fair price to Issuing Banks (so that they would not leave the MasterCard Scheme) with an attractive pricing structure to Merchants. We consider that this might very well involve a departure from "per transaction" pricing. For example:

(i) Sainsbury's, we know, uses multiple Acquiring Banks. The existing system encourages (or, at least, does not discourage) this because the price per transaction processed by the MasterCard Scheme does not materially change whether the Merchant uses one Acquiring Bank or ten. However, in the absence of a UK MIF, an Acquiring Bank might well negotiate a fee structure with Issuing Banks that contained some form of volume discount, to reflect the fact that Merchants like

[125] Day 23/pp22-23.

Sainsbury's effect millions of sales each year. Such a volume-based pricing-structure could well encourage such Merchants to stick with a single Acquiring Bank.

(ii) Some Merchants enter into fewer sales than Merchants like Sainsbury's, but their typical sale is at a higher price. We have seen that the average transaction value in Sainsbury's (for all card types) lies between £30 and £40. There will be some Merchants whose average transaction value will be far higher than this, and who will consider the *ad valorem* price to be pernicious. Assuming a MIF of 0.9%, why should a sale of £35 cost Sainsbury's 31.5p, and a sale of £400 cost another Merchant £3.60? It is not immediately clear that the higher costs of default in the higher value sale justifies the higher Interchange Fee paid by the Merchant. An Acquiring Bank could attract such Merchants by offering a flat rate or a capped *ad valorem* rate.

(iii) Small Merchants may be deterred from participating in the MasterCard Scheme or may – to defray the costs of the Scheme – surcharge. In order to incentivise participation in the Scheme, and to encourage card use, Acquiring Banks might offer a low volume/low price service or total value discount with fees only becoming payable after a certain level of transactions has been hit.

197. The detail of how the acquiring market might evolve in the counterfactual world where no UK MIF existed is, of course, precisely the sort of speculative question that arises on a counterfactual hypothesis. We need only consider the broad direction in which the acquiring market would go, absent the UK MIF. Given market forces and the competition between Acquiring Banks, we conclude, on the basis of the factual material before us, that:

(1) Bilateral Interchange Fees would be likely to be agreed between Issuing and Acquiring Banks, at a level that would result in Merchants

paying less than the present UK MIF, but a rate that would encourage Issuing Banks to remain in the MasterCard Scheme, and not precipitate the fatal erosion that a zero MIF and no bilateral agreements would generate.

(2) In part, Merchants would probably be prepared to pay such a price in order to retain the competition between MasterCard and Visa, and avoid what would, in effect, be a monopoly for Visa. They would also be sensitive to threats from MasterCard and the Issuing Banks that certain valuable services (free credit; fraud protection; immediate payment) would ultimately be stripped out of the Scheme or degraded unless a reasonable Interchange Fee was paid.

(3) The manner in which the Interchange Fee would be paid might well radically change. It is likely that Acquiring Banks would, on the counterfactual hypothesis, be able properly to differentiate themselves, and to compete for the services of Merchants in a manner precluded by a default Interchange Fee like the UK MIF. That would affect both Issuing Banks and Merchants:

(i) We have identified, in paragraph 196(10) above, how the charging structures that Acquiring Banks would develop would differentiate between different Merchant types. We have, postulated three different types of Merchant (high volume Merchants, high value Merchants and small Merchants) but we have no doubt that the market would evolve payment structures to fit the demands of Merchants.

(ii) A key constraint on such structures would be the requirement that Issuing Banks receive a "proper" price. We consider what that price might be further below. However, we consider it highly unlikely that Issuing Banks would continue to be paid on an *ad valorem* per transaction basis in all or even most cases. <u>How</u> Issuing Banks would be remunerated would be coloured by the payment structures in the acquiring market. We

stress this because, in the following paragraphs, when calculating what a "proper" price might be, we have resorted to *ad valorem* per transaction figures (i.e. where the Interchange Fee is calculated as a percentage of transaction value). We do so simply because these are the only figures available to us, and nothing more should be read into this.

(4) Obviously, the conclusion of bilateral Interchange Fees would involve transaction costs that a default Interchange Fee does not entail. However, we have seen no evidence to indicate that these would be excessive, or such as to be likely to prevent agreement being reached. In particular, the number of Issuing and Acquiring Banks involved is actually quite small.

(5) So far, we have only been considering what might happen to the Interchange Fee charged in relation to MasterCard transactions. How Visa would react to this new charging environment involves further speculation. If, as we consider likely, Acquiring Banks would use the freedom accorded to them by bilaterally negotiated MasterCard Interchange Fees to encourage Merchants to use their services, rather than those of other Acquiring Banks, there would be some commercial pressure on Visa to follow MasterCard's lead. We consider that it would at least be on the cards that Visa would, in these circumstances, abandon its own UK MIF.

(e) At what level would bilateral Interchange Fees have been agreed on the counterfactual hypothesis?

(i) Introduction

198. We have concluded that in the counterfactual world Issuing Banks and Acquiring Banks would probably have reached bilateral agreements regarding the levels of Interchange Fee payable. It is next necessary to consider at what level those Interchange Fees would have been agreed.

199. Four preliminary points need to be made:

(1) First, although we have been provided with the UK MIFs set by MasterCard over the claim period, MasterCard could not provide us with the similar rates for Visa. We have been able to identify some of these rates from the trial papers, but are conscious that this is an incomplete set.

(2) Secondly, as we have described, the applicable UK MIF varies not only according to transaction type, but also according to card type. Premium cards attract a higher MIF than non-premium cards. Naturally, the MIF payable by a Merchant in the UK will depend upon the types of card used in purchasing goods or services from that Merchant. Sainsbury's provided data in relation to what MIFs it paid over the claim period, differentiated according to scheme type (i.e. MasterCard or Visa) and according to card type (i.e. debit or credit). Beyond this, the data did not differentiate between different types of credit card. Thus, the data provided by Sainsbury's only enabled us to calculate what we refer to as a "blended" MIF, being an average of all MasterCard or (as the case may be) all Visa credit card transactions at Sainsbury's, without differentiating as between individual card types.

(3) Thirdly, we are very conscious that the only data regarding the MIFs paid by Merchants to Acquiring Banks is derived from Sainsbury's, and that we are using this as a proxy for what is happening across the entire market. Ideally, we would have had information in relation to other, different, Merchants, but that information was not (at least in the granularity required) available.

(4) Fourthly, we recognise that the conclusion we have reached regarding bilateral agreements in the counterfactual involves payment structures for Interchange Fees that are entirely different from the "per transaction" fee currently used in the market. As we noted in paragraph 197(3)(ii) above, although we continue, throughout the following paragraphs, to express Interchange Fees as a percentage of transaction value, we underline our conclusion that this is not how we consider Interchange Fees would have been calculated, paid for by Merchants or

received by Issuing Banks in the counterfactual world. As we have described, very different charging structures would be likely to emerge.[126]

(ii) What Sainsbury's paid?

200. It is necessary to begin by considering what Sainsbury's paid by way of MIFs over the claim period. We were provided with information as to what Sainsbury's paid to its Acquiring Banks on a yearly and monthly basis, differentiating between card scheme (MasterCard/Visa), card type (credit/debit), and acquirer (Barclays/HSBC/WorldPay).[127]

MasterCard credit cards

201. Using the annual, rather than the monthly, figures, the table below sets out, in relation to each Acquiring Bank:

(1) The total sum actually paid by way of MIF by Sainsbury's in respect of MasterCard credit card transactions used to purchase goods from Sainsbury's in each of the relevant years (Column 2);

(2) The value of the sales in respect of which that MIF was paid (Column 3); and

(3) What we have termed the "blended" MIF (Column 4) – which is the rate of MIF actually paid by Sainsbury's (Column 2) expressed as a percentage of the value of sales (Column 3). We call this a "blended" MIF because – as already mentioned and as further described below – different types of MasterCard credit cards attracted different rates of MIF. The Sainsbury's figures do not differentiate between card types, and so the MIF implied by the figures in Columns (2) and (3) is simply an average.

[126] Some indication of the likely approach – albeit in the context of the setting of the MIFs for premium cards – can be discerned in the evidence of Mr Willaert, quoted at paragraph 102(3)(iv) above. As Mr Willaert explained, when setting the MIF for a premium card, MasterCard would have regard to *(i)* the other premium cards in the market (e.g. Amex), and *(ii)* the extent to which the blended MIF for all of MasterCard's cards would rise given the introduction of the new card, with a view to ensuring both that the MIF for the individual card was high enough to make the card competitive, but that the blended MIF did not rise so high as to displease Merchants.

[127] This information was provided in two memoranda from Mr von Hinten-Reed dated 10 and 11 March 2016, based upon Sainsbury's recorded payments to its Acquiring Banks.

(1) Year	(2) MIF paid	(3) Value of sales	(4) "Blended" MIF
Transactions acquired by Barclays			
2006-2007	£2,302,513	£275,410,520	0.84%
2007-2008	£14,962,024	£1,777,950,170	0.84%
2008-2009	£18,698,170	£2,216,775,457	0.84%
2009-2010	£21,558,954	£2,515,172,861	0.86%
2010-2011	£24,912,372	£2,787,497,679	0.89%
2011-2012	£28,894,110	£3,144,136,186	0.92%
2012-2013	£30,026,944	£3,128,657,716	0.96%
2013-2014	£599,541	£59,234,734	1.01%
2014-2015	£29,125	£2,473,489	1.18%
2015-2016	£1,012	£117,334	0.86%
Transactions acquired by Worldpay			
2006-2007	£0	£0	-
2007-2008	£0	£0	-
2008-2009	£0	£0	-
2009-2010	£0	£0	-
2010-2011	£0	£0	-
2011-2012	£0	£0	-
2012-2013	£1,583,812	£167,778,518	0.94%
2013-2014	£32,627,710	£3,402,668,139	0.96%
2014-2015	£34,705,924	£3,550,317,914	0.98%
2015-2016	£19,240,520	£2,442,847,281	0.79%
Total of the transactions acquired (i.e. Barclays + Worldpay)			
2006-2007	£2,302,513	£275,410,520	0.84%
2007-2008	£14,962,024	£1,777,950,170	0.84%
2008-2009	£18,698,170	£2,216,775,457	0.84%
2009-2010	£21,558,954	£2,515,172,861	0.86%
2010-2011	£24,912,372	£2,787,497,679	0.89%
2011-2012	£28,894,110	£3,144,136,186	0.92%
2012-2013	£31,610,756	£3,296,436,234	0.96%
2013-2014	£33,227,251	£3,461,902,873	0.96%
2014-2015	£34,735,049	£3,552,791,403	0.98%
2015-2016	£19,241,532	£2,442,964,615	0.79%
Source: Mr von Hinten-Reed's 10 March 2016 memorandum, tables 3 and 9.			

Table 3: MIFs actually paid by Sainsbury's in respect of MasterCard credit card transactions

202. Table 3 discloses total value of sales (the total in Column 3) of £25,471,037,998 over the claim period and a total paid MIF of £230,142,731

(Column 2), resulting in a blended MIF over that period of 0.90%. The vast majority of these transactions would have been by way of "chip PIN" transactions (i.e. where the payment is made by card in-store, the transaction being validated by the entry of a "personal identification number"). For such transactions, MasterCard's MIFs were:

(1) For its "vanilla" (i.e. non-premium) card – the MasterCard "Consumer" card – 0.80% until September 2015, when the rate fell to 0.70%.

(2) For its MasterCard "World" card – a "premium" card:

(i) 1.30% until April 2011;

(ii) 1.25% from April 2011 to April 2015;

(iii) 0.80% from April 2015 to September 2015; and

(iv) 0.70% from September 2015 to the end of the claim period.

(3) For its MasterCard "World Signia" card – another "premium" card:

(i) 1.50% until April 2011;

(ii) 1.40% from April 2011 to April 2015;

(iii) 0.80% from April 2015 to September 2015; and

(iv) 0.70% from September 2015 to the end of the claim period.

<u>MasterCard debit cards</u>

203. As regards MasterCard debit card transactions, the position is as follows:

(1) Year	(2) MIF paid	(3) Value of sales	(4) "Blended" MIF
Barclays (Debit MasterCard)			
2006-2007	£0	£11	-
2007-2008	£5	£534	0.94%
2008-2009	£2	£92	2.17%

2009-2010	£0	£0	-
2010-2011	-£1	-£139	0.72%
2011-2012	-£46	-£5,794	0.79%
2012-2013	£68	-£6,808	-1.00%
2013-2014	£72	£39,710	0.18%
2014-2015	-£51	-£1,014	5.03%
2015-2016	£96	£11,431	0.84%
HSBC (Debit MasterCard)			
2006-2007	£0	£0	-
2007-2008	£0	£0	-
2008-2009	£1	£54	1.85%
2009-2010	£44,778	£19,507,757	0.23%
2010-2011	£229,540	£97,660,217	0.24%
2011-2012	£327,176	£128,147,603	0.26%
2012-2013	£260,871	£99,480,957	0.26%
2013-2014	£2,257	£854,455	0.26%
2014-2015	£0	£0	-
2015-2016	£0	£0	-
HSBC (Maestro)			
2006-2007	£0	£0	-
2007-2008	£3,829,441	£2,022,219,543	0.19%
2008-2009	£7,692,825	£4,100,671,097	0.19%
2009-2010	£5,772,048	£3,023,584,745	0.19%
2010-2011	£1,055,707	£552,389,054	0.19%
2011-2012	£347,008	£165,035,072	0.21%
2012-2013	£238,536	£119,142,280	0.20%
2013-2014	£1,074	£497,913	0.22%
2014-2015	£0	£0	-
2015-2016	£0	£0	-
Worldpay (Debit MasterCard)			
2006-2007	£0	£0	-
2007-2008	£0	£0	-
2008-2009	£0	£0	-
2009-2010	£0	£0	-
2010-2011	£0	£0	-
2011-2012	£0	£0	-
2012-2013	£42,015	£9,363,440	0.45%
2013-2014	£548,176	£137,675,856	0.40%
2014-2015	£821,223	£195,022,150	0.42%
2015-2016	£848,265	£187,820,324	0.45%
Worldpay (Maestro)			

2006-2007	£0	£0	-
2007-2008	£0	£0	-
2008-2009	£0	£0	-
2009-2010	£0	£0	-
2010-2011	£0	£0	-
2011-2012	£0	£0	-
2012-2013	£34,923	£11,976,833	0.29%
2013-2014	£335,392	£139,057,073	0.24%
2014-2015	£298,962	£111,705,577	0.27%
2015-2016	£98,466	£32,460,722	0.30%
Source: Mr von Hinten-Reed's 10 March 2016 memorandum, tables 4, 7, 8, 10 and 11.			

Table 4: MIFs actually paid by Sainsbury's in respect of MasterCard debit card transactions

204. Over the claim period, Sainsbury's used the services of three Acquiring Banks (Barclays, HSBC and Worldpay). The latter two (HSBC and Worldpay) acquired both MasterCard's debit transactions (i.e. those using the Debit MasterCard) and Maestro transactions. Barclays' role was *de minimis* and was confined to Debit MasterCard.

205. Aggregating the transactions, the position is as set out in the table below:

	MIF paid	Value of sales	"Blended" MIF
Total for all Debit MasterCard transactions over the claim period	£3,124,447	£875,570,836	0.36%
Total for all Maestro transactions over the claim period	£19,704,382	£10,278,739,909	0.19%
Total of all transactions over the claim period	£22,828,829	£11,154,310,745	0.20%

Table 5: Aggregated Debit MasterCard and Maestro MIFs

206. Over the claim period, the MIFs as set by MasterCard and by Maestro – it is important to bear in mind that until August 2009, the Maestro MIF was not set by MasterCard – were as follows:

(1) As regards Debit MasterCard chip PIN transactions, the MIF was:

(i) 0.12% plus 3.5p until March 2008;

(ii) 8p from March 2008 until January 2013; and

(iii) 11p from January 2013 until the end of the claim period.

(2) As regards Maestro chip PIN transactions, the MIF was:

(i) 5.97p until September 2009. This MIF was not set by MasterCard.

(ii) 6p from September 2009 until July 2012. This, and subsequent, MIFs were set by MasterCard.

(iii) 7p from July 2012 until the end of the claim period.

<u>Visa</u>

207. Sainsbury's, in addition to accepting MasterCard cards, also accepted Visa cards – both debit and credit. Taking the same approach as we have done in relation to MasterCard transactions, the position is as follows:

(1) Year	(2) MIF paid	(3) Value of sales	(4) "Blended" MIF
Visa credit card transactions acquired by Barclays			
2006-2007	£2,334,902	£285,139,884	0.82%
2007-2008	£11,832,953	£1,407,261,100	0.84%
2008-2009	£10,391,902	£1,243,143,352	0.84%
2009-2010	£9,922,182	£1,190,314,503	0.83%
2010-2011	£10,152,792	£1,206,787,241	0.84%
2011-2012	£10,103,333	£1,185,623,877	0.85%
2012-2013	£10,312,331	£1,192,889,397	0.86%
2013-2014	£10,837,628	£1,310,638,284	0.83%
2014-2015	£9,276,654	£1,203,656,238	0.77%
2015-2016	£3,353,293	£780,286,979	0.43%[128]
Visa credit card transactions acquired by Worldpay			
2006-2007	0	0	-
2007-2008	0	0	-
2008-2009	0	0	-

[128] MasterCard has suggested that the Visa data for 2015-2016 should be excluded from consideration on the basis that it includes the period after the 2015 Interchange Fee Regulations came into effect. However, our understanding from the memorandum of Mr von Hinten-Reed dated 11 March 2016, which provides a monthly breakdown of the data, is that it includes MasterCard and Visa data only up to November 2015, and therefore does not include any regulated MIFs. In any event, the approach suggested by MasterCard would not alter any of the Tribunal's conclusions.

2009-2010	0	0	-
2010-2011	0	0	-
2011-2012	0	0	-
2012-2013	£2	£157	1.27%
2013-2014	£238	£16,912	1.41%
2014-2015	£1,972	£127,200	1.55%
2015-2016	0	0	-
Total of the Visa credit card transactions acquired (i.e. Barclays + Worldpay)			
2006-2007	£2,334,902	£285,139,884	0.82%
2007-2008	£11,832,953	£1,407,261,100	0.84%
2008-2009	£10,391,902	£1,243,143,352	0.84%
2009-2010	£9,922,182	£1,190,314,503	0.83%
2010-2011	£10,152,792	£1,206,787,241	0.84%
2011-2012	£10,103,333	£1,185,623,877	0.85%
2012-2013	£10,312,333	£1,192,889,554	0.86%
2013-2014	£10,837,866	£1,310,655,196	0.83%
2014-2015	£9,278,626	£1,203,783,438	0.77%
2015-2016	£3,353,293	£780,286,979	0.43%
Visa debit card transactions acquired by Barclays			
2006-2007	£2,257,652	£900,529,784	0.25%
2007-2008	£13,091,383	£5,170,498,865	0.25%
2008-2009	£14,901,255	£5,907,916,753	0.25%
2009-2010	£20,956,902	£8,094,012,885	0.26%
2010-2011	£30,215,484	£11,366,995,391	0.27%
2011-2012	£34,517,812	£12,710,697,181	0.27%
2012-2013	£38,065,469	£13,368,192,218	0.28%
2013-2014	£40,876,327	£14,752,855,467	0.28%
2014-2015	£37,682,400	£13,677,825,875	0.28%
2015-2016	£17,866,377	£9,079,926,621	0.20%
Visa debit card transactions acquired by Worldpay			
2006-2007	0	0	-
2007-2008	0	0	-
2008-2009	0	0	-
2009-2010	0	0	-
2010-2011	0	0	-
2011-2012	0	0	-
2012-2013	£15	£3,884	0.39%
2013-2014	£274	£35,534	0.77%
2014-2015	£890,720	£109,534,626	0.81%
2015-2016	£311	£79,375	0.39%
Total of the Visa debit card transactions acquired (i.e. Barclays + Worldpay)			

2006-2007	£2,257,652	£900,529,784	0.25%
2007-2008	£13,091,383	£5,170,498,865	0.25%
2008-2009	£14,901,255	£5,907,916,753	0.25%
2009-2010	£20,956,902	£8,094,012,885	0.26%
2010-2011	£30,215,484	£11,366,995,391	0.27%
2011-2012	£34,517,812	£12,710,697,181	0.27%
2012-2013	£38,065,484	£13,368,196,102	0.28%
2013-2014	£40,876,601	£14,752,891,001	0.28%
2014-2015	£38,573,120	£13,787,360,501	0.28%
2015-2016	£17,866,688	£9,080,005,996	0.20%
Source: Mr von Hinten-Reed's 10 March 2016 memorandum, tables 5, 6, 12 and 13.			

Table 6: MIFs actually paid by Sainsbury's in respect of Visa credit card and debit card transactions

208. Aggregating these figures over the claim period, the following position is reached:

	MIF paid	Value of sales	"Blended" MIF
Total for all Visa credit card transactions over the claim period	£88,520,182	£11,005,885,124	0.80%
Total for all Visa debit card transactions over the claim period	£251,322,381	£95,139,104,459	0.26%

Table 7: Aggregated Visa credit and Visa debit MIFs

209. The Tribunal did not have access to the actual Visa MIFs imposed throughout the claim period. However, it is possible to estimate the "blended" MIF rates for Visa based on data provided by Sainsbury's, as set out below.

Overview

210. To sum up the position, therefore, over the claim period, the MIFs paid by Sainsbury's, the value of sales and the blended MIFs derived from these figures were as follows:

	MIF paid	Value of sales	"Blended" MIF
Total for all MasterCard credit card transactions over the claim period	£230,142,731	£25,471,037,998	0.90%
Total for all Visa credit card transactions over the claim period	£88,520,182	£11,005,885,124	0.80%
Total for all Debit MasterCard transactions over the claim period	£3,124,447	£875,570,836	0.36%

Total for all Maestro transactions over the claim period	£19,704,382	£10,278,739,909	0.19%
Total for all Visa debit card transactions over the claim period	£251,322,381	£95,139,104,459	0.26%

Table 8: Overview

(iii) Bilaterally agreed interchange fees for MasterCard credit cards

Introduction and approach

211. To recap, we have found that, in the counterfactual world, where there was no UK MIF:

(1) Issuing Banks would not be entitled to deduct any Interchange Fee from the monies being remitted to the Merchant via the Acquiring Bank, absent agreement between the Issuing Bank and the Acquiring Bank.

(2) Issuing Banks and Acquiring Banks would be likely to reach such an agreement.

(3) Such an agreement would be unlikely to be based on the *ad valorem* fees presently charged to Merchants. Instead, competition between Acquiring Banks would result in a whole range of different charging structures (along the lines we have described in paragraphs 197(3)(ii) above), tailored to the businesses of the Merchants paying these Interchange Fees. The question now to be considered is what that bilateral level would be.

212. A Merchant like Sainsbury's would, we consider, be attracted by an interchange rate that declined according to volume of transactions. In terms of what that rate might be – i.e. how much Sainsbury's would be prepared to pay – we consider a number of parameters:

(1) *Issuing Bank costs.* We consider that Merchants like Sainsbury's and their Acquiring Banks would be prepared to pay a sufficiently high price that would ensure that the Issuing Banks stayed in the Scheme. Essentially, this involves paying a price that the Issuing Banks would

be "happy" with, which in turn involves a consideration of the costs these banks would seek to recover from the Acquiring Market. We certainly do not suggest that the Issuing Banks would have *carte blanche* to name their price: that is scarcely likely given the starting point of a zero MIF. Rather we anticipate that Issuing Banks would have a very clear understanding of their costs, and a sophisticated view of which of these costs the Acquiring Market might be persuaded to bear. Equally, we anticipate that Acquiring Banks and sophisticated Merchants like Sainsbury's would themselves have a good sense of the cost of the services provided by Issuing Banks, and that a major factor in any bilateral price would be the cost to the Issuing Banks of the services provided by them to the Acquiring Market.

(2) *Sainsbury's interchange costs.* We consider that Sainsbury's would look very carefully at what Interchange Fees it was paying. In this regard, we assume that the MIFs it paid to Visa would continue unchanged, although for the reasons we give in paragraph 197(5) above, that approach might not endure. Although in the counterfactual world we are considering, the MIFs paid by Sainsbury's to MasterCard would not have been paid, we will nevertheless take the evidence of Sainsbury's attitude towards these charges into account: this evidence is highly material in gauging how Merchants like Sainsbury's and their Acquiring Banks would have approached negotiations on price.

(3) *Merchant Indifference Test.* We do not consider that a Merchant like Sainsbury's would seek to derive a proper price by reference to a test like the Merchant Indifference Test. The Merchant Indifference Test is, we consider, a conceptual construct that bears little or no relation to what happens in the real world of retail.

213. We examine these three points in turn below, before setting out our conclusion as to what bilateral price would (in the end) be likely to have been agreed.

Issuing Bank costs

214. The Visa II Decision considered Issuing Bank costs when seeking to formulate an appropriate answer to the Commission's competition concerns. The relevant recitals of the Decision are as follows:[129]

> "(83) The Visa network, like any network characterised by network externalities, will provide greater utility to each type of user the greater the number of users of the other type: the more merchants in the system, the greater the utility to cardholders and vice versa. The maximum number of users in the system will be achieved if the cost to each category of user is as closely as possible equivalent to the average marginal utility of the system to that category of user. The Commission accepts that this is not necessarily achieved with each bank simply charging its own customer, since one of the features of a four-party payment card scheme is that the card issuing bank provides specific services to the benefit of the merchant, via the acquiring bank. Given the difficulties of measuring the average marginal utility of a Visa card payment to each category of user, some acceptable proxy for this must be found, which meets the concerns of the Commission…
>
> (84) To this end, Visa has in its proposal for a modified MIF identified three main cost categories which in its view constitute an 'objective benchmark' for the level of costs of supplying Visa payment services and constitute an 'objective benchmark' against which to assess the Visa intra-regional MIFs paid by acquirers to issuers for POS transactions. These cost categories are (a) the cost of processing transactions; (b) the cost of providing the 'payment guarantee' and (c) the cost of the free funding period.
>
> (85) The Commission sees no reason to contest the relevance of these three cost categories and accepts Visa's point of view that they can all be said to be, at least in part, to the benefit of the merchant. First, on the processing service the Commission accepts that apart from account maintenance to the benefit of the cardholder, the issuing bank also processes the request for payment of its debt to the acquiring bank and ultimately to the merchant, which incurs some administration costs. There is no doubt that the merchant benefits from the latter processing services, in particular in the context of international payment card transactions…
>
> (86) Secondly, as concerns the payment guarantee, the Commission accepts that the 'payment guarantee' is a kind of insurance against fraud and cardholder default for merchants, and that the 'payment guarantee' element in the revised Visa MIF is a kind of insurance premium, which is of importance in particular in the context of international card payments. In general, retailers benefit from a 'payment guarantee' because without it they would have few means of obtaining payment from Visa cardholders from other Member States in the case of fraud or insolvency. Fraud, in particular, is much higher for cross-border transactions than for domestic ones. No evidence has been provided to the Commission to suggest that in the absence of a payment guarantee, insurance against fraud and credit losses linked to international card payments would be widely available to retailers, or if so, that it would be available on terms affordable to medium-sized and small retailers.

[129] Emphasis added.

(87) As to the cost element of the 'payment guarantee' relating to bad debt write-offs arising from cardholder default the important consideration is that in the absence of this element of the 'payment guarantee', merchants would also have to insure themselves against the possibility of the customer not respecting his card payment for reason of insolvency. Such insurance would be likely to be particularly expensive for cross-border payments, as the recovery of debts is more difficult in a cross-border context than domestically. The risk of default is also higher in a cross-border context, since cardholders with a history of defaulting are particularly likely to carry out purchases abroad, where they are less likely to be on any default 'black lists'. In any event, fraud and insolvency control is more likely to be efficient if done by the issuing bank. The introduction of an optional 'payment guarantee' could lead the issuing banks to relax their controls, thus leading to an increase in the level of fraud and insolvency.

(88) Without a 'payment guarantee', some retailers would probably consider the risk of accepting Visa cards to be too great, and since the 'Honour All Cards Rule' obliges them to accept all Visa cards, they would have no choice but to cease to accept Visa cards completely. Visa cards would then be less attractive to cardholders, and some of these might then give up their Visa card, leading to a downward spiral in the size and level of usage of the Visa system, and a loss in turnover for all merchants.

(89) Thirdly, the 'free funding period' allows Visa cardholders to make purchases at any merchant who accepts Visa cards as if they all offered free credit. According to Visa, this benefits merchants because it encourages cardholders to increase their consumption by making additional purchases which otherwise they may not have made. While it is not proven that this facility increases total aggregate consumption, it is plausible that it may well stimulate cross-border purchases by cardholders travelling abroad, who usually do not have the means to check their account balance and cannot delay their purchase to later. Without the free-funding period, cardholders travelling abroad are likely to be more prudent with regard to their overall spending for fear of taking their account into the red. Whilst this phenomenon may have a neutral overall effect on total consumption in Europe, it nevertheless facilitates and encourages cross-border spending as opposed to domestic spending. In this light the inclusion of the free-funding period in a MIF for cross-border purchases can be justified, primarily as it benefits merchants with whom such purchases are made, but also as it promotes cross-border purchases within the single market. The Commission therefore sees no reasons, for the purposes and duration of the present exemption, to consider as unjustified the inclusion in the Visa intra-regional MIF of [*sic*] the cost of the free funding period, as a feature of international charge and credit cards that partly benefits the merchant for cross-border transactions.

(90) Given that the three services in question are provided by Visa issuing banks to merchants indirectly, via the acquiring bank, in the payment system of Visa issuers cannot, in the absence of a contractual relation, charge the costs related to these services directly to the merchant…

(91) In conclusion, the proposed modified intra-regional MIF in the Visa International Rules contributes to technical and economic progress in the meaning of Article [101(3) TFEU] first condition, namely the existence of a large-scale international payment system within positive network externalities."

215. Subject to three qualifications, we consider this to be a valuable statement of the benefit derived by Merchants from four-party schemes like the MasterCard and Visa Schemes. Our three qualifications are as follows:

(1) First, the Decision obviously concerned cross-border MIFs, and not domestic MIFs. Our focus is on the UK MIF.

(2) Secondly, the analysis is now rather dated (the Decision is dated 24 June 2002).

(3) Thirdly, whereas the Commission was, in its Decision, focusing on what an "exemptible" MIF might be, we are (at least in this section of the Judgment) concerned with the benefits of participating in the MasterCard Scheme as they might be perceived by Merchants, and the costs to Issuing Banks that can be associated with those benefits for the purpose of determining the minimum that Issuing Banks would demand in a bilateral negotiation in order to remain in the MasterCard Scheme.

216. The Decision identifies the following benefits, which we briefly comment upon:

(1) *The processing of transactions.* Of course, Merchants themselves incur some costs in this regard (for instance, in the installation of card-reading terminals at their point of sale and in the communications lines between the Merchant and the Acquiring Bank), which are paid for as part of the Merchant Service Charge. Nevertheless, the settlement system, by way of which monies move from the Cardholder, via the Issuing and Acquiring Banks, to the Merchant, is a clear benefit to the Merchant: it is the way the Merchant receives its money.

(2) *The cost of free funding.* By this, we mean the period of "free" credit extended by Issuing Banks to Cardholders. Although obviously the nature of the credit granted varies according to the contract between the Cardholder and the Issuing Bank, typically the terms of such credit will be as follows:

(i) The credit will extend from the date of the transaction (i.e. the purchase by the Cardholder) to the date on which the Cardholder is obliged to settle his debt with the Issuing Bank. The settlement date will depend on when the Cardholder is invoiced. Typically, the Cardholder is invoiced at the end of the month in which the transaction took place, and the Cardholder will normally have 28 days or a month to pay the invoiced amount. It follows that the credit extended is maximally about two months. If the transaction occurs late in this cycle (for example, if the transaction takes place on the 27th of the month, and the Cardholder is billed on the 31st), the credit extended will be rather less than two months.

(ii) The credit is only granted if the Cardholder completely discharges his debt to the Issuing Bank on the settlement date. Cardholders who do this are known in the business as "transactors". Cardholders do, however, have the option of paying only part of the outstanding debt to the Issuing Bank, and (subject to a limit or ceiling) borrowing the rest. In other words, the unpaid debt is rolled over from month-to-month. Where this occurs, the Cardholder (known in the business as a "revolver") pays interest on all transactions for the whole of the credit period. There is no interest free period, because the debt is not completely discharged at the end of the month.[130]

It will be necessary to consider the extent to which Merchants benefit from the cost of free funding. It may well be – as was contended by MasterCard – that free funding encourages purchases which would not otherwise be made, and in any event the Merchant gets paid "up front", whilst the Cardholder has a month's credit. This cost is borne by the Issuing Bank. But there is clearly also a benefit to Issuing Banks, as well as a general "scheme" benefit. The offer of free funding attracts Cardholders to the scheme, and removes the need for Merchants to

[130] See, for example, the evidence of Mr Sidenius Day 11/pp41-42.

provide credit as was hitherto more common. The offer of "free funding" (as well as benefits like free balance transfers) is a way in which Issuing Banks compete amongst themselves. So, the benefits of free funding appear to be split amongst *(i)* Cardholders, *(ii)* Issuing Banks, *(iii)* Merchants and *(iv)* as a general (unattributable) benefit of simply growing the scheme.

Equally, it is important to bear in mind that there may be an element (and quite possibly a large element) of cross-subsidisation between revolvers and transactors, and so there is a real question as to the extent to which the free-funding period is an <u>uncompensated</u> cost to the Issuing Banks.

We revert to these questions of benefit and cost in greater detail below.

(3) *Payment guarantee.* As to this:

(i) All transactions using a MasterCard credit or debit card are settled quickly through the interchange system. The evidence before us is that this occurs within 24 hours.[131] As we have described, there is, in the case of credit cards, an obvious benefit to Merchants, even when the Cardholder discharges his obligations to the Issuing Bank: the Merchant gets paid right away, whereas the Issuing Bank receives payment later. How much later, depends upon whether the Cardholder is a transactor or revolver, and when in the monthly cycle the transaction takes place.

(ii) The payment guarantee is also important in cases of fraud and Cardholder default. Fraud is a problem in the case of both credit and debit cards. Where a card is only ostensibly valid (i.e. is a "clone" or forgery) or where the card is valid, but has been stolen from the Cardholder, the Cardholder typically does not pay. As between the Issuing Bank and the Merchant, this

[131] Evidence of Mr Willaert, Day 10/p70.

loss is typically borne by the Issuing Bank, to the obvious benefit of the Merchant.

(iii) As regards Cardholder default, this is much more a risk relating to credit cards than debit cards. As regards credit cards, the default might occur relatively quickly – on the first settlement date after the transaction – or later if the Cardholder is a revolver. In such cases, the cost of default is much more naturally seen as a cost of the Issuing Bank (for which the Issuing Bank is compensated in interest or other types of charge), rather than as a benefit to the Merchant, which the Merchant might be inclined to pay for. Again, this is a matter which we consider in greater detail below.

217. In his first report, Dr Niels sought to carry this type of analysis – which he referred to as the "adjusted benefit-cost balancing approach" – further:[132]

> "…The first is the **adjusted benefit-cost balancing approach**. This is similar to the method traditionally applied by MasterCard, and to that agreed by the European Commission in the 2002 Visa exemption decision which applied in relation to the intra-EEA MIF until December 2007. A central question with this method relates to the extent to which merchants benefit from the scheme. I therefore consider in section 5 the extensive empirical evidence that exists on merchant benefits from accepting cards. Any concerns about issuer costs included in the UK MIF assessment that do not benefit merchants can be addressed by removing these costs from the assessment where appropriate. I apply this method in section 5."

Again, it is important to stress that Dr Niels carried out this analysis in order to determine the exemptible level of the UK MIF. We are not using his analysis for this purpose: we are (at least in this section of the Judgment) concerned with the benefits of participating in the MasterCard Scheme as they might be perceived by Merchants, and the costs to Issuing Banks that can be associated with those benefits for the purpose of determining the minimum that Issuing Banks would demand in a bilateral negotiation in order to remain in the MasterCard Scheme.

218. Dr Niels' approach was as follows:

[132] Niels 1/§4.50.

(1) His starting point – in terms of data – were cost studies carried out for MasterCard by Edgar, Dunn & Company.[133] Mr Sidenius gave evidence in relation to these cost studies.

(2) Mr Brealey called into question the accuracy of the costs data relied on by Dr Niels. The costs studies relied on by Dr Niels contained data from 2007 or earlier, whereas the claim period covers 2007 to 2015. Dr Niels fairly accepted that it would have been preferable to have costs data throughout the period, but suggested that the 2007 data was likely to underestimate the actual costs in later years. This is because the largest element – credit default costs – was in his view likely to have increased in the following years owing to the economic downturn.[134] In our view, although the data is admittedly imperfect, it is the most reliable data available to the Tribunal and we consider that it is sufficiently robust for us to rely on.

(3) The methodology used by Edgar, Dunn & Company in carrying out such cost studies differed according to credit and debit cards, although in each case the object was to carry out an adjusted benefit-cost balancing approach:[135]

(i) In the case of debit cards, a "Baxter method" was applied:[136]

> "The Baxter method for debit cards…considers the total end-to-end cost of a debit card transaction by measuring the costs of both issuers and acquirers. The interchange fee is then set, taking account of where these costs are incurred, so that the resulting cost allocation between the two sides of the network reflects their relative willingness to pay. This approach is intended to be consistent with the economic principles set out by Baxter in 1983…"

(ii) In the case of credit cards, a "proxy method" was applied:[137]

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[133] Niels 1/§5.4. The cost studies in question are: *(i)* the "MasterCard International 2005 Intra EEA Cross Border Cost Study – Domestic Study Results" (dated January 2006, the "2005 Cost Study") in relation to credit cards (see Sidenius 1/§§21-35; Niels 1/§5.18); *(ii)* the "MasterCard Worldwide 2008 UK Cost Study – Pay Later report" (dated October 2008, the "2008 Cost Study") in relation to credit cards (see Sidenius 1/§§21-35; Niels 1/§5.18); *(iii)* the "MasterCard Europe 2006 – MasterCard Debit Cost Analysis UK" (dated June 2006, the "2006 Cost Study") in relation to debit cards (see Sidenius 1/§§36-51; Niels 1/§5.26).

[134] Day 16/pp125-130.

[135] Niels 1/§5.8.

[136] Niels 1/§5.9.

> "The proxy method for credit cards…is based on the same principles as the Baxter method – i.e. it seeks to set the interchange fee so that the resulting cost allocation between the two sides of the network reflects their relative willingness to pay. However, instead of measuring the full end-to-end cost of a transaction as in the case of debit cards, the proxy method for credit cards focuses only on three main heads of costs which, under the scheme's default rules, are incurred on the issuing side of the network, while generating benefits for merchants – processing costs, payment guarantee (in relation to both fraud and cardholder default) and the interest-free period."

It is not entirely clear why the Baxter method, properly so called, was deemed suitable for debit cards whereas use of a "proxy method...based on the same principles" was adopted for credit cards. In regard to the latter method, it seems that it was considered possible to assess costs to be allocated between Acquiring Banks and Issuing Banks using a sub-set of Issuing Bank' costs consisting of costs relating to fraud and credit card risks, funding of the interest-free period, and operating. It may be that it was thought that these categories were sufficient in themselves to be a proxy for the total costs, or that the relevant data were only collected from a sample representing the largest Issuing Banks which was a proxy for all, or that the costs in question are a proxy because the level and structure of costs might well vary over time, but the calibration exercise can only be carried out intermittently.

(4) Dr Niels summarised the results of the various Edgar, Dunn & Company cost studies considered by him in Niels 1/§§5.15 to 5.27. The results – stated as an *ad valorem* cost (i.e. a cost expressed as a percentage of average transaction value) – are as follows:

Cost Category	2005 Cost Study	2008 Cost Study
Credit and fraud losses, including risk control, comprising:	**1.70%**	**2.04%**
(i) Credit write-offs	1.37%	1.78%
(ii) Collections department	0.16%	0.17%
(iii) Fraud costs	0.17%	0.10%
Funding costs	**0.25%**	**0.27%**
Processing costs	**0.16%**	**0.10%**

[137] 1 Niels/§5.10.

TOTAL COST	**2.11%**	**2.41%**

Table 9: Credit card costs

It is necessary to explain the meaning of the cost categories adopted by Dr Niels in a little greater detail. Essentially:

(i) "Credit and fraud losses" are the costs incurred by Issuing Banks as a result of providing the payment guarantee to Merchants (i.e. credit and fraud write-offs) and costs involved in mitigating those risks.[138]

(ii) "Funding costs" are the Issuing Bank's cost of providing an interest-free period to Cardholders.[139]

(iii) "Processing costs" are the Issuing Bank's cost of processing and settling the transaction.[140]

(5) The position as regards debit card costs was 0.34%.[141] We consider the appropriate bilateral interchange fee for debit cards separately below.

(6) Apart from the attack on the datedness of the Edgar, Dunn & Company figures,[142] Mr von Hinten-Reed did not take issue with these figures.[143] Where the experts did disagree was in relation to the allocation of these costs between Issuing Banks and Merchants (paying via the Merchant Service Charge levied by Acquiring Banks). Dr Niels considered that 100% of the processing costs and of the fraud costs should be paid by the Merchants,[144] and that a proportion – which he put at either 25% or 50%[145] - of the other (credit related) costs should

[138] Niels 1/§5.16.
[139] Niels 1/§5.16.
[140] Niels 1/§5.16.
[141] Niels 1/§5.27.
[142] Which we have considered in paragraph 218(2) above.
[143] Von Hinten-Reed 2/§638.
[144] Niels 1/§5.83.
[145] Niels 1/§5.89.

also be paid by the Merchants. Thus, Dr Niels considered that the exemptible UK MIF (on this basis) should be as follows:[146]

Cost Category	2005 Cost Study			2008 Cost Study		
	Allocation of a proportion of the credit related costs to Merchants (figures affected by the discount are shaded)			**Allocation of a proportion of the credit related costs to Merchants** (figures affected by the discount are shaded)		
	100%	**50%**	**25%**	**100%**	**50%**	**25%**
Credit and fraud losses, including risk control, comprising:	**1.70%**	**0.935%**	**0.5525%**	**2.04%**	**1.075%**	**0.5875%**
(i) Credit write-offs	1.37%	0.685%	0.3425%	1.78%	0.89%	0.445%
(ii) Collections department	0.16%	0.08%	0.04%	0.17%	0.085%	0.0425
(iii) Fraud costs	0.17%	0.17%	0.17%	0.10%	0.10%	0.10%
Funding costs	**0.25%**	**0.125%**	**0.0625%**	**0.27%**	**0.135%**	**0.0675%**
Processing costs	**0.16%**	**0.16%**	**0.16%**	**0.10%**	**0.10%**	**0.10%**
DR NIELS' "EXEMPTIBLE" MIF	**2.11%**	**1.22%**	**0.78%**	**2.41%**	**1.31%**	**0.76%**

Table 10: Apportionment of costs

(7) Mr von Hinten-Reed considered that no part of the credit related costs – shaded in the above table – should be paid for by the Merchants.[147] According to him, this gave rise to "exemptible" MIFs[148] of 0.35% and 0.2%.[149]

(8) Neither expert considered further the 0.34% debit card costs referred to in paragraph 218(5) above.

219. Although we have set out the position of the expert economists in some detail, we are not convinced that the allocation of costs (even when seeking to calculate an exemptible MIF) is truly a matter of expert economic opinion,

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[146] There are minor differences between our calculations and those of Dr Niels at Niels 1/§5.85, Table 5.2. This is either because of rounding differences or because Dr Niels has at times used approximations that he has not stated in his report. Niels 1/§5.85 states that "[a]s it is not possible to quantify the benefits with precision, the table shows some approximate scenarios". We have not explored this further, as the differences are so small as to be immaterial.
[147] Von Hinten-Reed 2/§640.
[148] We should be clear that at no point did Mr von Hinten-Reed suggest that this was an appropriate way of assessing the "exemptible" MIF: he was critiquing the position of Dr Niels.
[149] Von Hinten-Reed 2/§639, Table 8-2.

particularly when those economists are not expert in the payment system market.[150] Although we have carefully considered the opinions of Dr Niels and Mr von Hinten-Reed, at the end of the day what costs an Issuing Bank would seek to recover in a bilateral negotiation with the participants in the Acquiring Market (namely, the Acquiring Banks/Merchants) is a question of counterfactual speculation for us (on the basis of such evidence as exists). Our conclusions are as follows:

(1) We agree with the experts that it is the Merchants (and not the Issuing Banks) who benefit from non-credit related costs, and that Issuing Banks would expect to recover all of these costs from the Acquiring Market.

(2) Turning to the credit-related costs, we consider first the funding costs of the interest-free period. We consider that Issuing Banks would expect to recover an element of the funding costs and that Merchants would be prepared to pay an element of these costs, for the following reasons:

(i) Although the Issuing Bank itself benefits from the provision of an interest-free period (as a means of attracting Cardholder customers), there is a general scheme benefit (in that more Cardholders are attracted, with the result that there are more transactions) and a specific benefit to Merchants.

(ii) Some of the main benefits to Merchants, which we consider they would perceive and value, are set out in paragraphs 214*ff* of MasterCard's written closing submissions. In particular:

(a) Merchants benefit from customers being able to purchase goods and pay next month at no cost – which is the facility which the interest-free period provides. Moreover, Merchants do not have to bear the costs of setting up their own credit facility for their customers.

[150] See our comments at paragraphs 36 to 41 above on the question of expertise.

(b) For the Merchant, the benefit is not only that the Merchant receives payment now, whereas the Cardholder pays later, but also, there are some transactions that either would not take place at all absent the provision of a credit-free period or which would take place, but in a manner less advantageous to the Merchant. By way of example, we have seen that the average transaction value in a Sainsbury's store using a MasterCard credit card is nearly £6 higher than what is spent using a Maestro debit card, and there is a similar differential between Visa credit and Visa debit cards.[151]

(iii) Against this, there is the undoubted possibility that Issuing Banks are already charging for the funding costs of some or all of the interest-free period through the interest charged to revolvers and/or through charges levied on all Cardholders. Neither party could point to any evidence on this question. There are two possibilities:

(a) The Issuing Banks extend credit to all Cardholders, both revolvers and transactors, but the interest charged to revolvers is at a rate calculated only by reference to the credit extended to the revolvers.

(b) The Issuing Banks extend credit to all Cardholders, both revolvers and transactors, and the interest charged to revolvers is at a rate calculated by reference to the credit extended to the revolvers <u>and</u> the transactors.

Although there was no evidence either way, we consider that Issuing Banks may seek to recover some of their funding costs

[151] This evidence was confidential, but we have summarised its substance in a manner that preserves this confidentiality. The evidence is set out in MasterCard Closing/§218.

by way of (non-interest) charges to transactors and/or interest paid by revolvers, and this is a factor we take into account.

For all of these reasons, we consider that Issuing Banks would expect to recover an element of the funding costs through the Interchange Fee and that Merchants would be prepared to pay an element of these costs. We put the amount that Issuing Banks would expect to recover from Interchange Fees at 50%.

(3) Turning now to the other costs of extending credit – credit write-offs and collections – we consider that these are intrinsic to the decision by the Issuing Bank to extend credit to the Cardholder, and that the interest rate charged appropriately compensates the Issuing Bank for the risks involved. It is the Issuing Bank and not the Merchant that decides whether the Cardholder is a good or a bad credit risk. It is the Issuing Bank and not the Merchant that decides the amount of credit to be extended to the Cardholder. It is the Issuing Bank and not the Merchant that decides the terms on which the Cardholder will be permitted to "revolve" credit, rather than pay, and the rate of interest to be paid. There is no doubt in our mind that these costs are for the account of the Issuing Banks, and that the Issuing Banks are properly compensated in interest for the risks of default and the costs of collection.

(4) We set out our conclusions in the table below. In reaching a final figure as to what Issuing Banks would expect to recover by way of bilateral Interchange Fee and what Merchants would (as a minimum) be prepared to pay, we have (in Column (6)) averaged the figures deriving from the 2005 Cost Study and the 2008 Cost Study.

Cost Category	2005 Cost Study		2008 Cost Study		Average
(1)	**(2) 100%**	**(3) Tribunal allocation**	**(4) 100%**	**(5) Tribunal allocation**	**(6) An average of the figures in Column (3) and Column (5)**
Credit and fraud losses, including risk control, comprising:	**1.70%**	**0.17%**	**2.04%**	**0.10%**	**0.135%**
(i) Credit write-offs	1.37%	-	1.78%	-	
(ii) Collections department	0.16%	-	0.17%	-	
(iii) Fraud costs	0.17%	0.17%	0.10%	0.10%	0.135%
Funding costs	**0.25%**	**0.125%**	**0.27%**	**0.135%**	**0.13%**
Processing costs	**0.16%**	**0.16%**	**0.10%**	**0.10%**	**0.13%**
TOTAL	**2.11%**	**0.46%**	**2.41%**	**0.34%**	**0.40%**

Table 11: Allocation of costs

220. We do need to treat these figures with some care:

(1) Whilst the 2005 and 2008 Cost Studies represent the best data available to us, they are merely two "snapshots" in time.

(2) What is more, whilst 2005 and 2008 are helpful dates for considering the beginning of the claim period, as one progresses towards the end of the claim period, they get increasingly out of date.

(3) The figures in the 2008 Cost Study are, plainly, skewed by the very high credit write-offs that reflect the economic situation prevailing at that time. We recognise that this is an atypical factor. However, its impact on our exercise is nil, as we do not allocate any of this category of costs to Merchants.

221. The 2005 and 2008 Cost Studies disclose the following interchange rates that ought to cover the legitimate costs of an Issuing Bank:

(1) 0.34% if one takes only the 2008 Cost Study.

(2) 0.40% if one takes the average of the 2005 and 2008 Cost Studies.

(3) 0.46% if one takes only the 2005 Cost Study.

In short, there is a range. Given the uncertainties, we reject the use of the 2008 Cost Study on its own. Whilst it is tempting to take the average of the two Cost Studies, it is (in order to avoid a conclusion that would under-reward the Issuing Banks in our counterfactual hypothesis[152]) appropriate to use only the higher figures in the 2005 Cost Study. Accordingly, on the basis of the material available to us, we conclude that Issuing Banks would be most unlikely to agree an interchange fee that did not return a rate of (the equivalent of[153]) 0.46%.

222. We do not say that Sainsbury's would have been prepared to pay <u>only</u> this amount. Indeed, given that Issuing Banks would have a far clearer idea of their costs than Sainsbury's, we anticipate that Issuing Banks would seek a higher price, and we consider that Sainsbury's would probably be prepared to pay more than a rate of (the equivalent of[154]) 0.46%. The question is how much more: that is a question to which we now turn.

<u>Sainsbury's interchange costs</u>

223. Obviously, as Mr Coupe described (see paragraph 190 above), Sainsbury's would seek to reduce its costs so that they were as low as possible. However, for the reasons we have given in paragraphs 182 to 197 above, Sainsbury's would not (and nor would its Acquiring Banks) insist on a zero Interchange Fee.

224. We consider that Sainsbury's would accept that it should pay a price that covered the costs of providing the <u>benefits</u> of the service Sainsbury's received, and there would, no doubt, be careful negotiation between Issuing Banks on the one hand, and Acquiring Banks and large Merchants (like Sainsbury's) on the other hand, in which the benefits of the MasterCard Scheme and the costs of these benefits would be debated. It is for this reason that we have spent so much time considering the price below which Issuing Banks would not go:

[152] Since this assessment bears directly on the amount of damages MasterCard will be liable to pay – a factor we consider in more detail in Section K below – it is also appropriate for us to err on the side of under- rather than over-compensation of Sainsbury's.
[153] As we have stated in paragraph 197(3)(ii) above, we consider that the Interchange Fees paid to Issuing Banks would be calculated altogether differently.
[154] *Ibid.*

that price, as we have stated, is an *ad valorem* rate of (the equivalent of[155]) 0.46%.

225. Of course, Issuing Banks would seek to persuade Sainsbury's to pay a higher price and – not having perfect knowledge of Issuing Bank costs – Sainsbury's might be persuaded to pay this price.

226. However, just as Issuing Banks would have a floor price, below which they would not go, so too Sainsbury's would be likely to have a ceiling price above which it would not pay. We consider that this ceiling price would be no higher than an *ad valorem* rate of (the equivalent of[156]) 0.50% for the following reasons:

(1) Sainsbury's would be opposed to paying Interchange Fees at the level of MasterCard's premium credit cards. As we have described in paragraph 202, the premium rates for the MasterCard World and World Signia cards were, for most of the claim period, at levels of MIF well above 1%, reducing only because of MasterCard's recognition that the EU Interchange Fee Regulation would become law. We consider that Sainsbury's would be absolutely opposed to paying an Interchange Fee that was anything above the "vanilla" non-premium card rate of 0.80% (see paragraph 202(1) above). The evidence of Mr Brooks was that Sainsbury's was particularly concerned about the "premium" rates it was obliged to pay,[157] and we consider that Sainsbury's would be looking for an Interchange Fee well below the 0.80% "vanilla" MIF. Sainsbury's would, of course, be well aware that the "blended" MIF that it paid to Visa over the claim period was 0.80%, whereas it paid MasterCard 0.90%.[158]

(2) In terms of its negotiations, we consider that Sainsbury's would use the rates it paid in respect of debit card transactions as a starting point for

[155] *Ibid.*
[156] *Ibid.*
[157] Brooks 1/§§17-18.
[158] See Table 7 above. If – as is likely – the negotiation of the bilateral Interchange Fee occurred at the start of the claim period, then of course Sainsbury's would not have the information. But it would have data relating to the period prior to the claim period (which we do not have).

an appropriate price in respect of credit cards. This is because we consider that – of the credit-related costs associated with credit cards – Sainsbury's would only consider the cost of free funding and fraud protection to be a benefit to it. For the reasons we have given, we consider that Sainsbury's would have discounted the other so-called benefits of MasterCard credit cards (namely, the costs of extending credit).

(3) Thus, Sainsbury's would have adopted a negotiating strategy based upon its debit card costs, but with a degree of upwards flexibility to reflect the benefits of credit cards to Merchants that we have described. Thus, Sainsbury's starting point would be the "blended" MIFs it paid in respect of Debit MasterCard (0.36%), Visa (0.26%) and Maestro (0.19%).

(4) No doubt – by providing certain information as to costs – Issuing Banks could persuade Sainsbury's upwards. We consider that Sainsbury's – and other Merchants – would be most influenced by the costs of the Issuing Banks. For that reason, we consider that anything materially above (the equivalent of[159]) 0.46% would be something of a triumph. For present purposes, we are prepared to accept that Issuing Banks would be able to make a case for an Interchange Fee of (the equivalent of[160]) 0.50%, which Sainsbury's and its Acquiring Banks might have accepted, but no more than that.

Irrelevance of the Merchant Indifference Test for these purposes

227. The Merchant Indifference Test is a test used by the Commission to derive an "exemptible" MIF. Since the Merchant Indifference Test is often abbreviated to the acronym "MIT", such a rate is often known as the "MIT-MIF".

228. Mr von Hinten-Reed described the MIT-MIF test in his first report:[161]

> "704 The so-called MIT-MIF is a methodology used to determine the appropriate level of the interchange fee paid by merchants (via the acquirers) to the

[159] See footnote 153 above.
[160] *Ibid.*
[161] Von Hinten-Reed 1.

issuers for each card payment. The idea behind the MIT-MIF methodology is that the level of the merchant fee should be such that a merchant would not want to refuse a non-repeat consumer who wants to pay for her purchases by card. This would be the case if the cost of card payments, including interchange fee, does not exceed the cost of alternative means of payment.

705 The original theory of the MIT was developed by French academics Rochet and Tirole to study the optimal regulation of interchange fees. The comparison of the costs of payments was used to illustrate the social costs and benefits of substituting cards for cash…

706 Merchants derive two types of benefit from card transactions. First, there is transaction savings derived from lower cost of card relative to cash transactions. The second is the benefit of additional sales that would not have occurred if they did not accept cards. The first benefit clearly is an efficiency benefit…The second benefit is not a benefit to the economy since if the sale had not taken place in merchant A, it would have done in merchant B. The idea behind the artificial construction of the MIT is that it focuses only on the transaction savings since the hypothetical tourist has cash and will never return to the store again. There is no possibility of losing sales by declining cards. It is this feature of the MIT-MIF, i.e. the focus on efficiency benefits that makes it potentially useful for considering Article 101(3)(a) efficiency issues. A second feature of the MIT test is that it sets the size of the MIT-MIF level of MIF payment at the level of the benefits the merchant receives which may be thought to be relevant to Article 101(3)(b) fair share issues. For both these reasons the MIT-MIF test is in my opinion a good candidate for thinking about Article 101(3)."

229. At the outset, it is therefore fair to say that no-one has contended that the MIT-MIF is an appropriate vehicle for considering how Issuing Banks and Acquiring Banks' Merchants would approach their bilateral negotiations regarding the level of an Interchange Fee absent a MIF. We consider why the MIT-MIF is, in fact, an unrealistic and unhelpful test for an "exemptible" MIF elsewhere in this Judgment. For the present, we confine ourselves to explaining why we have not had regard to the MIT-MIF when considering the Issuing Banks' floor price or Sainsbury's ceiling price in a counterfactual negotiated bilateral:

(1) The MIT-MIF involves calculations that we consider Merchants would not have undertaken in the ordinary course of business. Mr von Hinten-Reed frankly accepted this, but suggested that in the counterfactual Sainsbury's would have undertaken such an exercise for

purposes of negotiating with Issuing Banks. We regard this suggestion as implausible.[162]

(2) This is because the MIT-MIF is so far divorced from commercial realities as to be an exercise the Merchant would not undertake. The notion that a Merchant, when considering what price to pay to participate in a payment scheme, would be minded to assume that its customers have "cash and will never return to the store again" is a proposition that only needs to be stated to be rejected. The reason why Merchants are interested in payment schemes is because – to adopt Mr Brealey's phrase – they are a "fantastic thing" and Merchants use them to attract customers. They know that if they do not accept payment by card, significant customers will go elsewhere.

230. In short, we regard the MIT-MIF as entirely unhelpful for the purpose of predicting how Merchants would behave in the course of bilateral negotiations.

Conclusion on the level of the bilaterally agreed Interchange Fee for MasterCard credit cards

231. Accordingly, the MIT does not affect our conclusion that an Interchange Fee of (the equivalent of[163]) 0.50% would be agreed between Merchants in the position of Sainsbury's, their Acquiring Banks and the Issuing Banks issuing MasterCard credit cards in the UK.

(iv) A bilateral Interchange Fee for debit cards

232. The manner in which the end-to-end costs for MasterCard debit cards was established was described in paragraph 218(3)(i) above. Essentially, this was the "Baxter" rate, and the figure was 0.34%.

233. This figure was not exposed to any scrutiny by either side during the course of the trial, no doubt because of the very small sums involved.[164] Neither expert

[162] See paragraphs 187 and 188 above.
[163] See footnote 153 above.
[164] In closing Mr Hoskins stated (Day 23/p22): "The claim, as you know, relating to debit cards, is less than 1% of the total claim. So I'm not sure either party is pushing you to do a Rolls-Royce job on debit

engaged in any great level of analysis. Our conclusions as regards the amounts that an Issuing Bank would seek to recover for its costs and the minimum that a Merchant would be prepared to pay are as follows:

(1) Because debit cards, by definition, do not involve any credit-related costs, the starting point must be that Issuing Banks would expect to recover all of the costs incurred by them in respect of MasterCard debit cards.

(2) The figure of 0.34% is very close to the "blended" MIF in fact paid by Sainsbury's to Issuing Banks in respect of Debit MasterCards over the period of the claim (0.36%), as can be seen from Table 8 above. That is, in one sense, unsurprising, since the 0.34% is an attempt by MasterCard to calculate the Issuing Banks' costs in respect of these very transactions.

(3) However, when one considers the MIFs actually paid by Sainsbury's in respect of Visa debit cards (0.26%) and Maestro (0.19%),[165] the Debit MasterCard Interchange Fee of 0.36% seems too high and out of line. We consider that, for these reasons, Merchants in the position of Sainsbury's would in the counterfactual be unlikely to accept a rate of 0.34%, and would seek to agree a lower bilateral rate more in line with that of Visa. It may be that Visa could, in negotiations, have prevailed upon Merchants to pay a little more than the Visa debit MIF. But we doubt it would be very much more, and put it at no higher than 0.27%.

234. For these reasons, we consider that Sainsbury's would have agreed an interchange fee for Debit MasterCards of 0.27%, and that (because this is essentially in line with the Visa rates, whose costs must be similar) Issuing Banks would have agreed such a rate.

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cards particularly. I will leave that to Mr Brealey to say if I'm wrong, but I'm really not sure whether it is worth anyone's while to have that…"

[165] See Table 8 above.

(f) Conclusion: did the setting of the UK MIF as a default rate have the effect of appreciably restricting competition?

(i) The parties' contentions

235. In the light of the foregoing, we turn to the question of whether the UK MIF has the effect of preventing, restricting or distorting competition. The contention of Sainsbury's is that the UK MIF constitutes a floor on the Interchange Fee that is higher than would be negotiated absent the UK MIF.

236. MasterCard's answer to this is twofold. Paragraph 68 of the Re-Amended Defence states:

> "(e) Insofar as [Sainsbury's] contends that the appropriate counterfactual is a zero MIF, this would restrict competition in the issuing market by forcing issuers to recover all of their costs from cardholders – thereby acting as a de facto floor for the setting of cardholder fees. Furthermore, it is denied that this is a realistic counterfactual, since it would not be commercially viable for issuers to recover all of their costs from cardholders in circumstances in which other card Schemes such as Visa and American Express were not doing so.
>
> (f) Insofar as [Sainsbury's] contends that the appropriate counterfactual is that interchange fees were negotiated bilaterally, it is denied that such bilaterally negotiated fees would have been any lower than the UK MIF. Furthermore, given the costs involved in such negotiations (which would be initially borne by acquirers who would be likely to pass such costs on to merchants), the overall cost to merchants would have been higher. Furthermore, it is denied that this is a realistic counterfactual given the practical difficulties of each issuer having to reach a bilateral agreement with each acquirer (and vice versa) before the Scheme could operate and the inability of the Scheme to operate, in the absence of a default MIF, to the extent that a bilateral agreement had not been reached."

237. A number of points arise out of MasterCard's Defence:

(1) MasterCard seeks to draw a distinction between a "no MIF" counterfactual and a "bilaterally negotiated IF" counterfactual. We see no such distinction. Rather, there is a close relationship between these two counterfactuals, in that the "no MIF" counterfactual <u>leads to</u> a "bilaterally negotiated IF" counterfactual.

(2) We do not accept – for the reasons we have given – that the MasterCard Scheme would not function without a UK MIF. Without a default, the Scheme would operate with, in effect, a default Interchange Fee of zero: that fact would impel Issuing Banks to negotiate with Acquiring Banks.

For the reasons we have given, we consider that such negotiations would be likely to result in an agreed fee payable by Acquiring Banks to Issuing Banks.

(3) We do not consider the practical difficulties of reaching agreement as to a bilateral Interchange Fee or a series of bilaterals would prevent agreement being reached. As we have noted, the relatively limited number of Issuing Banks and Acquiring Banks in the UK makes such agreement eminently possible.

(4) In the light of the evidence before us, we consider that in terms of value flowing from Merchants to Issuing Banks the Interchange Fee would be the *ad valorem* equivalent of 0.50% for MasterCard credit cards and 0.27% for MasterCard debit cards.

(ii) Movement away from MasterCard debit cards?

238. As can be seen from Table 8, a debit card Interchange Fee of 0.27% is practically the same as Visa's debit card Interchange Fee of 0.26%. For this reason, we do not consider that there would be a flow of Issuing Banks away from the MasterCard debit cards.

(iii) Movement away from MasterCard credit cards?

239. The position as regards MasterCard credit cards is rather different, and warrants more extensive consideration. Specifically, Visa's MIF for the claim period amounted to 0.80%, which (assuming Visa did not itself change its charging structure) is obviously higher than the 0.50% that we consider would have been bilaterally agreed as between MasterCard Issuing Banks on the one hand and Acquiring Banks/Merchants on the other.

240. MasterCard's contention was that, all other things remaining equal, a significantly lower MasterCard Interchange Fee compared to a significantly higher equivalent Visa Interchange Fee would cause Issuing Banks to drift away from the MasterCard Scheme and into the Visa Scheme. Unless something changed, that drift would continue until the MasterCard Scheme had practically no participating Issuing Banks, so that (as a consequence)

Merchants would no longer consider it worth their while accepting MasterCard cards. As a result, the demand for the acquisition of MasterCard transactions would also fall, and Acquiring Banks would also cease to participate in the MasterCard Scheme. In short, the MasterCard Scheme would – given these assumptions – collapse.

241. We accept that Interchange Fees as between different payment schemes are a significant factor bearing on the minds of Issuing Banks. We also accept that this is a factor that we must take into account when considering whether the UK MIF has the effect of appreciably restricting competition. That is because:

(1) As we have found, we must consider the effect of the UK MIF not only in the acquiring market, but also in the issuing market and in the inter-scheme market.

(2) Even looking at the acquiring market alone, the collapse of the MasterCard Scheme (even if that collapse only extended to credit cards) would be an adverse effect in that market.

242. The question we must consider, therefore, is the extent to which a difference in Interchange Fee rates of the kind that we find would have been likely to exist in the counterfactual world (namely between 0.50% and 0.80%) would cause MasterCard's "doomsday" scenario to arise, whereby there would be a one-way move away from the MasterCard Scheme so as to cause it to fail altogether. The main plank for MasterCard's contention in this counterfactual was what had happened to its Maestro card, which we consider next.

The Maestro example

Background

243. Visa operated the first international debit payment scheme in the UK. Switch was historically the other main UK debit payment scheme. MasterCard acquired Switch in 1999 and merged it into MasterCard's debit card product, Maestro, in 2002. From 2002, Visa and Maestro were the only significant competitors in the field of debit payment schemes.

244. The Maestro debit scheme rules differed from those of the MasterCard credit card payment scheme in two important respects. First, Interchange Fees were to be set bilaterally, or by arbitration in the event of disagreement, with a default rate put in place pending the conclusion of any arbitration. We were told that in practice bilateral rates were generally agreed at around the level of the default rate. Second, MasterCard did not have the power to set the default Interchange Fee for Maestro debit cards.[166] This responsibility was retained until August 2009 by the board of a company named S2 Card Services ("S2"). S2 was controlled by the major banks, some of which were net acquirers.[167]

245. MasterCard clearly considered the arrangement whereby S2 set Maestro's interchange fee disadvantageous and identified in 2006 that "both RBS and HSBC are considering moving their business for the higher interchange [offered by Visa]".[168] MasterCard developed a strategy to increase its market presence in the debit market through the creation of a new product which it would own and fully control, including the setting of Interchange Fees. The strategy culminated in the launch in 2007 of Debit MasterCard. Rather than setting interchange on a pure flat fee per transaction (as was the system used by Maestro and Visa Debit) or on an *ad valorem* basis (as was the case for Visa Credit and MasterCard credit cards), MasterCard initially set a combined *ad valorem* and fixed fee interchange fee structure. For example, for Chip/PIN the Interchange Fee would be 0.12% + 3.5p.[169] MasterCard considered that this combined fee structure would be attractive to Issuing Banks, and would make debit cards attractive for both low value transactions and "big ticket" payments. However, the fee structure proved very unpopular with Merchants and Acquiring Banks. A number of major UK retailers refused to accept any fee structure containing an *ad valorem* rate. As a result of the difficulty gaining acceptance, in the course of 2007 MasterCard switched to a flat, per transaction, fee for Debit MasterCard transactions. For Chip/PIN transactions on Debit MasterCard this amounted to 8p per transaction. This fee matched the interchange fee that MasterCard understood

[166] Douglas 1/§29.
[167] Douglas 1/§30.
[168] MasterCard internal email dated 9 July 2006.
[169] MasterCard 2006 presentation "Debit MasterCard - A new choice in the debit business".

that Visa Debit intended to levy on Chip/PIN transactions following Visa's proposed rate changes in January 2008.[170]

Developments from 2004 onwards

246. In 2004, Visa held around 55% to 60% of the UK debit card market. Lloyds Bank and Barclays were Visa's largest issuers. Maestro held the remaining around 35% to 40% of the debit card market, its cards being issued by HSBC, RBS and NatWest and certain smaller issuers.[171]

247. By 2006, Visa's market share had increased to around 60% to 65% (and MasterCard's share had correspondingly decreased to around 30% to 35%) following the migration by one relatively small issuer, HBoS, from Maestro to Visa Debit. There was no detailed evidence before the Tribunal explaining the reason for HBoS's migration.

248. During 2006 and 2007, the two remaining large issuers of Maestro cards, RBS and HSBC, underwent a procurement process. Visa offered its debit product, whilst MasterCard put forward a "segmented" offering: Maestro for lower value / higher risk customers (*e.g.* students, youths) and Debit MasterCard for more affluent customers. It was around this time that Debit MasterCard was experiencing difficulties with "acceptance" amongst retailers who were unhappy with the proposed combined *ad valorem* and fixed interchange fee.

249. The procurement process culminated in the decision in late 2007 by both banks to "flip" their portfolios from Maestro to Visa Debit. As a result of these procurement decisions, from around 2009, Maestro rapidly lost market share as RBS and HSBC began to migrate their customers' accounts to Visa Debit. By 2013, MasterCard's market share had fallen to just 3%, this share being held almost entirely by Debit MasterCard. Maestro had practically vanished from the UK market.

250. From 2004 onwards Maestro had set a lower default MIF than Visa Debit, the differential amounting to some 2.9p per transaction. In around July 2006,

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[170] 24th European Interchange Committee Agenda Item 1 and Minutes dated 26 July 2007.

[171] The precise market shares are unclear as there were some differences between MasterCard's witness evidence and contemporaneous estimates.

Visa announced its intention to further raise its UK debit card MIF with effect from 1 January 2007. Contemporaneous internal emails indicate that MasterCard recognised that this would create a competitive disadvantage for Maestro. However, S2 did not respond by raising the Maestro default MIF. This was, apparently, because of a "stalemate of issuer and acquirer interests on the board."[172] Accordingly, the pre-existing differential in MIFs grew by around a further 1.4p per transaction. The relevant figures are set out in the table below:

Period	Until 31 December 2006	From 1 January 2007
Maestro MIF (weighted average transaction)	6.6p / transaction	6.6p / transaction
Visa Debit MIF (weighted average transaction)	9.5p / transaction	10.6p / transaction
Differential	2.9p / transaction	4.3p / transaction

Table 12: Differential in Maestro and Visa Debit UK MIFs

The reasons for the collapse of Maestro in the UK

251. The evidence of the witnesses called by MasterCard was firmly that HSBC and RBS had flipped their portfolios to Visa Debit primarily as a result of the interchange fee differential between Maestro and Visa Debit. MasterCard calculated the differential to equate to around £120 million per annum to RBS and HSBC together. Mr Douglas stated that "[i]t was common knowledge in banks at that time that MasterCard was in a very unfavourable position in the UK debit market due to its interchange issues ... The effect of this disparity in rates was obvious: from a 39% share of the UK debit market in 2003, Maestro's market share dropped to 30% in 2006 and to below 3% by 2013."[173] Mr Perez described the Maestro scheme as "haemorrhaging major issuers and market share at that time to Visa Debit as a result of default interchange fees being too low."[174] Mr Willaert, based on his knowledge from discussions with his team, stated that "[the Maestro] fallback fee which was being set by [S2] was substantially lower than Visa Debit's equivalent fallback interchange fee. This gave issuers a clear incentive to switch from issuing

[172] See footnote 168 above.
[173] Douglas 1/§§31 to 35.
[174] Perez 1/§47.

Maestro cards to Visa debit cards and, over a period of several years, the majority of the UK issuers of Maestro debit cards did so." [175]

252. We consider that this evidence sits uneasily with the contemporaneous documentary evidence, which was put to these witnesses in cross-examination. We do not accept the "doomsday" picture painted by MasterCard's witnesses, whereby they contended that the only reason for the collapse of Maestro in the UK was the level of its Interchange Fee.

253. The reality is incontestably more complex. The immediate cause of the collapse of Maestro was the decision of two major Issuing Banks – RBS and HSBC – to "flip" their card portfolios from Maestro to Visa Debit. The key question is why they elected to do so.

254. Two of the most important documents that shed light on the thinking of RBS and HSBC are analyses conducted by MasterCard itself, as part of an assessment as to why the RBS and HSBC procurements had been lost to Visa. The first document, dated 14 January 2008, is a document entitled "UK debit strategy". The second document is a set of slides dated 31 August 2009 entitled: "UK Strategy Development". We consider these documents in turn.

255. The 2008 document entitled "UK debit strategy" explains that the decision of RBS and HSBC to move away from Maestro was "felt to be as a result of the following combination of factors…":

> "Visa economics:
>
> - Visa Debit attracts interchange at 4p per transaction above the Maestro rate set by S2
> - Very attractive Visa financial proposals. Although the value of these is unknown, the impending Visa IPO may well have engendered strong value to these deals
>
> Product offer:
>
> - Visa Debit, rather than DMC is the lower risk option, as it is already established in market, whereas DMC has yet to be proven.
> - In the UK market, the lower international acceptance of Maestro outside Europe (particularly USA), puts it at a competitive disadvantage

[175] Willaert 1/§39.

Regulatory:

- As prominent participants in S2, with the responsibility of setting Maestro IC, HSBC and RBSG will have been attracted by a move to an established product (Visa Debit) rather than be seen to move from one MCE product (Maestro) to a higher IC product (DMC)".

256. Slide 33 of the 31 August 2009 set of slides has the header "The reasons for the portfolio losses in Debit". It reads as follows:

"**Multiple factors influenced HSBC and RBS's decisions to migrate their debit portfolios from [MasterCard], notably overall economics, acceptance and marketing**

Contributory Factors to Loss of RBS and HSBC Debit RFPs		**Resolved**	**Comments**
[MasterCard] Debit Strategy	• Perceived to lack a cohesive global debit strategy against VISA's perceived one size fits all solution. Bank's challenged [MasterCard's] ability to position/support both Maestro and Debit MasterCard (DMC) effectively.		• Difficult to communicate a dual brand strategy to consumers
Product Strategy	• The UK was still Maestro based, providing strong UK acceptance but inconsistent throughout Europe and little across other Global markets (with the US representing a key acceptance gap)	û	• UK is now Debit MasterCard led
Acceptance	• At the time of both RFP submissions DMC was not launched and did not have a tested acceptance network	ü	• DMC is now fully implemented on acquiring and issuing sides
Pricing	• The British Retail Consortium rejected the DMC ad-valorem pricing structure versus VISA's tried and tested solution (fixed fee).	ü	• We have now reverted to a fixed fee only structure
Regulatory	• The European Commission ruling on [MasterCard] cross-border interchange was still pending at the time of RFP	ü	• Interim arrangement in place pending appeal at Court of First Instance
First to market	• Both HSBC and RBS were hesitant to be first with a new product with no acceptance and higher market economics	ü	• NAG agreement in place
Financial Proposal	• Both HSBC & RBS stated that VISA's pricing structure and incentive support was significantly more favourable than [MasterCard's]. VISA Europe also positioned the	û	• VISA Europe continues to leverage the IPO potential in its negotiations

	advantages of a future IPO and associated incremental proceeds		tactics
Brand Marketing	• VISA was able to demonstrate significant investment behind its brand advertising in the UK Market, coupled with its ownership of the 2012 London Olympics sponsorship asset	û	• Poor Maestro marketing platform and marketing support available
UK Maestro (S2) Governance & Contract	• [MasterCard] unable to address the uncompetitive pricing position of UK Maestro due to heavy Acquirer influence of S2 members. The contract provided no protection post July 2007 to migrate away from the Maestro brand	ü	• Control over interchange setting for UK Maestro has now been regained”

257. Of course, these documents set out MasterCard’s own contemporaneous thinking as to why HSBC and RBS “flipped” to Visa, rather than staying with Maestro. We had no evidence from HSBC or RBS themselves. We find these documents – which were produced for internal consumption relatively soon after the procurement processes with HSBC and RBS had so clearly failed – to be far more valuable indicators of the reasons for that failure than the long-after-the-event analysis in witness statements prepared for the purposes of on-going litigation in which there is a particular focus on the significance of Interchange Fee income, and when memories are likely to have faded somewhat.

258. We find that:

(1) Unsuprisingly, sophisticated Issuing Banks like HSBC and RBS do not look only at one factor. The Interchange Fee they are likely to be paid will, obviously, be a significant factor – but, at the end of the day, it is just one consideration amongst many.

(2) In this case, the significance of the Interchange Fee differential between MasterCard’s offering and that of Visa was complicated by two additional factors:

(i) MasterCard's offering was based on <u>two</u> products (Maestro and Debit MasterCard), with <u>different</u> Interchange Fee rates. As we have noted, the difference between Maestro's Interchange Fee and that of Visa was significant (see paragraph 250 above). But – as the MIF rates in paragraph 206 above demonstrate – the MIF for Debit MasterCard was significantly higher than that for Maestro, and so correspondingly closer to the Visa debit MIF. Although we appreciate that Table 8 above sets out the "blended" MIF for all relevant cards over the entire claim period (and not just for the time when MasterCard was engaged in the procurement process with HSBC and RBS), the figures are nevertheless instructive. The blended MIFs paid by Sainsbury's over the claim period were:

(a) 0.36% for all Debit MasterCard transactions.

(b) 0.19% for all Maestro transactions.

(c) 0.26% for all Visa debit card transactions.

Slide 33 shows that MasterCard's offering to HSBC and RBS involved a potentially higher MIF for Debit MasterCard transactions than offered in the case of Maestro transactions. The problem for MasterCard was that the "mixed" *ad valorem* plus flat fee rate it was proposing was meeting with significant Merchant push-back, doubtless because Merchants disliked the *ad valorem* element.

(ii) The Interchange Fee was not the only financial consideration in favour of Visa Debit: it is clear that Visa put forward other financial incentives to tempt RBS and HSBC to transfer their portfolios.

(3) Slide 33 demonstrates a whole range of other factors that MasterCard considered would have influenced RBS and HSBC to go to Visa rather than stay with MasterCard.

(4) Cross-examination also established that Maestro (though not Debit MasterCard) suffered a number of shortcomings compared with Visa Debit. Mr Douglas, Mr Perez and Mr Willaert all accepted that Maestro had a limited international acceptance, particularly in the USA. [176] MasterCard had approximately 23 million locations worldwide, whilst Maestro had just 10 million locations. [177] Despite these witnesses' explanations that international spending represented a relatively small share of spending by cardholders, and the suggestion that Maestro found acceptance "where it mattered" (*i.e.* in airports and major cities), we nevertheless consider that this was a major contributory factor which led to the decision of HSBC and RBS to reject Maestro in favour of Visa Debit.

(5) Maestro also suffered from a number of other less significant shortcomings compared with Visa Debit. For example, Mr Douglas conceded that Maestro was less suitable for use in online transactions (a mode of distribution which was beginning to gain importance in 2007). [178] The documentary evidence also indicates that the Maestro card was less able to process recurring payments, which would have reduced its convenience for some Cardholders. [179]

Conclusion on the Maestro example

259. The evidence relating to Maestro was described by Mr Hoskins in opening as the "prize evidence" in the case. We find the contention that it was the Interchange Fee differential between Visa and Maestro that was the main cause of the collapse of the Maestro market in the UK to be unsubstantiated by the facts, and we reject it. Helpful although we found the evidence of MasterCard's witnesses in general, we do not accept their evidence on this point, preferring the analysis in MasterCard's own contemporaneous documents. We find that MasterCard has established no more than that Maestro's lower Interchange Fee was one of a number of factors which led to

[176] Evidence of Mr Douglas Day 8/p63, Mr Perez Day 9/p26 and Mr Willaert Day 10/pp37-38.
[177] See footnote 169 above.
[178] Day 8/p64.
[179] 15th European Interchange Committee Agenda Item 1 dated 3 July 2006.

the decision of HSBC and RBS to reject MasterCard's bid in the procurement processes. Taking the evidence as a whole, we consider that the combined Maestro/Debit MasterCard offering was unattractive to these banks compared with the simplicity of the well-established Visa Debit offering.

Would the MasterCard Scheme collapse in the counterfactual?

260. Contrary to MasterCard's submissions, we do not consider that the Maestro example supports the contention that a significant difference in Interchange Fee rates between different cards will inevitably cause Issuing Banks to change scheme. We accept that the level of Interchange Fees is a factor bearing on the decisions that Issuing Banks will make in terms of scheme choice. The Maestro example demonstrates no more than the somewhat obvious point that the level of competing Interchange Fees is a factor bearing on the decision of Issuing Banks to participate in one payment scheme rather than another.

261. The question for us is whether the difference between a rate of 0.50% (the bilateral Interchange Fee that we find would have been agreed in the counterfactual world) and a rate of 0.80% (the rate that we assume Visa would maintain for its credit cards) would be sufficiently great to cause such a shift. We do not consider that it is:

(1) We concluded in paragraphs 159 to 164 above that Visa's Interchange Fees should not be assumed to be the same as MasterCard's on the counterfactual hypothesis, and that – all other things being equal – Visa would seek to maintain the differential between MasterCard's no-default MIF and Visa's MIF for as long as commercially possible.

(2) What we did not consider in paragraphs 159 to 164 was the effect on Visa of the sort of bilaterally agreed Interchange Fees that we find would have been concluded in the counterfactual world. Our conclusions in this regard are set out in paragraph 197. In paragraph 197(5), we noted that Visa might well itself come under commercial pressure to follow MasterCard's lead in abandoning the monolithic

"one size fits all" MIF, and instead encouraging Interchange Fees that reflect the different businesses of participating Merchants.

(3) In other words, the environment in which Issuing Banks would be considering whether to move away from MasterCard and towards Visa would contain within it a significant degree of uncertainty as to what Visa itself would do. Certainly, Issuing Banks would consider and take into account in their decision-making the difference between the MasterCard bilateral Interchange Fee and the Visa MIF, but they would also ask themselves "How long will this difference last?" and "Is it worth incurring the costs of migrating away from MasterCard and to Visa?" We consider that these difficult questions would incline Issuing Banks to stay within the Master Card Scheme.

(4) We observed in paragraph 61 above that Merchants and Acquiring Banks – unlike Issuing Banks – would find it difficult to abandon a well-established payment scheme like MasterCard or Visa, because of the (well-grounded) risk that customers participating in only one Scheme might take their custom elsewhere. As we noted in paragraph 61(1) above, it is striking that of the Merchants accepting payment by MasterCard, 100% also accept payment by Visa. Inevitably, this limits the extent to which Merchants and Acquiring Banks can bring pressure to bear on the operators of payment schemes to lower their rates. Whilst fully accepting the existence of these limits, it is nevertheless clear that Merchants and Acquiring Banks do have at least some influence. MasterCard itself recorded that "[t]he British Retail Consortium rejected the DMC ad-valorem pricing structure" [180]. Certain negotiations between Sainsbury's and Amex also demonstrate the sort of hard-edged dealings that can go on between Merchants and the operators of payment schemes.[181] Of course, we accept that Amex is not nearly as commonly used as a payment system as either MasterCard or Visa, and no doubt this strengthened Sainsbury's

[180] See paragraph 256 above.
[181] The Tribunal was shown various documents evidencing Amex and Sainsbury's negotiation of Amex's "discount rate" fee – emails during 13 March 2015 until 16 April 2015.

negotiating position, but nevertheless this is another example where a Merchant is negotiating with the operator of a payment system.

(5) In the counterfactual world, we consider that both Acquiring Banks and Merchants would – for their own reasons – seek to persuade Visa both to lower its MIF and to encourage a departure from a "one-size-fits all" Interchange Fee structure.

(6) In light of the foregoing, we consider that it is by no means a safe assumption that Visa would, in the counterfactual world, be able or inclined to maintain its MIF at 0.80%. Issuing Banks would be aware that this rate would have the potential to fall.

(7) Even if the MIF of 0.80% were maintained by Visa, we consider that Issuing Banks would not be inclined to move away from MasterCard in so dramatic a way as to materially prejudice the MasterCard Scheme as a payment system. We reach this conclusion for the following reasons:

(i) It is inaccurate to say that the difference in rates between MasterCard and Visa on the counterfactual hypothesis is the difference between 0.50% and 0.80%. As we have repeatedly made clear, we do not consider that the Interchange Fee paid by Merchants to Issuing Banks via Acquiring Banks would be calculated at an *ad valorem* rate of 0.50%. A 0.50% *ad valorem* charge covers the costs Issuing Banks would expect to recover, but does not reflect the way Merchants would be charged or Issuing Banks paid. We have concluded that Acquiring Banks would re-package the way they charged Merchants, so as to attract more Merchants to the scheme by evolving charging structures tailored to the Merchants' business. It is quite possible that Issuing Banks would receive more in Interchange Fees in the counterfactual world. The effective difference in rate between the MasterCard bilateral and Visa MIF would not

be so stark as the difference between 0.50% and 0.80% would suggest.

(ii) The point that Interchange Fees are but one factor informing an Issuing Bank's decision to participate in one payment scheme rather than another is underlined by the fact that Interchange Fees in the UK market are not uniform. Over the claim period, MasterCard's Interchange Fees were higher than Visa's, as is demonstrated by Table 8. The "blended" MIF for MasterCard credit card transactions over the claim period was 0.90%, whereas that for Visa credit card transactions was 0.80%. Equally, the "blended" MIF for MasterCard debit card transactions over the claim period was 0.36% (this is ignoring Maestro), whereas that for Visa debit card transactions was 0.26%. Although these differences are not as great as the difference between 0.50% and 0.80%, it is nevertheless of note that Visa did not feel inclined to increase its MIFs to match those of MasterCard. This simply underlines what we already know from the contemporaneous MasterCard documentation: that the Interchange Fee rate is "a" factor, but no more than that.

(iii) Of equal – perhaps greater – significance is the fact that the MasterCard Scheme was a well-established and well-functioning one, with an established client base. Given that the bilateral Interchange Fee that we consider would have been concluded in the counterfactual world would have been more than enough to enable Issuing Banks to cover their costs and make a profit, we consider that Issuing Banks would not have drifted away from the MasterCard Scheme on the counterfactual hypothesis.

262. MasterCard also argued that it would have lost significant market share to Amex in the counterfactual where it was prevented from implementing a MIF. We reject this contention, for the reasons provided in paragraphs 261(1) to

261(7) above, which apply mutatis mutandis. The evidence amply demonstrated that Amex would have faced very considerable pressure from merchants to lower its "discount rates" fees in the event that the MasterCard Scheme (and also perhaps the Visa Scheme) had implemented lower Interchange Fees. This finding was supported by documentary evidence of discussions between Sainsbury's and Amex in the context of the introduction of the 2015 Interchange Fee Regulations and the experience in Australia where regulatory measures had imposed a (relatively flexible) system of Interchange Fee capping.

263. Accordingly, we do not accept MasterCard's contention that removal of the UK MIF would result in the collapse of the MasterCard Scheme.

(iv) A less expansive scheme

264. We have noted that during the course of negotiations between MasterCard, Issuing Banks, Acquiring Banks and Merchants the point might be made that a less expansive scheme might be offered, at a lower cost. For instance, it might be suggested that a debit card only payment scheme be offered, eliminating credit and its costs.

265. Although we consider that the threat to scale back services would be made during the course of negotiations, we have concluded that a price would bilaterally be agreed between Issuing Banks and Acquiring Banks so as to enable the former to continue to offer the full benefits of the MasterCard Scheme to Merchants.

(v) Effect of appreciably restricting competition

266. We have concluded that if there was no UK MIF:

(1) The MasterCard Scheme would not undergo a significant collapse, even if the Visa UK MIF remained appreciably higher than the bilateral Interchange Fee that we find would have been agreed.

(2) The absence of the UK MIF would significantly affect the acquiring market, in that Acquiring Banks would no longer offer a Merchant Service Charge that was – in effect – the UK MIF, but would actually

be in a position to compete amongst themselves on price and to price in a manner intended to encourage Merchants to buy card acceptance services from them. In short, Acquiring Banks would be able properly to differentiate their services.

(3) The Interchange Fee would fall from around 0.90% to (the equivalent of) 0.50% in the case of MasterCard credit cards and from around 0.36% to (the equivalent of) 0.27% in the case of MasterCard debit cards. This conclusion, of course, supports Sainsbury's contention that the UK MIF constituted a "floor" below which the Interchange Fee could not go and, equally clearly, entails a rejection of MasterCard's contention that bilaterally negotiated Interchange Fees would have been no lower than the UK MIF. Because of the importance of this conclusion, it is appropriate that we set out our thinking in full:

(i) MasterCard's case involved a contention that the UK MIF set by MasterCard represented the outcome that would have been achieved in bilateral negotiations or else was sufficiently close to that outcome so as to render bilateral negotiations inefficient.

(ii) We accept that MasterCard sought to set the UK MIF at what it considered to be an "appropriate" level, taking account of all interests. In particular, we accept the evidence of Mr Willaert (set out at paragraph 102(3) above) in this regard.

(iii) However, we consider that the UK MIF – which, of course, operated as a default – would have accorded greater weight to the interests of Issuing Banks than to the interests of Acquiring Banks. This is simply because, whilst Issuing Banks do not have to issue MasterCard cards, and can choose between MasterCard, Visa and perhaps Amex, Merchants need to, and in practice do, accept payment via all rival systems, rather than just one. A Merchant choosing to accept payment by Visa, and not MasterCard, or *vice versa* would run the risk of losing sales for no real benefit. Thus, a Merchant who considers a default

Interchange Fee to be too high is left with the unattractive alternatives of:

(a) Complaining, but ultimately accepting the Interchange Fee.

(b) Refusing to accept the cards in question – which, for the reasons we have given, is an extreme course.

(c) Surcharging, which (particularly for organisations like Sainsbury's) is an unattractive course.[182] Although surcharging is not so extreme a course as refusing to accept a card altogether, it will nevertheless likely have the effect of deterring custom.

(iv) These negotiating weaknesses on the part of Merchants would also affect the position of Acquiring Banks, who would effectively be negotiating on the Merchants' behalf, with Issuing Banks; their negotiating position would be correspondingly weak.

(v) In the absence of any UK MIF, a bilaterally negotiated Interchange Fee removes this weakness on the part of Merchants / Acquiring Banks. Instead of the default being what MasterCard sets, Issuing Banks will have to justify to Acquiring Banks the Interchange Fees they seek, and we consider that Acquiring Banks would be able to negotiate on a much more level playing field with the Issuing Banks. In short, we consider that – despite additional transaction costs – a bilaterally negotiated Interchange Fee would not only be lower than the UK MIF, but would be significantly more efficient in terms of setting an appropriate price for the undoubtedly beneficial payment scheme services offered by the MasterCard

[182] See, for example, Brooks 1/§32.

Scheme. By “appropriate” we mean a price that would facilitate competition in the acquiring market.

267. For these reasons, we conclude that in the counterfactual world that would be likely to exist in the absence of a UK MIF set by MasterCard, there would be very significant and better competition in the acquiring market than existed in the real world over the claim period. We consider that neither the issuing market nor competition between payment schemes would be adversely affected. In these circumstances, we are of the view that the UK MIF was a restriction on competition by effect within the meaning of Article 101(1) TFEU.

268. As we have noted (in paragraph 17(2)(vi) above), MasterCard puts Sainsbury’s to proof that any restriction of competition had an appreciable effect on competition. An agreement will not be caught by Article 101(1) TFEU if it does not have an “appreciable” impact on competition.[183]

269. We can deal with this point relatively briefly. There is no doubt that the UK MIF had an appreciable effect: given the absence of any bilateral Interchange Fee agreements in the UK, the UK MIF was not simply the default Interchange Fee, it was the Interchange Fee. [184]

(vi) Is any level of MIF a restriction on competition?

270. From time-to-time in argument before us, it was contended that any level of MIF must be a restriction on competition. That, so it was suggested, is because a MIF – at whatever level – represents an agreement to fix the Interchange Fee.

271. Although it is not strictly necessary to decide it in the circumstances, we do not agree with this contention:

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[183] Case 5/69, *Völk v Vervaecke* [1969] ECR 295; Case C-226/11, *Expedia Inc v Autorité de la concurrence* [2013] 4 CMLR 14.

[184] The Commission’s “Notice on agreements of minor importance which do not appreciably restrict competition under Article 101(1) of the [TFEU] (De Minimis Notice)” suggests (in paragraph 8(a)) that horizontal agreements are presumed not to have any appreciable effect where the aggregate market share held by the parties to the agreement does not exceed 10% on any of the relevant markets affected by the agreement.

(1) We do not consider the case where there is no default at all to be a case where a default is implicitly set. A "no default" Interchange Fee scheme is just that: the chain of settlement of transactions between Cardholder, Issuing Bank, Acquiring Bank and Merchant is simply left unpriced, with no default price. The price remains something to be agreed between Issuing Banks and Acquiring Banks.

(2) More importantly, it does not follow from the conclusions we have reached that any MIF must, *ipso facto*, be a restriction on competition. The reason we consider the UK MIF as set in the real world to be a restriction by effect is because, although the UK MIF is an Interchange Fee ostensibly set as a default rate, the rate selected in fact precludes or inhibits the agreement of a true market price. That is the mischievous effect of the UK MIF on competition. As we have described in paragraph 266(3) above, given the dynamic between Acquiring Banks and Merchants on the one hand and Issuing Banks on the other, there is a danger that if the MIF is set too high, Issuing Banks will be disinclined to negotiate, and Acquiring Banks/Merchants will not have the market power to make them.

(3) It follows that a MIF that is at a level that still incentivises Issuing Banks to negotiate with Acquiring Banks and which does not preclude or inhibit the agreement of a true market price would very arguably not – at least on the facts of this case – amount to a restriction on competition.

(6) Objective Necessity

(a) The law

272. In *MasterCard*, the Court of Justice stated:

"89. It is apparent from the case-law of the Court of Justice that if a given operation or activity is not covered by the prohibition rule laid down in Article [101(1) TFEU], owing to its neutrality or positive effect in terms of competition, a restriction of the commercial autonomy of one or more of the participants in that operation or activity is not covered by that prohibition rule either if that restriction is objectively necessary to the implementation of that

operation or that activity and proportionate to the objectives of one or the other…

90. Where it is not possible to dissociate such a restriction from the main operation or activity without jeopardising its existence and aims, it is necessary to examine the compatibility of that restriction with [Article 101 TFEU] in conjunction with the compatibility of the main operation or activity to which it is ancillary, even though, taken in isolation, such a restriction may appear on the face of it to be covered by the prohibition rule in Article [101(1) TFEU].

91. Where it is a matter of determining whether an anti-competitive restriction can escape the prohibition laid down in [Article 101(1) TFEU] because it is ancillary to a main operation that is not anti-competitive in nature, it is necessary to inquire whether that operation would be impossible to carry out in the absence of the restriction in question. Contrary to what the appellants claim, the fact that that operation is simply more difficult to implement or even less profitable without the restriction concerned cannot be deemed to give that restriction the 'objective necessity' required in order for it to be classified as ancillary. Such an interpretation would effectively extend that concept to restrictions which are not strictly indispensible to the implementation of the main operation. Such an outcome would undermine the effectiveness of the prohibition laid down in [Article 101(1) TFEU]."

273. The exception to the Article 101(1) TFEU prohibition is best considered in stages:

(1) First, there must be a given "operation" or "activity" that is <u>not</u> caught by the prohibition because of its neutrality or positive effect in terms of competition. In this case, that "operation" or "activity" is the MasterCard Scheme.

(2) Secondly, there must be inherent to this operation or activity, but ancillary to it, a restriction of commercial activity that would – but for its relation to that operation or activity – be caught by the Article 101(1) TFEU prohibition. In this case, that restriction is the agreement regarding the setting of the UK MIF that we have considered.

(3) Thirdly, the relationship between the "operation" or "activity" <u>not</u> prohibited and the restriction that would otherwise be prohibited must be such that <u>without the restriction</u> the primary operation or activity <u>could not be carried out</u>. In a sense, this requirement is captured by the words "inherent" and "ancillary" in the previous sub-paragraph, but they perhaps do not emphasise enough the fact that the test is an

extremely high one. The mere fact that the removal of the restriction would render the primary operation or activity less profitable or more difficult or would have adverse consequences for its functioning is not enough. In the words of the Court of Justice, "it is necessary to inquire whether that operation would be impossible to carry out in the absence of the restriction in question" (emphasis added).

(4) Fourthly, the restriction must not only be necessary for the implementation of the main operation or activity: it must also be proportionate to the underlying objectives of that operation or activity.

274. The question arises as to how the objective necessity of the ancillary restriction is to be demonstrated. How is a court to satisfy itself that the primary operation or activity is indeed impossible to carry on instead of merely more difficult or less profitable? The question really is whether the ancillary restriction can be detached from the primary operation or activity without rendering that operation or activity impossible to carry on, and it is answered through the use of a "counterfactual hypothesis".

275. In *MasterCard*, the Court of Justice had this to say about counterfactual hypotheses. As a general proposition – relevant to all counterfactuals – "it is important that that hypothesis is appropriate to the issue it is supposed to clarify and that the assumption on which it is based is not unrealistic".[185]

276. Moving on to counterfactual hypothesis in the specific context of ancillary restrictions, the Court of Justice held:

> "109. Accordingly, in order to contest the ancillary nature of a restriction…the Commission may rely on the existence of realistic alternatives that are less restrictive of competition than the restriction at issue.
>
> …
>
> 111. …the alternatives on which the Commission may rely in the context of the assessment of the objective necessity of a restriction are not limited to the situation that would arise in the absence of the restriction in question but may also extend to other counterfactual hypotheses based, inter alia, on realistic situations that might arise in the absence of that restriction."

[185] Paragraph 108.

277. Thus, when considering the appropriate counterfactual hypothesis, it is not obligatory only to consider what would happen if the ancillary restriction were removed altogether. Provided that the hypothesis meets the overriding touchstone of being realistic, it is entirely proper for the counterfactual to postulate the existence of some restriction different from that existing in the real world. If such a lesser restraint is realistic and enables the main operation or activity to be economically viable, then the restraint is not truly ancillary.

278. As regards objective necessity, it is necessary to note two points:

(1) Whether a restrictive provision is objectively necessary to the main operation or activity (which is not restrictive of competition) is a question distinct from the question of whether that provision can be justified under Article 101(3) TFEU.[186]

(2) Market definition plays no role in formulating the appropriate counterfactual used to determine whether a restraint is objectively necessary for the operation of the main activity or not. The Court of Justice implicitly approved the statement by the General Court (in the decision appealed against) that "…considerations relating to the indispensable nature of the restriction in the light of the competitive situation on the relevant market are not part of an analysis of the ancillary nature of the restriction…".[187] This is unsurprising: the definition of the market in which the main activity occurs does not assist in answering the question of whether the main activity could be performed absent the ancillary restriction.

(b) Objective necessity in the present case

279. In the light of our conclusion that – absent a UK MIF – a perfectly viable bilateral Interchange Fee would have been agreed between the Issuing and the Acquiring Banks, we consider that the question of objective necessity answers itself. The legal analysis we were taken to, and which we have set out above, does not especially assist, since this is not a marginal case. It is plain that the

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[186] See *MasterCard* at paragraphs 91 to 93.
[187] See *MasterCard* at paragraph 81.

UK MIF was on no view inherently necessary to the operation of the MasterCard Scheme. The Scheme would operate perfectly well – indeed, it would be more competitive and better – without the UK MIF.

I. Exemptibility under Article 101(3) TFEU

(1) Introduction

280. MasterCard contends in its defence that the UK MIF as set was exemptible. Paragraph 87 of MasterCard's Re-Amended Defence states that "MasterCard will contend and put forward evidence to demonstrate that the conditions of section 9 of the Competition Act 1998, Article 101(3) TFEU and Article 53(3) EEA were met in relation to the UK MIFs in force for such period as is relevant".

281. This defence, if successful, would be a complete defence to Sainsbury's claim.

282. In this Section we consider:

(1) First, in Section I(2) below, in general terms the conditions that have to be met in order for an agreement that is restrictive of competition to be exempted.

(2) Secondly, in Section I(3) below, the application of these conditions to the setting of the UK MIF.

(2) Conditions for Exemption

283. An agreement that infringes Article 101(1) TFEU is not necessarily unlawful: Article 101(1) TFEU may be declared "inapplicable" provided four cumulative conditions are met:[188]

(1) The agreement must contribute to improving the production or distribution of goods, or to promoting technical or economic progress.

(2) Consumers must receive a fair share of the resulting benefits.

[188] See the notice of the Commission of the European Union entitled Guidelines on the Application of Article 81(3) of the Treaty (2004/C 101/08) (the "Commission's Article 81(3) Guidelines") at paragraph 34.

(3) The restrictions must be indispensable to the attainment of these objectives.

(4) The agreement must not afford the parties the possibility of eliminating competition in respect of a substantial part of the products in question.

284. These four cumulative conditions are each expanded upon in the Commission's Article 81(3) Guidelines. We refer to these Guidelines as necessary below.

(3) Application of these Conditions to the UK MIF

285. We have concluded that, on the counterfactual hypothesis, bilateral Interchange Fees would have been agreed between Issuing and Acquiring Banks. Although we consider that Interchange Fees would have been agreed so as to provide an equivalent revenue to 0.50% per transaction in the case of MasterCard credit cards and 0.27% in the case of MasterCard debit cards, we stress again that this is not how we consider Interchange Fees would be likely to be structured on the counterfactual hypothesis. We consider that these bilateral Interchange Fees would have involved the development of novel charging structures between Issuing Banks and Acquiring Banks/Merchants. In other words, the manner in which Merchants would pay would be differently structured; and, as a consequence, the revenue flows to Issuing Banks would not be calculated by reference to an *ad valorem* rate per transaction.

286. We also concluded that one of the reasons why bilateral Interchange Fees were not agreed in the "real" world is because of the existence of the UK MIF. In other words, the fact that the UK MIF effectively guaranteed a revenue flow of 0.90% per transaction rendered the Issuing Banks (given their negotiating strength vis-à-vis Acquiring Banks and Merchants) most unlikely to engage in negotiation, particularly if those negotiations were aiming at an Interchange Fee of less than 0.90%.

287. For this reason, it is very difficult to see how the UK MIF as actually set can possibly be exempted under Article 101(3) TFEU. We reach this conclusion

accepting as correct MasterCard's contention that the beneficial effects of the UK MIF had to be assessed across all three relevant markets – the market between payment systems, the "issuing" market and the "acquiring" market.[189] In short, the Tribunal was not confined to considering benefits arising solely on the acquiring market, and has not so confined itself.[190] Although Mr von Hinten-Reed only considered benefits arising on the acquiring market – an approach that he felt was compelled by Article 101(3) TFEU[191] – we reject that approach as inconsistent with the manner in which the relevant markets must be defined and inconsistent with the true nature of the markets in which the UK MIF operates.

288. Nevertheless, it is our clear view that the UK MIF as set cannot be exempted under Article 101(3). We consider that none of the cumulative conditions for exemption are met:

(1) *Condition 1: The agreement must contribute to improving the production or distribution of goods, or to promoting technical or economic progress.* The UK MIF does not contribute to improving the production or distribution of goods, or to promoting technical or economic progress. As we have found:

(i) The UK MIF is not necessary to the operation of the MasterCard Scheme. It does not, in fact, make any contribution to the Scheme, beyond the saving of the transaction costs that would be incurred in negotiating bilateral agreements.

(ii) The UK MIF as set in fact acts as an inhibitor to economic progress, frustrating bilateral negotiations between Issuing Banks and Acquiring Banks/Merchants, creating upward

[189] We consider that this follows inevitably from the conclusion we reached in relation to the markets relevant to assessing whether the setting of the UK MIF had the effect of appreciably restricting competition. In paragraph 137 above, we concluded that we needed to consider actual and potential anti-competitive effects for the purposes of Article 101(1) TFEU in three markets – the issuing market, the acquiring market and the market between payment systems. It would be perverse for the markets relevant to an assessment of exemptibility under Article 101(3) TFEU to be any narrower.
[190] MasterCard Closing/§§207-208.
[191] See, in particular, the exchange at Day 14/pp169-170.

pressure on MSCs, and preventing new charging structures from arising.

(2) *Condition 2: Consumers must receive a fair share of the resulting benefits.* Since we are of the view that the UK MIF as set is essentially detrimental in effect, it follows that this question does not actually arise. There are no "resulting benefits" to share with consumers.

(3) *Condition 3: The agreement must be indispensable to the attainment of these objectives.* It is our conclusion that the UK MIF is not indispensable to the operation of the MasterCard Scheme. Accordingly, even though we accept that the MasterCard Scheme itself is highly beneficial, that is irrelevant. We accept (indeed, it is *ex hypothesi*) that the UK MIF is indispensable in avoiding the transaction costs of bilateral agreements, but that is all.

(4) *Condition 4: The agreement must not afford the parties the possibility of eliminating competition in respect of a substantial part of the products in question.* This, as we have concluded, is exactly what the UK MIF does do: even though, as we have accepted, MasterCard seeks to create the "right" price as between the issuing and the acquiring markets, the effect of inter-market competition drives the UK MIF upwards, and prevents or inhibits the negotiation of a proper – market-based – Interchange Fee as between the issuing and acquiring markets. In short, as we have found, the UK MIF has the effect of precluding or inhibiting competition.

289. Both MasterCard and Sainsbury's addressed us on what might be an exemptible level of MIF and adduced much evidence in this regard, in particular from Mr von Hinten-Reed and Dr Niels. In deference to the arguments and evidence of the parties, it may assist if we make the following points:

(1) We consider that an "exemptible" MIF must, as a starting point, reflect the fact that it represents a price in three markets: it is the price paid by Merchants/Acquiring Banks in the acquiring market; it is the price

received by Issuing Banks in the issuing market; and it is a price that affects inter-scheme competition, in that the relative Interchange Fees between schemes (e.g. as between MasterCard and Visa) will be a factor (but no more than that) bearing on Issuing Banks as to what card types they issue.

(2) In other words, the MIF acts as a "pivot" or the "see-saw" between various markets. For this reason, a MIF that is calibrated by reference to one market only, ignoring the others, is fundamentally inappropriate. This approach is consistent with the Court of Justice's *dicta* at paragraphs 237-242 of its *MasterCard* judgment:

"237 [I]n the case of a two-sided system such as the MasterCard scheme, in order to assess whether a measure which in principle infringes the prohibition laid down in Article [101(1) TFEU]— in so far as it creates restrictive effects in regard to one of the two groups of consumers associated with that system — can fulfil the first condition laid down in Article [101(3) TFEU], it is necessary to take into account the system of which that measure forms part, including, where appropriate, all the objective advantages flowing from that measure not only on the market in respect of which the restriction has been established, but also on the market which includes the other group of consumers associated with that system, in particular where, as in this instance, it is undisputed that there is interaction between the two sides of the system in question. To that end, it is necessary to assess, where appropriate, whether such advantages are of such a character as to compensate for the disadvantages which that measure entails for competition.

238 However, in the present case, LBG's argument that the General Court wrongly ignored the two-sided nature of the system cannot be accepted. As noted in paragraph 233 of the present judgment, in paragraphs 208 to 219 of the judgment under appeal, the General Court examined the appellants' arguments as to the role of the MIF in balancing the 'issuing' and 'acquiring' sides of the MasterCard system and, for that purpose, specifically recognised, in paragraph 210 of that judgment, that there was interaction between those two sides. The fact that the General Court concluded that the argument that the MIF contribute to increasing the output of the system should be rejected does not alter the fact that the General Court took the two-sided nature of the system in question into account in its analysis.

239 Likewise, the General Court also took into account the two-sided nature of the system when examining the advantages flowing from the MIF that are enjoyed by merchants, notably in paragraphs 222 and 223 of the judgment under appeal, in which it recognised that the increase in the number of cards in circulation may increase the utility of the MasterCard system as far as merchants are concerned, even

though, in its definitive assessment of the facts, the General Court concluded that the risk of adverse effects for merchants is higher the greater the number of cards in circulation.

240 In particular, as regards the argument by which LBG complains that the General Court did not take into account the advantages flowing from the MIF for cardholders, it must be held that, in the light of what has been stated in paragraphs 234 to 236 of the present judgment, the General Court was, in principle, required, when examining the first condition laid down in Article [101(3) TFEU], to take into account all the objective advantages flowing from the MIF, not only on the relevant market, namely the acquiring market, but also on the separate but connected issuing market.

241 It follows from this that, should the General Court have found that there were appreciable objective advantages flowing from the MIF for merchants, even if those advantages did not in themselves prove sufficient to compensate for the restrictive effects identified pursuant to Article [101(1) TFEU], all the advantages on both consumer markets in the MasterCard scheme, including therefore on the cardholders' market, could, if necessary, have justified the MIF if, taken together, those advantages were of such a character as to compensate for the restrictive effects of those fees.

242 However, as is recalled in paragraph 234 of the present judgment, examination of the first condition laid down in Article [101(3) TFEU] raises the question whether the advantages derived from the measure at issue are of such a character as to compensate for the disadvantages resulting therefrom. Thus, where, as in the present case, restrictive effects have been found on only one market of a two-sided system, the advantages flowing from the restrictive measure on a separate but connected market also associated with that system cannot, in themselves, be of such a character as to compensate for the disadvantages resulting from that measure in the absence of any proof of the existence of appreciable objective advantages attributable to that measure in the relevant market, in particular, as is apparent from paragraphs 21 and 168 to 180 of the judgment under appeal, where the consumers on those markets are not substantially the same."

(3) For this reason, we reject the MIT as an appropriate measure for an exemptible level of MIF. We described the MIT, as it is known, in paragraphs 227 to 228 above. As Mr von Hinten-Reed explained, the MIT is a test used to determine the extent to which – in a one-off transaction – a Merchant would prefer payment by card rather than cash. If cash is more expensive than payment by card, then the Merchant will prefer payment by card. If payment by card is more expensive than payment by cash, then the Merchant will prefer payment in cash. If the costs are the same, the Merchant will, truly, be indifferent.

(4) There are many problems with the MIT:

(i) Second-order problems arise out of the difficulties in applying the MIT in order to calculate the MIT-MIF. The MIT – being the extent to which a Merchant saves money by offering payment by card rather than cash – is not actually a test used by Merchants. Merchants, quite rightly and rationally, focus on the benefits (in terms of attracting customers) of offering payment by card. Accordingly, the level of the MIT-MIF has in the past been calculated by reference to specially conducted surveys. MasterCard was, quite rightly, very sceptical of the accuracy of these surveys. Mr von Hinten-Reed – who was himself hugely sceptical of the value of Sainsbury's own returns in these surveys[192] – in fact conducted his own analysis, based upon only Sainsbury's own data. Of course, that fact (as Mr von Hinten-Reed accepted) has the effect of skewing the analysis; but the fact that Mr von Hinten-Reed had to analyse Sainsbury's own data in order to reach his assessment of the MIT-MIF – which he put at 0.15% - simply underlines the practical difficulties of this measure.

(ii) More fundamentally, the MIT only works where payment by cash is an alternative to payment by card. Only where these alternatives exist, is it possible to compute the cost advantages to a Merchant of using one, rather than the other. The case of on-line transactions – where cash simply cannot be used – thus presents something of a problem. The answer is either to leave such transactions out of account or to find some proxy for cash (such as PayPal or Amex). Neither course is satisfactory; and this simply serves to underline the essential unsuitability of the MIT as a measure.

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[192] In cross-examination Mr von Hinten-Reed stated that Sainsbury's, in its response for the survey had "got it horribly wrong" and that the submission "wasn't fit for purpose". He had advised Sainsbury's not to submit its draft response, but it appears that there was an internal miscommunication and the response was sent against his advice (Day 13/pp101-103).

(iii) Further, the MIT is a test that is wholly unfit for purpose:

(a) We have already noted that the MIT does not actually look at the advantages gained by Merchants through the use of cards, even though this will be the driver for Merchants accepting payment by card, and Merchants will not consider the MIT.

(b) Even more importantly, the MIT leaves out of account altogether the costs of card schemes in the issuing market. In other words, the MIT will sanction as "exemptible" a rate that is well below the costs of Issuing Banks and below the proportion of those costs from which Merchants benefit. The point is well-illustrated by reference to the 2005 Cost Study summarised in Table 9 above. As we have said, Mr Von Hinten Reed's calculation of the MIT-MIF was 0.15%, which is 0.01% below the processing costs of Issuing Banks as calculated in the 2005 Cost Study. The MIT approach regards this outcome as perfectly acceptable, even though Issuing Banks are not even recovering the costs of a service that is unequivocally for the benefit of the Merchant (because it causes monies to move from the Cardholder to the Merchant).[193]

(5) That leads us to the most fundamental objection to the MIT, which is that it looks (and even then in an odd and indefensible way) to only one market, the acquiring market. It ignores the fact that a MIF is a price in more than one market.

(6) In order properly to reflect the demands of Article 101(3) TFEU, an exemptible MIF needs to function as a defensible price in all relevant

[193] We are, of course, assuming the figures to be correct: but that is precisely the point. The MIT-MIF sees nothing wrong with this palpably absurd outcome.

markets, but in particular in the issuing and acquiring markets. For this reason, an exemptible MIF must:

(i) Assess the benefits of a card scheme derived by Acquiring Banks and, more particularly, Merchants.

(ii) Quantify the costs to Issuing Banks of those benefits.

(7) That, two-stage, process is essentially the one we have conducted in relation to credit cards in paragraphs 211*ff* above, based upon the 2005 and 2008 Cost Studies and – but for our conclusion regarding the negotiation of bilateral Interchange Fees – this is the course we would have followed. We would, in short, have concluded that a MIF could be exempted at 0.46%, for the reasons given in paragraphs 219 to 222 above. (We have obviously ignored the uplift beyond this percentage that Issuing Banks might have negotiated: the bilateral Interchange Fee of 0.50% turns on Issuing Bank's ability to negotiate a slightly better deal with the acquiring market, because the acquiring market has less than perfect knowledge of issuing market costs. That, however, is not a factor that pertains when calculating an "exemptible" MIF.)

(8) However, for the reasons given in Section H above, we have concluded that bilateral Interchange Fees in relation to credit cards <u>would</u> have been concluded and it is not, therefore, necessary for us to express a final view on the exemptible level of a UK MIF. The conclusions that we have reached are that:

(i) On no view can the UK MIF <u>as set</u> be exempted; and

(ii) <u>Assuming</u> a bilaterally agreed Interchange Fee of 0.50%, a MIF of 0.46% would (for the reasons given in paragraphs 266 to 271 above) preclude or at the very least substantially inhibit the conclusion of a bilaterally agreed Interchange Fee. We consider that a MIF of 0.46% could only be regarded as potentially exemptible <u>absent</u> the likelihood of a bilaterally agreed Interchange Fee.

(9) Similarly, in relation to debit cards, we concluded that a bilateral Interchange Fee of 0.27% would be agreed. Apart from the difference in rate, our conclusions as expressed in relation to credit cards apply equally to debit cards.

J. Illegality

(1) Introduction

290. It was common ground that the so-called "illegality" or *ex turpi causa* defence was a defence principally defined by English law. However, both parties appeared to accept a substantial "EU" gloss to aspects of the defence, which it will be necessary to consider.

291. In *Les Laboratoires Servier v Apotex (No 3)* [2014] UKSC 55, [2015] IP&T 1 at paragraph 22, Lord Sumption summarised the elements of an *ex turpi causa* defence as follows:

> "..The application of the ex turpi causa principle commonly raises three questions: (i) what acts constitute turpitude for the purpose of the defence? (ii) what relationship must the turpitude have to the claim? (iii) on what principles should the turpitude of an agent be attributed to his principal, especially when the principal is a corporation?..."

292. This constitutes a helpful framework for considering the illegality defence raised by MasterCard. Using this framework, MasterCard's case can be stated as follows:

(1) *The turpitude.* The acts alleged to constitute the turpitude are, in this case, the fact that Sainsbury's Bank was an Issuing Bank under the MasterCard Scheme. As such, it issued MasterCard Cards; agreed – pursuant to the MasterCard Scheme Rules and as has been described in paragraph 45 above – in the setting of the UK MIF (even if this was actually set by MasterCard); and was the recipient of MIFs in those cases where Cards issued by it were used with Merchants.

(2) *Relationship of the turpitude to the claim.* Assuming, for this purpose, that any turpitude by Sainsbury's Bank can be attributed to Sainsbury's, then Sainsbury's is, on the one hand, claiming damages

for a UK MIF that was too high and which it paid as a Merchant in circumstances where it received that overpayment from Acquiring Banks in its capacity as Issuing Bank in respect of each transaction involving a Sainsbury's Bank issued MasterCard. (Of course, there is no precise correlation between these payments: as Merchant, Sainsbury's will have paid the MIF in respect of all MasterCard transactions with it, irrespective of the Issuing Bank who issued the card; and Sainsbury's Bank will have received the UK MIF in respect of all MasterCard transactions using cards issued by it, irrespective of whether these were with Sainsbury's as Merchant.)

(3) *Attribution of the turpitude.* It is here that the "EU" gloss mentioned in paragraph 290 particularly comes into play. Sainsbury's Bank is, of course, a different legal person from Sainsbury's. Under English domestic law, it is by no means clear how the acts of Sainsbury's Bank might be attributed to Sainsbury's. We were not addressed on the law on this point, and proceed on the basis (which appeared to be accepted by MasterCard) that if English law applied, there could be no attribution of the conduct or state of mind of Sainsbury's Bank to Sainsbury's. MasterCard advanced no case on this point, but contended that the question of attribution was, in a case such as this, substantially governed by principles of European law. MasterCard contended that the turpitude of Sainsbury's Bank could be attributed to Sainsbury's by reason of the fact that they form part of a single economic entity or "undertaking" as that concept is defined in the case law of the Court of Justice.

293. EU law is also relevant in considering the extent to which one party to an anti-competitive agreement is precluded from bringing a claim as against another party to that agreement. This is an aspect of the illegality defence that is specific to competition claims, and arises out of the decision of the Court of Justice in Case C-453/99, *Courage Ltd v Crehan*, [2001] ECR I-6297, [2002] 1 QB 507, where the Court of Justice stated that it would not be contrary to the principles of EU law to deny a party who is found to bear significant

responsibility for the distortion of competition the right to obtain damages from the other contracting party. The corollary, of course, is that a party not having significant responsibility should not be precluded from bringing a claim by an illegality defence.

294. We consider this question of "significant responsibility" after the questions of *(i)* the turpitude, *(ii)* the relationship of the turpitude to the claim and *(iii)* the attribution of the turpitude.

(2) The Turpitude

(a) The law

(i) A crossroads

295. As has been noted in Professor Burrows' *A Restatement of the English Law of Contract*,[194] the illegality defence has recently been considered in no fewer than three Supreme Court decisions – *Hounga v Allen* [2014] UKSC 47, [2014] 1 WLR 2889; *Apotex* (see paragraph 291 above); and *Jetivia SA v Bilta (UK) Ltd* [2015] UKSC 23, [2015] 2 WLR 1168.[195]

296. In *Hounga*, the Supreme Court's approach towards illegality – including the definition of "turpitude" – turned "on a consideration of various public policy factors with a focus on preserving the integrity of the legal system, which in turn involved examining whether the claimant had profited from the wrongdoing and deterrence".[196]

297. By contrast, the approach of the majority in *Apotex*[197] was to adopt a much more "rule-based" than "policy-oriented" approach to illegality, following the approach of the House of Lords in *Tinsley v Milligan* [1994] 1 AC 340, which itself had rejected a more "policy-oriented" approach in the Court of Appeal, notably in *Euro-Diam Ltd v Bathurst* [1990] 1 QB 1.

[194] Burrows, *A Restatement of the English Law of Contract*, 1st ed (2016) ("*Restatement*"), p222.
[195] We are conscious that a fourth illegality case – *Patel v Mirza* (with a Supreme Court Case ID of 2014/0218) – has been heard, but not yet determined, by the Supreme Court.
[196] *Restatement* at p222.
[197] Lord Sumption gave the majority judgment. Lords Neuberger and Clarke agreed without handing down their own judgments. In his separate judgment, Lord Mance agreed with Lord Sumption (at paragraph 34). Neither judgment mentioned *Hounga*. Lord Toulson took an approach which was based on *Hounga*.

298. In *Apotex*, Lord Sumption described the difference between the two approaches – and the case-law culminating in *Tinsley v Milligan* – as follows:

> "14 The question what is involved in "founding on an immoral or illegal act" has given rise to a large body of inconsistent authority which rarely rises to the level of general principle. The main reason for the disordered state of the case law is the distaste of the courts for the consequences of applying their own rules, consequences which Lord Mansfield had pointed out two centuries ago. The only rational way of addressing this problem, if these consequences are regarded as intolerable, is to transform the rule into a mere power whose actual exercise would depend on the perceived equities of each case. The most notable modern attempt to achieve this transformation was made by the Court of Appeal in *Euro-Diam Ltd v Bathurst* [1990] 1 QB 1, in which the illegality defence was invoked in response to a claim on a property insurance. The Court of Appeal placed the reported cases in a number of distinct factual categories, united by a common principle. Kerr LJ, delivering the only reasoned judgment, expressed that principle, at p 35, by saying that the test was whether
>
> > "in all the circumstances it would be an affront to the public conscience to grant the plaintiff the relief which he seeks because the court would thereby appear to assist or encourage the plaintiff in his illegal conduct or to encourage others in similar acts."
>
> That question, he suggested, needed to be approached "pragmatically and with caution, depending on the circumstances". Under this "public conscience" test, the application of the illegality defence was not discretionary in law. But it was clearly discretionary in nature. In substance it called for a value judgment about the significance of the illegality and the injustice of barring the claimant's claim on account of it.
>
> 15 This development had been foreshadowed by some earlier decisions of the Court of Appeal. But it was decisively rejected by the House of Lords in *Tinsley v Milligan* [1994] 1 AC 340. That appeal arose out of an agreement under which two ladies bought a house to live in out of jointly owned funds. They agreed to vest it in one of them alone so that the other could claim social security benefits on the fraudulent basis that she did not own her home and was paying rent. In the ordinary course, the joint purchase of property by two people in the name of one of them would give rise to an equitable proprietary interest in the other. The question was whether the assertion of this interest in a court of law was debarred by the dishonesty of the parties' purpose. The Court of Appeal, by a majority, had applied the "public conscience" test. Ralph Gibson LJ dissented, observing in his judgment [1992] Ch 310, 334, that:
>
> > "[i]n so far as the basis of the ex turpi causa defence, as founded on public policy, is directed at deterrence it seems to me that the force of the deterrent effect is in the existence of the known rule and in its stern application. Lawyers have long known of the rule and must have advised many people of its existence."
>
> 16 In the House of Lords, the committee was divided on the correct test as well as on the correct result. But it was unanimous in rejecting the public conscience test, on the ground that it was unprincipled. The leading speech on

this point was that of Lord Goff. Like almost every court which has reviewed the question, he took as his starting point the statement of Lord Mansfield CJ in Holman v Johnson 1 Cowp 341, 343. He observed [1994] 1 AC 340, 355:

> "That principle has been applied again and again, for over 200 years. It is applicable in courts of equity as well as courts of law: see, e g, the notes to *Roberts v Roberts* (1818) Dan 143, 150—151 and *Ayerst v Jenkins* (1873) LR 16 Eq 275, 283, *per* Lord Selborne LC. In 1869 Mellor J said that the maxim in pari delicto potior est conditio possidentis 'is as thoroughly settled as any proposition of law can be:' see *Taylor v Chester* (1869) LR 4 QB 309, 313. It is important to observe that, as Lord Mansfield made clear, the principle is not a principle of justice; it is a principle of policy, whose application is indiscriminate and so can lead to unfair consequences as between the parties to litigation. Moreover the principle allows no room for the exercise of any discretion by the court in favour of one party or the other."

Lord Goff acknowledged, at p 364D-E that:

> "The real criticism of the present rules is not that they are unprincipled, but rather that they are indiscriminate in their effect, and are capable therefore of producing injustice."

Indeed, in the case before him, he regarded the claimant's misconduct as "relatively minor" and pointed out that she had already made amends for it by repaying the sums dishonestly obtained in social security benefits. However, he considered that the illegality defence was governed by "established rules of law": p 364F. Endorsing the view of Ralph Gibson LJ in the passage from which I have cited above, he rejected, at p 358E-F, the public conscience test as contrary to 200 years of authority, because it required the court to:

> "weigh, or balance, the adverse consequences of respectively granting or refusing relief. This is little different, if at all, from stating that the court has a discretion whether to grant or refuse relief. It is very diffcult to reconcile such a test with the principle of policy stated by Lord Mansfield CJ in *Holman v Johnson*…or with the established principles to which I have referred."

Its adoption, he said, p 363B:

> "would constitute a revolution in this branch of the law, under which what is in effect a discretion would become vested in the court to deal with the matter by the process of a balancing operation, in place of a system of rules, ultimately derived from the principle of public policy enunciated by Lord Mansfield CJ in Holman v Johnson."

As he pointed out, at p 362G-H, short of treating the application of the rule as discretionary, it is difficult to make a principled distinction between degrees of iniquity.

17 Lord Browne-Wilkinson, at p 369B, agreed with Lord Goff on this point, observing that:

> "the consequences of being a party to an illegal transaction cannot depend, as the majority in the Court of Appeal held, on such an imponderable factor

> as the extent to which the public conscience would be affronted by recognising rights created by illegal transactions."
>
> The other members of the Committee all agreed with the speeches of Lord Goff and Lord Browne-Wilkinson on this point."

299. Thus, the nature of what amounts to "turpitude" is at a crossroads. In the third illegality case to reach the Supreme Court – *Jetivia* – Lord Neuberger (giving the joint judgment of himself, Lord Clarke and Lord Carnwath) recognised this, but did not determine the direction in which the law should go:[198]

> "[W]hile the proper approach to the defence of illegality needs to be addressed by this court…as soon as appropriately possible, this is not the case in which it should be decided. We have had no real argument on the topic: this case is concerned with attribution, and that is the issue on which the arguments have correctly focussed. Further, in this case, as in the two recent Supreme Court decisions of *Les Laboratoires* and *Hounga*, the outcome is the same irrespective of the correct approach to the illegality defence."

300. In these circumstances, it is appropriate first to state both approaches to "turpitude" before considering their application to the facts.

(ii) The "rule-based" approach

301. In *Apotex*, Lord Sumption considered what amounted to "turpitude". He noted that, in *Holman v Johnson* 1 Cowp 241, Lord Mansfield CJ had referred not only to criminal acts as amounting to "turpitude", but also "immoral or illegal ones".[199] Lord Sumption considered that what was meant by this was "acts which engage the interests of the state or, as we would put it today, the public interest. The illegality defence, where it arises, arises in the public interest, irrespective of the interests or rights of the parties. It is because the public has its own interest in conduct giving rise to the illegality defence that the judge may be bound to take the point of his own motion, contrary to the ordinary principle in adversarial litigation".[200]

302. In paragraph 25, Lord Sumption said as follows:

> "The ex turpi causa principle is concerned with claims founded on acts which are contrary to the public law of the state and engage the public interest. The paradigm case is, as I have said, a criminal act. In addition, it is concerned with a limited

[198] At paragraph 15.
[199] At paragraph 23.
[200] At paragraph 23.

category of acts which, while not necessarily criminal, can conveniently be described as "quasi-criminal" because they engage the public interest in the same way. Leaving aside the rather special case of contracts prohibited by law, which can give rise to no enforceable rights, this additional category of non-criminal acts giving rise to the defence includes cases of dishonesty or corruption, which have always been regarded as engaging the public interest even in the context of purely civil disputes; some anomalous categories of misconduct, such as prostitution, which without itself being criminal are contrary to public policy and involve criminal liability on the part of secondary parties; and the infringement of statutory rules enacted for the protection of the public interest and attracting civil sanctions of a penal character, such as the competition law considered by Flaux J in *Safeway Stores Ltd v Twigger…*"

303. In *Safeway Stores Ltd v Twigger* [2010] EWHC 11 (Comm), [2010] Bus LR 974, Flaux J noted (at paragraph 24) that the *ex turpi causa* rule was not confined to criminal acts, and <u>could</u> extend to anti-competitive acts in breach of the Chapter I prohibition (at paragraphs 24 to 43). *Twigger* was appealed to the Court of Appeal ([2010] EWCA Civ 1472, [2011] Bus LR 1629), where the case was decided on different grounds. Nevertheless, Flaux J's conclusion that a breach of the Chapter I prohibition (and, no doubt, other infringements of competition law) is capable of triggering the illegality defence was not contradicted by the Court of Appeal and has clearly received the imprimatur of the Supreme Court.

304. Liability under Article 101 TFEU is – to a certain extent – strict, in that it is no defence to assert that there was no intention to breach competition law. It is perfectly possible to breach Article 101 TFEU innocently, negligently or deliberately. It would seem to be essentially inconsistent with the basis of and *rationale* for the illegality defence for essentially innocent conduct to trigger that defence.

305. In *Apotex*, Lord Sumption noted (at paragraph 29):

"It is right to add that there may be exceptional cases where even criminal and quasi-criminal acts will not constitute turpitude for the purposes of the illegality defence. In *Gray v Thames Trains Ltd* [2009] AC 1339, para 83, Lord Rodger of Earlsferry suggested that some offences might be too trivial to engage the defence. In general, however, the exceptional cases are implicit in the rule itself. This applies in particular where the act in question was not in reality the claimant's at all. Leaving aside questions of attribution which arise when an agent is involved, and which are no part of the present appeal, there is a recognised exception to the category of turpitudinous acts for cases of strict liability, generally arising under statute, where the claimant was not privy to the facts making his act unlawful: see *Stone & Rolls Ltd v Moore Stephens* [2009] AC 1391, paras 24, 27, per Lord Phillips of Worth Matravers. In such cases, the fact that liability is strict and that the claimant was not aware of the

facts making his conduct unlawful may provide a reason for holding that it is not turpitude at all. This is the most satisfactory explanation of the decision of the Singapore Court of Appeal in *United Project Consultants Pte Ltd v Leong Kwok Onn (trading as Leon Kwok Onn & Co)* [2005] 4 SLR 214, where a taxpayer sought to recover from his accountant an administrative penalty under a statutory provision dealing with the innocent submission of an incorrect tax return: see paras 55, 57. More generally, the wrong alleged against the defendant may consist precisely in causing an innocent claimant to commit an offence of strict liability. The leading case is *Burrows v Rhodes* [1899] 1 QB 816, which arose out of the Jameson Raid of 1895. The plaintiff was induced to enlist in the raid, contrary to section 11 of the Foreign Enlistment Act 1870 (33 & 34 Vict c 90), by the defendants' fraudulent representation that it had the sanction of the Crown (which would have made it lawful). In most cases of this kind the illegality defence would not arise, for there would be no criminal act, the element of mens rea being absent. But the pleadings in *Burrows v Rhodes* required the court to make the rather artificial assumption that the plaintiff would have been convicted under section 11 even without mens rea: see pp 830—832 (Kennedy J). The court held that even so, the defence was not available. This was because the plaintiff was not aware of the facts making enlistment illegal and on the assumption being made by the court he was criminally liable only because that liability was strict. As Kennedy J suggested at p 834, the exception would not necessarily have applied if Burrows had been claiming damages arising directly from the sentence of a criminal court or from some other penal sanction imposed on him by law. That situation would have engaged Lord Hoffmann's "narrower rule", and in that context it

> "must be assumed that the sentence…was what the criminal court regarded as appropriate to reflect the personal responsibility of the accused for the crime that he had committed": *Gray v Thames Trains Ltd* [2009] AC 1339, para 41 (Lord Hoffmann).

Cf *Askey v Golden Wine Co Ltd* [1948] 2 All ER 35, 38 (Denning LJ); *State Railway Authority of New South Wales v Wiegold* (1991) 25 NSWLR 500, 514 (Samuels JA). The application of the exception for cases of strict liability may require a court to determine whether the claimant was in fact privy to the illegality. To that extent, an inquiry into the claimant's moral culpability may be necessary in such cases before his act can be characterised in law as "turpitude". This may be a difficult question, but it is not a question of degree. The conclusion will be a finding that the claimant was aware of the illegality or that he was not. It is a long way from the kind of value judgment implicit in the search for a proportionate relationship between the illegality and its legal consequences of the claim."

306. The distinction between innocent breaches of competition law on the one hand, and negligent or deliberate breaches on the other was drawn by Flaux J in *Twigger*. In that case, Flaux J considered a number of factors in reaching his conclusion that breaches of competition law were capable of triggering the illegality defence. One of these was the "significant responsibility" test that we consider separately in paragraphs 405 to 418 below.[201] Another was the fact that the Competition and Markets Authority – formerly the OFT – only

[201] See *Twigger* at paragraph 30.

has jurisdiction under section 36(3) of the Competition Act 1998 to impose a penalty in respect of a competition law infringement that "has been committed intentionally or negligently by the undertaking".[202]

307. We conclude that:

(1) Since the *ex turpi causa* principle is concerned with claims founded on acts which are contrary to the public law of the state and engage the public interest, infringements of competition law can be, but are not necessarily, sufficiently turpitudinous so as to trigger the principle.

(2) Whether an infringement of competition law can trigger an illegality defence depends upon whether that infringement is an "innocent" one (in which case, we consider it cannot) or a "negligent" or "deliberate" one (in which case it may do).

(3) We consider that the drawing of such a distinction is one that is compelled by Lord Sumption's analysis of "strict liability" infringements[203] and by the fact that (for penalty purposes) this is precisely the distinction drawn in section 36(3) of the Competition Act 1998.[204] If Parliament and EU law have determined that the regulatory authorities should have no jurisdiction to punish innocent, as opposed to negligent or intentional, breaches of competition law, then we consider this to be clear guidance as to what would and would not engage the public interest for the purposes of the illegality defence.

308. We consider further below what can constitute an "intentional" or "negligent" infringement of competition law.

(iii) The "policy-oriented" approach

309. The policy-oriented approach was stated by Lord Toulson in *Apotex*:

> "57 Servier relies on the often quoted statement of Lord Mansfield CJ in *Holman v Johnson* 1 Cowp 341, 343 in which he said that "The principle of public policy is this; ex dolo malo non oritur actio". That statement made in 1775

[202] See *Twigger* at paragraphs 36 to 38.
[203] See *Apotex* at paragraph 29, quoted at paragraph 305 above.
[204] Reflecting Article 23 of Regulation 1/2003.

remains a succinct statement of broad principle, but, as the cases over the last 240 years demonstrate, it does not provide a simple measuring rod for determining the boundaries of the principle. The case law is notoriously untidy. In deciding whether the principle should be applied in circumstances not directly covered by well-established authorities, it is right to proceed carefully on a case by case basis, considering the policies which underlie the broad principle. This has been said in the past by judges at the highest level.

58 In *Vita Food Products Inc v Unus Shipping Co Ltd* [1939] AC 277, 293, Lord Wright said:

> "Each case has to be considered on its merits. Nor must it be forgotten that the rule by which contracts not expressly forbidden by statute or declared to be void are in proper cases nullified for disobedience to a statute is a rule of public policy only, and public policy understood in a wider sense may at times be better served by refusing to nullify a bargain save on serious and sufficient grounds."

59 In *Gray v Thames Trains Ltd* [2009] AC 1339, 1370, para 30, Lord Hoffmann said:

> "The maxim ex turpi causa expresses not so much a principle as a policy. Furthermore, that policy is not based upon a single justification but on a group of reasons, which vary in different situations."

60 This observation was endorsed by Lord Phillips in *Stone & Rolls Ltd v Moore Stephens* [2009] AC 1391, para 25, where he said that it is necessary to give consideration to the policy underlying ex turpi causa in order to decide whether the defence was bound to defeat a claim.

61 In *Hounga v Allen* [2014] UKSC 47, [2014] 1 WLR 2889, Lord Wilson said in the judgment of the majority, at para 42:

> "The defence of illegality rests upon the foundation of public policy. 'The principle of public policy is this…' said Lord Mansfield by way of preface to his classic exposition of the defence in *Holman v Johnson* (1775) 1 Cowp 341, 343. 'Rules which rest upon the foundation of public policy, not being rules which belong to the fixed or customary law, are capable, on proper occasion, of expansion or modification': *Maxim Nordenfelt Guns and Ammunition Co Nordenfelt* [1893] 1 Ch 630, 661A (Bowen LJ). So it is necessary, first, to ask 'What is the aspect of public policy which founds the defence?' and, second, to ask 'But is there another aspect of public policy to which application of the defence would run counter?'"

62 I would therefore make no criticism of the Court of Appeal for considering whether public policy considerations merited applying the doctrine of illegality to the facts of the present case. In so doing it adopted a similar approach to that of the majority of this court in *Hounga v Allen*."

310. The policy-oriented approach involves a balancing approach. The factors we have identified in relation to the rules-based approach are obviously relevant, but the approach is an intrinsically more flexible one. It is necessary to consider:

(1) First, those aspects of public policy that found the illegality defence.

(2) Secondly, and assuming that the public interest is sufficiently engaged to *prima facie* trigger the defence, countervailing public policy considerations.

311. It will readily be appreciated that under the "rule-based" approach, only the first of these questions is considered. If a breach of the law is found to be sufficiently serious, then the illegality defence is made out. With the "policy-oriented" approach, that is only the first question, and it is counter-balanced by the second question, which concerns countervailing public policy considerations. Whether the existence of this second, balancing, question affects the ambit of the first, is something that it will be necessary to consider.

312. Given the state of English law, we see no option but to apply both the rules-based approach and the policy-oriented approach to the facts of the present case. Only if they result in different outcomes, do we consider it appropriate to choose between these approaches.

(b) Application of the law to the facts

313. We have found that MasterCard and Sainsbury's Bank were both party to an agreement that was restrictive of competition by effect but not by object. We do not consider that that fact is sufficient *per se* to amount to "turpitude" either under the "rules-based" approach or under the "policy-oriented" approach. However, we consider that the manner in which this illegal agreement is to be assessed differs markedly according as to which approach is adopted.

314. In considering the question of whether turpitude exists, we assume (without, for the moment, deciding) that Sainsbury's and Sainsbury's Bank form part of the same economic entity or "undertaking", and that the state of mind and conduct of both are elided and considered as one.

(i) The "rule-based" approach

315. Under the "rule-based" approach, *prima facie* this is a case where the illegality defence ought to pertain. There has been a breach of competition law; and, for

the reasons given by Flaux J in *Twigger*, a breach of competition law is capable of triggering the illegality defence.

316. However, as we have noted, breach of Article 101 TFEU is strict: it is quite possible to breach Article 101 TFEU innocently, although no doubt there will be cases where such a breach could be characterised either as negligent or intentional (e.g. involving dishonesty). For the reasons we have given in paragraphs 301 to 307 above, we consider that it is necessary to distinguish between innocent (on the one hand) and negligent or intentional (on the other hand) infringements.

317. The distinctions between innocent, negligent and intentional breaches of competition law were considered (in the context of section 36(3) of the Competition Act 1998) by the Competition Commission Appeal Tribunal (the predecessor to the Competition Appeal Tribunal) in *Napp Pharmaceutical Holdings Limited v Director General of Fair Trading* [2002] Comp AR 13:

> "455 …It follows that we uphold the Director's submission that, in order to impose a penalty under section 36(3), he has to be satisfied, as a threshold matter, that the infringement was either intentional, or negligent. However, he does not, for the purposes of crossing that threshold, have to determine specifically which it was. He may well have to do so, however, at the subsequent stage of his appraisal when he is considering the gravity of the infringement.
>
> 456 As to the meaning of "intentionally" in section 36(3), in our judgment an infringement is committed intentionally for the purposes of the Act if the undertaking must have been aware that its conduct was of such a nature as to encourage a restriction or distortion of competition…It is sufficient that the undertaking could not have been unaware that its conduct had the object or would have the effect of restricting competition, without it being necessary to show that the undertaking also knew that it was infringing the Chapter I or Chapter II prohibition...While in some cases the undertaking's intention will be confirmed by internal documents, in our judgment, and in the absence of any evidence to the contrary, the fact that certain consequences are plainly foreseeable is an element from which the requisite intention may be inferred. If, therefore, a dominant undertaking pursues a certain policy which in fact has, or would foreseeably have, an anti-competitive effect, it may be legitimate to infer that it is acting "intentionally" for the purposes of section 36(3).
>
> 457 As to "negligently", there appears to be little discussion of this concept in the case law of the European Community. In our judgment an infringement is committed negligently for the purposes of section 36(3) if the undertaking ought to have known that its conduct would result in a restriction or distortion of competition...For the purposes of the present case, however, we do not need to decide precisely where the concept of "negligently" shades into the

> concept of "intentionally" for the purposes of section 36(3), nor attempt an exhaustive judicial interpretation of either term."

318. One of the problems with effects-based infringements of competition law[205] is that it can be extremely difficult to say whether a given agreement has the effect of restricting competition. In other words, the test for an intentional breach of competition law (i.e. whether an undertaking could not have been unaware that its conduct would have the effect of restricting competition – paragraph 456 of *Napp*) and for a negligent breach (i.e. if the undertaking ought to have known that its conduct would result in a restriction of competition – paragraph 457 of *Napp*) contain hidden difficulties of assessment beyond simply working out whether competition law has been infringed.

319. An analogous question was considered by this Tribunal in *2 Travel Group plc (in liquidation) v Cardiff City Transport Services Ltd* [2012] CAT 19. In that case, the Tribunal had to consider the circumstances in which exemplary damages could be imposed where there was an infringement of competition law. One of the questions considered by the Tribunal was the extent to which a decision taken by an undertaking in the knowledge that there was a risk of a breach of the competition rules could be said to amount to that level of conscious wrongdoing sufficient to meet Lord Devlin's second category of exemplary damages in *Rookes v Barnard*, namely that a defendant has acted in cynical disregard of a claimant's rights.

320. Although *2 Travel* involved an infringement of the Chapter II prohibition (rather than Article 101 TFEU or the Chapter I prohibition) and (as we have noted) concerned exemplary damages rather than illegality, we find the following paragraphs in *2 Travel* of assistance in determining whether there has been a sufficiently serious breach of competition law for the purposes of the *ex turpi causa* defence:

> "482 The reason that complaints of breaches of the Chapter II prohibition present a particular problem is that often a company will be unable to predict with

[205] Object-based infringements may – and probably ought to – be different, given the need for the restriction to be obvious: see paragraph 100 above. However, as we concluded in paragraph 102 above, the agreement to set the UK MIF was not a restriction by object.

certainty whether or not a proposed measure would amount to an infringement…

483 This being the case, it follows that many business decisions taken by a dominant undertaking will be taken in the knowledge that there is a risk that the company's actions will be found to breach competition rules.

484 On the face of it, Lord Devlin's second category is specifically aimed at the punishment and deterrence of such calculated risks. Yet we consider that – unless we are compelled to by higher authority – to impose on undertakings an exposure to exemplary damages in all cases where a company proceeds with conduct despite there being a known risk of an infringement of the Chapter II prohibition would be wrong. It would have the effect of deterring actions that might well have a pro-competitive effect.

485 Obviously – as *Devenish* shows – exemplary damages can in theory be awarded where there is an intentional breach of the law i.e. the defendant acts knowing that what he does constitutes an infringement of competition law and intending that infringement. It is equally clear – from the case-law we have cited – that the jurisdiction to award exemplary damages extends beyond this core case, and that cases which may be termed cases of "recklessness" can be sufficiently outrageous so as to fall within Lord Devlin's second category (see, in particular, paragraphs 466, 468, 470 and 471 above).

486 In *R v G* [2004] 1 AC 1034 at [32], Lord Bingham defined recklessness in the context of the criminal law as the "knowing disregard of an appreciated and unacceptable risk of causing an injurious result or a deliberate closing of the mind to such risk" (emphasis added). The key word – for present purposes – is "unacceptable". It is only when a risk is "unacceptable", but is nevertheless consciously disregarded, that conduct becomes "reckless". The conscious disregard of an acceptable risk is not recklessness.

487 What, then, is an "unacceptable" risk? We consider that an unacceptable risk is one capable of being characterised as:

(1) Involving conduct that entails a cynical disregard for a claimant's rights (to use Lord Devlin's test in *Rookes v Barnard*); or

(2) Behaving outrageously (Lord Hailsham in *Cassell v Broome*) or in outrageous disregard of the claimant's rights (Lord Nicholls in *Kuddus*).

488 We consider that where there is only a small risk that the Chapter II prohibition will be infringed no question of exemplary damages should arise. In *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378 at 390, Lord Nicholls considered the sometimes difficult question of a company carrying out a transaction for someone whilst nevertheless being aware of a risk that the transaction is unauthorised:

> "...frequently the situation is neither clearly white nor clearly black... Instead there is a gradually darkening spectrum which can be described with labels such as clearly authorised, probably authorised, possibly authorised, wholly unclear, probably [un]authorised and, finally, clearly unauthorised."

489 We consider this appreciation that matters are rarely black-and-white to be a particularly helpful insight. Applying it analogously, in the context of infringements of the Chapter II prohibition, an undertaking may be aware that its proposed conduct is *(i)* clearly lawful, *(ii)* probably lawful, *(iii)* possibly lawful, *(iv)* wholly unclear, *(v)* probably unlawful or *(vi)* clearly unlawful.

490 We consider that it will only be in those cases where an undertaking is aware that its proposed conduct is either probably unlawful or clearly unlawful that a risk can be classed as "unacceptable". Whether the risk is, in fact, "unacceptable" will in addition depend upon all the facts of the case, including (for example):

(1) Any expected pro-competitive effects of the conduct.

(2) The degree and seriousness of any anti-competitive effects.

(3) The motive of the undertaking for acting.

(4) The practicability of achieving the same commercial or pro-competitive aim by following a different course of action with less serious anti- competitive effects."

321. In determining whether there has been a negligent or deliberate breach of Article 101 TFEU on the part of Sainsbury's (which, for present purposes, we assume to include Sainsbury's Bank: see paragraph 314 above), we consider it helpful to begin with the position of the progenitor of the MasterCard Scheme – MasterCard itself. We consider that MasterCard, as the promulgator of the MasterCard Scheme, as the setter of the UK MIF, and as a party on whom the Commission's and the OFT's regulatory eye was focused, would be expected to have the clearest and best idea as to whether the UK MIF amounted to a negligent or a deliberate infringement of competition law, and that this constitutes a helpful guide (but no more than that) as to how Sainsbury's Bank's participation in the MasterCard Scheme is to be regarded.

322. Put this way, the conclusion in relation to MasterCard is obvious: we consider that MasterCard has, in these proceedings, advanced a case that the UK MIF was not a restriction on competition which – although it has failed – concerned difficult questions of fact and law. It is, in our view, impossible to characterise MasterCard's continued setting of the UK MIF as either a negligent or, still less, deliberate breach of competition law. Of course, MasterCard would have appreciated that there was a risk that it might be found to be in breach of competition law. But on the sort of scale contemplated in paragraph 489 of *Cardiff Bus* - *(i)* clearly lawful, *(ii)* probably lawful, *(iii)* possibly lawful, *(iv)*

wholly unclear, *(v)* probably unlawful or *(vi)* clearly unlawful – we consider that the case could not reasonably be considered to fall within any category beyond *(iv)* (wholly unclear), and may well be said to fall in an earlier category.

323. In reaching this conclusion, we are fortified by the conclusion we reached in relation to restriction of competition by object. In paragraph 102 above, we concluded that there was no "object" infringement, and that conclusion supports the conclusion that we reach here, that it would not have been clear to MasterCard that it was infringing Article 101 TFEU. We consider that any legal advice given to MasterCard to this effect could not properly have been described as negligent.

324. We have reached this conclusion, without having had to consider the question of Article 101(3) TFEU exemption. Had we concluded that the risk of infringement of Article 101(1) TFEU was so great that MasterCard's continued setting of a UK MIF was either a negligent or a deliberate breach of Article 101(1) TFEU, it would have been necessary to consider whether the possibility of an exemption would cause us to modify that view. Obviously, the Commission had the prospect of exemption well in mind in its dealings with Visa and MasterCard, and this plainly would have been a relevant factor. However, given the conclusion we have reached, the point does not have to be considered; and, in any event, even if it did arise, we have concluded that the UK MIF as set would not have been exempted under Article 101(3) TFEU for the reasons given in Section I above.

325. The position of Sainsbury's (including Sainsbury's Bank) is, in our view, *a fortiori* that of MasterCard. Sainsbury's Bank was, of course, simply a licensee[206] of the MasterCard Scheme, as were and are many other banks and other financial institutions. We consider that, whilst Sainsbury's Bank might – and probably would – have been aware of the (not unacceptable) risk of the MasterCard Scheme (and, specifically, the UK MIFs) being found to be in breach of competition law – that would have been the extent of Sainsbury's Bank's (and Sainsbury's) appreciation.

[206] At one point an affiliate of a licensee.

326. Against this, MasterCard made three points, which we do not find persuasive, individually or cumulatively:

(1) First, that some of the internal documentation disclosed by Sainsbury's showed a subjective appreciation that competition law was being infringed. In one set of slides dated 13 March 2006, entitled "2005/2006 Year End Report to J Sainsbury plc Audit Committee" Interchange Fees were identified as a "Top 15" operational risk. The slides reveal that Sainsbury's Bank appreciated that there was a low-to-medium risk that Interchange Fees "would be reduced by regulators". Another document entitled "Interchange Risk Update", which was prepared for a meeting on 26 September 2012, assesses the risk of retrospective damages actions against Sainsbury's Bank. It concludes that the risk "seems somewhat…remote" and notes that "[t]here is a great deal of uncertainty as to whether [Sainsbury's Bank] could be held liable…". We consider that these documents show no more than an appreciation of a risk of infringement. What these documents do not show is so high a sense of risk as to amount to either an intentional or negligent breach of Article 101 TFEU.

(2) Secondly, that Sainsbury's Bank could, easily, have negotiated a bilateral non-infringing Interchange Fee with the Acquiring Banks.[207] We consider this to be right: Sainsbury's Bank could, with relative ease, have negotiated a bilateral Interchange Fee below, at or above the UK MIF with the Acquiring Banks active in the UK Market. However, we consider that no inference can be drawn from the fact that Sainsbury's Bank did not negotiate such a bilateral Interchange Fee. That failure to act – if it can be called that – says nothing about Sainsbury's Bank's perception of the extent to which it was at risk of infringing Article 101 TFEU by participating in the UK MIF.

(3) Thirdly, it was suggested that the fact that Sainsbury's commenced this claim – and, before that, no doubt engaged in extensive debate and discussion about whether a claim should be made – evidenced a

[207] MasterCard Opening, footnote 360.

subjective awareness on the part of Sainsbury's that Sainsbury's Bank was itself infringing Article 101 TFEU.[208] This point is essentially misconceived: it presupposes that the test for infringing Article 101 TFEU is the same as the test for *ex turpi causa*, when this is not the case. As we have stated, liability under Article 101 TFEU is strict, in the sense that the provision can be infringed innocently, whereas – in order to be sufficiently serious so as to trigger the illegality defence – the infringement must be negligent (at the very least) or worse. In short, the fact that Sainsbury's commenced proceedings against MasterCard says nothing about turpitude.

327. For the reasons we have given we conclude that – on a "rules-based" approach – the conduct of Sainsbury's Bank, assuming that conduct should be attributed to Sainsbury's, is insufficiently wrongful or turpitudinous so as to trigger the illegality defence.

(ii) The "policy-based" approach

328. As was described in paragraph 310 above, the "policy-based" approach turns on a consideration of two, related, questions:

(1) First, those aspects of public policy that found the illegality defence.

(2) Secondly, and assuming that the public interest is sufficiently engaged to *prima facie* trigger the defence, countervailing public policy considerations needs must be considered.

329. The first question is, in substance, the same as that considered in the "rule-based" approach. However, it is an open question as to whether the ambit of unlawful behaviour relevant on the "policy-based" approach is <u>wider</u> than on the "rule-based" approach because of the existence of the second, "balancing", question. To put the same point another way, is our conclusion that the conduct of Sainsbury's under the "rule-based" approach determinative of the first question on the "policy-oriented" approach?

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[208] MasterCard Closing/§946.

330. We consider that the existence of the second, "balancing", question renders the approach that must be taken in respect of the first question more wide-ranging. Although the conclusion that we have reached in relation to the nature of Sainsbury's Bank's infringement of Article 101 TFEU – namely, that it was an innocent, and not a negligent or intentional breach – stands and is a cogent factor, there is one additional factor – not relevant on the "rule-based" approach – that we feel must be taken into account.

331. This is the benefit that Sainsbury's Bank received by way of UK MIFs as a result of its participation in the MasterCard Scheme. These UK MIFs were, on any view, substantial. They are set out in Abrahams 1/§§22 to 24 (which evidence was not disputed in cross-examination):

> "22 Further, the Bank's interchange revenues have grown over the years, as shown in the table below which sets out the interchange received by the Bank in respect of MasterCard consumer credit domestic transactions in the last six years.

	2009	2010	2011	2012	2013	2014
Total interchange received by Sainsbury's Bank from MasterCard Consumer Credit Domestic Transactions (£)	8,815,310	10,196,556	10,309,835	10,665,779	12,004,188	14,519,576

> 23 This has benefitted the Group. Of these revenues, a substantial part derive from sales on MasterCard payment cards in Sainsbury's Supermarkets' stores (i.e., to the extent interchange fees are paid by [Sainsbury's] through merchant service charges, a substantial part of them remain within the Group). The remainder will have been received by the Bank pursuant to transactions at other retailers.
>
> 24 The table below shows how much of the interchange fees paid in the last six years in respect of MasterCard transactions in Sainsbury's Supermarkets (and now claimed by it from MasterCard) has stayed within the Sainsbury's Group – ultimately being received by the Bank.

	2009	2010	2011	2012	2013	2014
Total interchange paid in respect of Sainsbury's Supermarkets MC transactions (£)	17,417,281	19,831,402	23,144,305	26,698,147	33,534,164	34,276,178
Total of this paid to Sainsbury's Bank (£)	2,234,834	2,452,599	2,627,002	3,099,271	4,102,308	4,634,521
% of above IC paid to Bank	13%	12%	11%	12%	12%	14%

332. Thus, the position is as follows:

(1) The precise quantification of Sainsbury's claim is undertaken in Section J below. However, the figures with which we have been provided in terms of the UK MIFs paid by Sainsbury's do not have stripped out from them UK MIFs paid by Sainsbury's to Sainsbury's Bank. Sainsbury's claims damages from MasterCard based upon all UK MIFs paid by Sainsbury's over the claim period, including those UK MIFs paid by Sainsbury's to Sainsbury's Bank. These latter sums are, on any view, significant – amounting in the years 2009-2014 to £19,150,535. Assuming, as we do for the present, that Sainsbury's and Sainsbury's Bank are one undertaking, we consider that it is a relevant factor to take into account that (when viewed as a single economic entity) the Sainsbury's undertaking is double-recovering, in that it is recovering as damages from MasterCard sums that it has (in effect) paid to itself.[209]

(2) More broadly, the Sainsbury's "undertaking" is at one and the same time (successfully) alleging through Sainsbury's that the UK MIF breaches Article 101 TFEU, whilst another part of that same undertaking received substantial payments (from Sainsbury's and from other Merchants through their Acquiring Banks) by virtue of that very infringement. These payments amount in the years 2009-2014 to

[209] I.e. an Interchange Fee has been paid by Sainsbury's to Sainsbury's Bank.

£66,511,244 (including the £19,150,535 paid by Sainsbury's and referred to in paragraph 332(1) above).

333. Accordingly, notwithstanding our conclusion that the infringement, by Sainsbury's Bank, of Article 101 TFEU was innocent and neither negligent nor intended, we are more inclined to consider that the illegality defence is *prima facie* engaged when following the "policy-oriented" approach than when applying the "rule-based" approach. That, however, is because of the second, "balancing", question.

334. Turning to that question, we consider that it would be disproportionate – in the case, we stress, of an innocent infringement – to permit the receipt of a benefit by one legal person within an undertaking wholly to defeat a claim by another legal person within that same undertaking where that claim is materially greater than the benefit received.

335. In conclusion, although we consider the question to be somewhat more finely balanced, we do not consider turpitude to exist on the "policy-oriented" approach either.

(3) Relationship of the Turpitude to the Claim

336. In *Hounga*, Lord Wilson (with whom Lady Hale and Lord Kerr agreed) decided the matter by balancing the aspects of public policy founding the defence against other aspects of public policy running counter to this (see paragraph 310 above). The relationship that the turpitude had to have to the claim was not considered.

337. Equally, Lord Sumption, in *Apotex*, also decided the matter on whether turpitude existed, and not on the necessary relationship between turpitude and claim.

338. By contract, in *Hounga*, Lord Hughes (with whom Lord Carnwath agreed) stated that it was necessary that there be a "sufficiently close connection between the illegality and the claim made".[210] Lord Hughes cited with

[210] Paragraph 55 of *Hounga*, (*per* Lord Hughes).

approval the judgment of Bingham LJ in *Saunders v Edwards* [1987] 1 WL 1116 at 1134:

"Where issues of illegality are raised, the courts have…to steer a middle course between two unacceptable positions. On the one hand it is unacceptable that any court of law should aid or lend its authority to a party seeking to pursue or enforce an object or agreement which the law prohibits. On the other hand, it is unacceptable that the court should, on the first indication of unlawfulness affecting any aspect of a transaction, draw up its skirts and refuse all assistance to the plaintiff, no matter how serious his loss nor how disproportionate his loss to the unlawfulness of his conduct …on the whole the courts have tended to adopt a pragmatic approach to these problems, seeking where possible to see that genuine wrongs are righted so long as the court does not thereby promote or countenance a nefarious object or bargain which it is bound to condemn. Where the plaintiff's action in truth arises directly *ex turpi causa*, he is likely to fail…Where the plaintiff has suffered a genuine wrong, to which allegedly unlawful conduct is incidental, he is likely to succeed…"

339. Lord Hughes suggested that "it can be seen that the proportionality to which Bingham LJ was directing his attention was such as lay between the claimant's offence and the claim, not as between the claimant's turpitude and that of the defendant. However, although the relative turpitude of claimant and defendant is not the test, the extent of the claimant's turpitude may be relevant to determining whether there is a sufficiently close connection between the illegal act and the claim."[211]

340. In *Apotex*, Lord Sumption simply noted and commented upon the reasoning of the House of Lords in *Tinsley v Milligan* (at paragraph 18):

"The House was divided on the question what should be substituted for the public conscience test. Lord Keith and Lord Goff favoured a rule which would bar any claim tainted by a sufficiently close factual connection with the illegal purpose, and would have dismissed the claim to an equitable interest in the house on that ground. Lord Browne-Wilkinson, with whom Lord Jauncey of and Lord Lowry agreed, preferred the "reliance test" derived from the decision of the Court of Appeal in *Bowmakers Ltd v Barnet Instruments Ltd* [1945] KB 65 and of the Privy Council in *Palaniappa Chettiar v Arunasalam Chettiar* [1962] AC 294. The effect of this test was that the claim was barred only if the claimant needed to rely on (i.e. to assert, whether by way of pleading or evidence) facts which disclosed the illegality: see Lord Browne-Wilkinson [1994] 1 AC 340, 37C-D, 375—376; cf Lord Jauncy, at p 366C-G. Both are intended to exclude those consequences of an illegal act which are merely collateral to the claim. Neither makes the application of the illegality defence dependent on a value judgment about the significance of the illegality or the consequences for the parties of barring the claim. For present purposes, it is enough to point out that neither test is discretionary in nature. Neither of them is based on achieving proportionality between the claimant's misconduct and his loss, a concept derived from public law which is not easily transposed into the law of obligations. On

[211] At paragraph 58.

the contrary, Lord Goff recognised, as Lord Mansfield CJ had before him, that the practical operation of the law in this field will often produce disproportionately harsh consequences."

341. It is, therefore, unclear precisely what test is the applicable one.

342. We consider that, if the test is one of sufficiently close factual connection, then that test is plainly met in this case. Sainsbury's is contending that the UK MIF set by MasterCard was anti-competitive and unlawful, and we have accepted that contention. The agreement that is unlawful and void pursuant to Article 101(1) and 101(2) TFEU respectively is precisely the same agreement pursuant to which Sainsbury's Bank received Interchange Fees. Indeed, as we have noted, considerable Interchange Fees were <u>received</u> by Sainsbury's Bank which were <u>paid</u> by Sainsbury's (i.e. those purchases in a Sainsbury's store using a Sainsbury's Bank card). We can imagine few closer factual connections than this.

343. Although more difficult, we consider that it is also the case that Sainsbury's needs to rely on (i.e. to assert, whether by way of pleading or evidence) facts which disclose the illegality, specifically the illegality of the agreement in relation to the UK MIF. Sainsbury's does not, of course, plead anything in relation to Sainsbury's Bank, but that does not prevent the "reliance" test from being met.

(4) Attribution of the Turpitude

(a) The law regarding "undertaking" and attribution of liability

(i) The issue stated

344. It is by no means self-evident that attribution <u>is</u> a question of EU law. English law contains detailed rules on the attribution of one actor's conduct or state of mind to another, and at first blush it is difficult to see why these rules should be displaced by European law. That would mean that the scope of the illegality defence would depend on whether the defence rested on a turpitude based upon an infringement of competition law (in which case, European law would apply) or whether it rested on a turpitude not having a "European dimension" (in which case, English law would apply). A defence that has a

scope dependent upon what is, in effect, subject-matter, seems both counter-intuitive and wrong in principle.

345. On the other hand, in terms of the parties that may be joined, the scope of a claim based upon an infringement of competition law is wider than that which prevails in a domestic English-law context. Thus, by way of example, it is possible, for the purposes of establishing jurisdiction, for a claim alleging infringement of competition law to be made against a company domiciled in the UK, where that company was part of the same "undertaking" as another company that in fact was the infringer.[212] Absent the EU competition law meaning of "undertaking", there could be no question of jurisdiction being founded on this basis, and the reason it is possible in competition cases is simply because (unlike purely domestic English law, which does not in general recognise forms of "enterprise" liability) European competition law thinks in terms of "undertakings" rather than legal persons. Given that the ambit of the persons who may be joined as defendants to a competition claim is defined by European law, it would seem both counter-intuitive and wrong in principle for any defence, similarly founded on an infringement of competition law, to be subject to narrower rules of attribution.

346. The issue is, therefore, a difficult and finely balanced one. The parties were unable to point to any authority that was determinative of the point, and we approach it from first principles, and such case law as may assist.

(ii) A right to damages

347. In Case C-453/99, *Courage Ltd v Crehan*, [2001] ECR I-6297, [2002] 1 QB 507 Mr Crehan, a publican, had entered into two leases which obliged him to buy the beer he sold in his pub from Courage. He did not pay for the beer delivered pursuant to this "tie" agreement. Courage claimed for unpaid deliveries of beer from Mr Crehan. Mr Crehan contended that the beer tie was unlawful and unenforceable and counter-claimed for damages.

[212] The circumstances in which, under EU law, the infringing conduct can be attributed to the other company is discussed later in this judgment.

348. The Court of Appeal referred various questions to the Court of Justice, including the inter-relationship between directly effective EU rights under Article 101 and the illegality defence. The Court of Justice held as follows:

(1) EU law creates its own legal order, which is integrated into the legal systems of the Member States, and which the Courts of those States are bound to apply. The subjects of that legal order are not just the Member States, but also their nationals.[213]

(2) EU law not only imposes burdens, but also "gives rise to rights which become part of their legal assets".[214]

(3) Such rights include not only the right to have an agreement infringing Article 101(1) TFEU declared void (if not exemptible),[215] but also the right to claim damages. The Court of Justice stressed the importance of this:

> "25 As regards the possibility of seeking compensation for loss caused by a contract or by conduct liable to restrict or distort competition, it should be remembered from the outset that, in accordance with settled case law, the national courts whose task it is to apply the provisions of Community law in areas within their jurisdiction must ensure that those rules take full effect and must protect the rights which they confer on individuals…
>
> 26 The full effectiveness of [Article 101 TFEU] and, in particular, the practical effect of the prohibition laid down in [Article 101(1) TFEU] would be put at risk if it were not open to any individual to claim damages for loss caused to him by a contract or by conduct liable to restrict or distort competition.
>
> 27 Indeed, the existence of such a right strengthens the working of the Community competition rules and discourages agreements or practices, which are frequently covert, which are liable to restrict or distort competition. From that point of view, actions for damages before the national courts can make a significant contribution to the maintenance of effective competition in the Community."

(4) The Court of Justice also stressed that, for this reason, an absolute bar preventing a party to an anti-competitive agreement from asserting a

[213] At paragraph 19.
[214] At paragraph 19.
[215] At paragraphs 21 to 22.

claim would be contrary to EU law;[216] but that in the absence of EU rules on the point, "it is for the domestic legal system of each member state to designate the courts and tribunals having jurisdiction and to lay down the detailed procedural rules governing actions for safeguarding rights which individuals derive directly from Community law, provided that such rules are not less favourable than those governing similar domestic actions (principle of equivalence) and that they do not render practically impossible or excessively difficult the exercise of rights conferred by Community law (principle of effectiveness)".[217]

(5) Thus, a claim in damages for breach of Article 101(1) TFEU is a claim brought under national law, in the sense that it is brought in a national court, pursuant to national law jurisdictional and procedural rules, albeit that the cause of action is derived from a directly effective provision of the TFEU, and that the approach of the national courts is constrained by and subject to the principles of equivalence and effectiveness. The Court of Justice made clear that a similar approach applies in relation to defences to a claim for damages for breach e.g. of Article 101 TFEU (such as the defence of illegality and a pass-on defence):

> "30 In that regard, the court has held that Community law does not prevent national courts from taking steps to ensure that the protection of the rights guaranteed by Community law does not entail the unjust enrichment of those who enjoy them: see, in particular, *Ireks-Arkady GmbH vCouncil and Commission of the European Communities* (Case 238/78) [1979] ECR 2955, 2974, para 14; *Hans Just I/S v Danish Ministry for Fiscal Affairs* (Case 68/79) [1980] ECR 501, 523, para 26 and *Kapniki Mikhailidis AE v c Idrima Kinonikon Asphaliseon* (Joined Cases C-441 and 442/98) [2000] ECR I-7145, 7176-7177, para 31.
>
> 31 Similarly, provided that the principles of equivalence and effectiveness are respected (see *Palmisani,* paragraph 27), Community law does not preclude national law from denying a party who is found to bear significant responsibility for the distortion of competition the right to obtain damages from the other contracting party…"

[216] At paragraphs 24 and 28.
[217] At paragraph 29.

349. In short, whilst rights conferred by EU law (including for infringement of competition law) are, unsurprisingly, defined by EU law, the nature of the cause of action and of any defence to it operate at the level of national law, but subject always to EU law constraints.

350. When considering the rights and obligations derived from Article 101(1) TFEU, it is immediately apparent that the conduct that is prohibited is defined, in large measure, by reference to "undertakings". By the same token, the concept of the "undertaking" would be expected to be an element that defines the scope of any claim to damages.

(iii) The "undertaking"

351. In the following paragraphs, we examine the meaning given to the concept of an "undertaking". It will be necessary to consider whether Sainsbury's and Sainsbury's Bank are part of the same undertaking, and whether the existence of a single undertaking is the relevant touchstone for the attribution of the turpitude.

352. Article 101(1) TFEU refers to "undertakings", a concept that is unknown in English law. The concept of an undertaking is primarily an <u>economic</u> rather than a <u>legal</u> one. Whilst undefined in the TFEU, it has been given extensive consideration by the EU Courts and by the EU Commission. We must therefore have regard to the relevant decisions of the EU Courts and the relevant decisions and statements of the EU Commission.

353. In *Höfner and Elser v Macrotron GmbH* Case C-41/90, [1991] ECR I-1979, at paragraph 21, the Court of Justice stated that "the concept of an undertaking encompasses every entity engaged in an economic activity regardless of the legal status of the entity and the way in which it is financed".

354. Bellamy & Child notes:[218]

> "The General Court has stated that Article 101 is addressed to economic entities made up of a collection of physical and human resources capable of taking part in the commission of an infringement of the kind referred to in that Article."

[218] Bellamy & Child at paragraph 2.003.

355. In a passage cited by the Court of Justice with apparent approval in *Akzo Nobel NV and Others v Commission,* C-97/08 P, [2009] ECR I-8237 the General Court described the concept in similar terms, as follows (see paragraph 27 of the Court of Justice's judgment):

> "57. It must be borne in mind, first of all, that the concept of undertaking within the meaning of Article 81 EC includes economic entities which consist of a unitary organisation of personal, tangible and intangible elements, which pursue a specific economic aim on a long-term basis and can contribute to the commission of an infringement of the kind referred to in that provision (see Case T-9/99 *HFB and Others* v *Commission* [2002] ECR II-1487, paragraph 54 and the case-law cited)."

356. An undertaking therefore designates an economic unit, rather than an entity characterised by having legal personality. In *Hydrotherm Gerätebau GmbH v Compact del Dott Ing Mario Andreoli & C* Case C-170/83, [1984] ECR 2999 at paragraph 11, the Court of Justice stated that "[i]n competition law, the term 'undertaking' must be understood as designating an economic unit for the purpose of the subject-matter of the agreement in question, even if in law that economic unit consists of several persons, natural or legal".

357. Because the focus of EU law is on the economic, rather than the legal, nature of an entity, a number of individual legal bodies can be treated as a single undertaking for the purposes of competition law.

358. Thus, a single undertaking may comprise a parent company and its subsidiary, provided that the relationship between them is such that they form a single economic entity. Equally, an employee (obviously a natural person in his or her own right) will typically be part of the undertaking that employs him or her. Similarly, an independent contractor and the person engaging that contractor can be a single undertaking. In *Marlines v Commission* Case T-56/99, [2003] ECR II-5225, a cartel case, the Court of First Instance (now the General Court) had to consider whether a manager of certain vessels was a part of the same economic unit as the owners of those vessels. The Court concluded that he was, and stated at paragraph 60:

> "It is clear from case-law that, where an agent works for his principal, he can in principle be regarded as an auxiliary organ forming an integral part of the latter's undertaking bound to carry out the principal's instructions and thus, like a commercial employee, forms an economic unit with this undertaking (*Suiker Unie and Others v Commission*, cited above, paragraph 539)."

359. The basic definition of an undertaking – set out in paragraphs 352 to 355 above – is uncontroversial. The concept is neutral as regards legal personality, and does not seek to define itself by reference to the legal persons that might comprise it.

360. The meaning of an "undertaking" is also "context sensitive". Thus, as Whish & Bailey note (at p87):

> "It is important to understand at the outset that the same legal entity may be acting as an undertaking when it carries on one activity but not when it is carrying on another. A 'functional approach' must be adopted when determining whether an entity, when engaged in a particular activity, is doing so as an undertaking for the purpose of the competition rules. As the Court of Justice said in *MOTOE*:
>
> > "The classification as an activity falling within the exercise of public powers or as an economic activity must be carried out separately for each activity exercised by a given entity."
>
> Thus, for example, a local authority in the UK may (a) have powers to adopt bye-laws specifying where cars can and cannot be parked and (b) own land which it operates commercially as a car park. When performing function (a) the authority would, in the language of *Wouters*, be exercising the powers of a public authority and therefore would not be acting as an undertaking; the behaviour in (b) however, would be economic, and therefore that of an undertaking."

(iv) Is the concept of an "undertaking" determinative for the attribution of turpitude?

361. It was MasterCard's case that:

(1) All of the legal persons who are members of an undertaking are liable for an infringement committed by any one of them. Thus, assuming *A*, *B* and *C* (each having distinct legal personality) are all part of one undertaking, and *C* (but only *C*) commits an infringement of competition law, a claimant can claim damages from *A* (without necessarily joining *C* to the proceedings) for that infringement. In effect, the liability is that of the undertaking, which liability (at least for the purposes of English proceedings) is translated into a claim against each and every one of the legal persons comprising that undertaking.

(2) It followed from this that any illegality defence must have a similar scope, at least in terms of the attribution of the acts or state of mind of

one of the persons comprising the undertaking to the other persons comprising that undertaking.

362. Sainsbury's appeared to accept that any illegality defence must have a similar scope, at least in terms of the attribution of the acts or state of mind of one of the persons comprising the undertaking to the other persons comprising that undertaking. However:

(1) In the first place, Sainsbury's noted that the concept of an "undertaking" was – at least to an extent – "context sensitive", as we have seen. In other words, the scope of an undertaking varied according to the issue under consideration.

(2) Secondly, Sainsbury's disputed MasterCard's assertion that liability for an infringement of competition law can be imputed to every entity that is a member of an undertaking, merely because it is a member.[219] The principal authority relied upon by Sainsbury's in this regard was the decision of Asplin J in *Tesco Stores Ltd v MasterCard Incorporated* [2015] EWHC 1145 (Civ) at paragraph 76:

> "I also agree with Mr Railton [leading counsel for the Tesco claimants] that even if the [Tesco claimants] and Tesco Bank are a single economic entity for the purposes of Competition law, it cannot be said that the Claimants do not have a realistic as opposed to fanciful prospect of success in showing that nevertheless, the alleged infringement by Tesco Bank should not be imputed to them. I come to this conclusion based upon paragraph [77] of the judgment in the *Azko* case and paragraphs [97]-[99] of the Advocate General's opinion, together with the approach adopted in the *ArcelorMittal* decision of the Grand Chamber and the *Knauf* decision to which Mr Railton referred me. In my judgment they render it more than merely arguable that responsibility for an infringement within a single economic entity is not based upon strict liability (or to put the matter another way, mere membership of the entity) but requires something more which may be decisive influence. My conclusion is consistent with the approach of the Advocate General in the *Siemens Österreich* case to which I was referred and the way in which Etherton LJ dealt with the matter, albeit obiter in the *KME Yorkshire Ltd* case."

Given that this was an application by MasterCard to strike out the claims of the Tesco claimants on the basis that those claims had no real prospect of success and/or that there were no reasonable grounds for bringing the claim because of the illegality defence, and given that

[219] Sainsbury's Opening/§469.

Asplin J did no more than decide that the claims of the Tesco claimants should proceed to trial, the *Tesco* case is not one that can be determinative.

363. These are points of law of some importance, and it is necessary for us to reach our own view on them, even if the parties before us were, at least to some extent, *ad idem*:

(1) The problem with the economic basis for the meaning of an "undertaking" is that at some point it must be translated into legal terms: at some point, it will be necessary to be clear as to which legal persons form a part of the undertaking and which do not. This point has been clearly expressed both by the EU courts and the English courts.

(2) In Case C-97/08P, *Akzo Nobel NV v European Commission*, [2009] 5 CMLR 23, it was necessary to identify which legal persons formed part of an undertaking for the purposes of fining for breach of what is now Article 101 TFEU. The Advocate General noted that:[220]

> "…whereas the competition rules are directed at undertakings and apply to them directly regardless of how they are organised and their legal nature, decisions by competition authorities penalising breaches of competition rules can be directed only at persons, not least because such decisions must be enforced. For that reason, in every case in which a competition authority penalises a cartel offence, the question arises as to the attribution of that conduct to a specific person."

(3) Later in the Opinion, Advocate General Kokott rejected an argument that imposing liability on the parent of an infringing subsidiary conflicted with the principle of personal responsibility. At paragraphs 97 to 99, she said:

> "97. The fact that the parent company which exercises decisive influence over its subsidiaries can be held jointly and severally liable for their cartel offences does not in any way constitute an exception to the principle of personal responsibility, (78) but is the expression of that very principle. That is because the parent company and the subsidiaries under its decisive influence are collectively a single undertaking for the purposes of competition law and responsible for

[220] At paragraph 37.

that undertaking. (79) If that undertaking deliberately or negligently infringes the competition rules, in particular Article [101 TFEU] and Article 53 of the EEA Agreement, that gives rise to the collective personal responsibility of all the principals in the group structure, regardless of whether they are the parent company or a subsidiary. (80)

98. This form of parent‑company responsibility under antitrust law also has nothing to with strict liability. On the contrary, as mentioned, the parent company is one of the principals of the undertaking which negligently or intentionally committed the competition offence. In simplified terms, it could be said that it is (together with all the subsidiaries under its decisive influence) the legal embodiment of the undertaking which negligently or intentionally infringed the competition rules.

99. Admittedly, the parent company's involvement in the commission of the offence may not have been directly apparent outwardly, for example, through the participation of its own staff in meetings of the cartel members. However, that does not detract from its personal (co‑)responsibility for the offence. As the parent company exercising decisive influence over its subsidiaries, it pulls the strings within the group of companies. It cannot simply shift responsibility for cartel offences committed within that group just to individual subsidiaries."

(4) The Advocate General's reference in paragraph 97 to "all the principals in the group structure, regardless of whether they are the parent company or a subsidiary" could be said to support the broader submission of MasterCard. However, the context was one in which the liability of a parent for an infringement committed by its subsidiary was in issue (see, in particular, paragraph 98, and the reference to "parent-company" responsibility): it was not a question of the liability of a <u>non-participating</u> subsidiary who happened to be a member of the same undertaking.

(5) The Court of Justice, too, emphasised (at paragraph 54), that EU competition law focused on the activities of undertakings, that the concept of an undertaking meant "an economic unit even if in law that economic unit consists of several persons, natural or legal" (at paragraph 55), but that when such an economic unit infringed competition law, whilst that economic entity must answer for the infringement, the infringement "must be imputed unequivocally to a legal person on whom fines may be imposed" (at paragraph 56 to 57). Specifically on the question of imputation, the Court said this:

"58. It is clear from settled case-law that the conduct of a subsidiary may be imputed to the parent company in particular where, although having a separate legal personality, that subsidiary does not decide independently upon its own conduct on the market, but carries out, in all material respects, the instructions given to it by the parent company (see, to that effect, *Imperial Chemical Industries v Commission*, paragraphs 132 and 133; *Geigy v Commission*, paragraph 44; Case 6/72 *Europemballage and Continental Can v Commission* [1973] ECR 215, paragraph 15; and *Stora*, paragraph 26), having regard in particular to the economic, organisational and legal links between those two legal entities (see, by analogy, *Dansk Rørindustri and Others v Commission*, paragraph 117, and *ETI and Others*, paragraph 49).

59. That is the case because, in such a situation, the parent company and its subsidiary form a single economic unit and therefore form a single undertaking for the purposes of the case-law mentioned in paragraphs 54 and 55 of this judgment. Thus, the fact that a parent company and its subsidiary constitute a single undertaking within the meaning of Article [101 TFEU] enables the Commission to address a decision imposing fines to the parent company, without having to establish the personal involvement of the latter in the infringement.

60. In the specific case where a parent company has a 100% shareholding in a subsidiary which has infringed the Community competition rules, first, the parent company can exercise a decisive influence over the conduct of the subsidiary (see, to that effect, *Imperial Chemical Industries v Commission*, paragraphs 136 and 137) and, second, there is a rebuttable presumption that the parent company does in fact exercise a decisive influence over the conduct of its subsidiary (see, to that effect, *AEG-Telefunken v Commission*, paragraph 50, and *Stora*, paragraph 29).

61. In those circumstances, it is sufficient for the Commission to prove that the subsidiary is wholly owned by the parent company in order to presume that the parent exercises a decisive influence over the commercial policy of the subsidiary. The Commission will be able to regard the parent company as jointly and severally liable for the payment of the fine imposed on its subsidiary, unless the parent company, which has the burden of rebutting that presumption, adduces sufficient evidence to show that its subsidiary acts independently on the market (see, to that effect, *Stora*, paragraph 29)."

(6) On the question whether to attribute liability to the parent would amount to the introduction of strict liability contrary to the principle of personal responsibility, the Court echoed the view expressed by the Advocate General, stating at paragraph 77 of the judgment:

"77. It must be observed in that connection that, as it is clear from paragraph 56 of this judgment, Community competition law is based on the principle of the personal responsibility of the economic entity

> which has committed the infringement. If the parent company is part of that economic unit, which, as stated in paragraph 55 of this judgment, may consist of several legal persons, the parent company is regarded as jointly and severally liable with the other legal persons making up that unit for infringements of competition law. Even if the parent company does not participate directly in the infringement, it exercises, in such a case, a decisive influence over the subsidiaries which have participated in it. It follows that, in that context, the liability of the parent company cannot be regarded as strict liability."

(7) Thus, it is clear that where a subsidiary carries out the instructions of its parent in all material respects and has no autonomy in relation to its conduct on the market, its infringing conduct may be imputed to the parent. This is because the two companies form a single "undertaking". In the case of a 100% subsidiary the Commission is not required to prove the personal involvement of the parent in the infringement – there is a rebuttable presumption of decisive influence.

(8) However, this does not deal specifically with situations other than attribution to a parent – e.g. attribution to a subsidiary or to a sister company, where all are within a single "undertaking". In the case of subsidiaries that are not 100% owned, joint ventures or sister companies, there is no presumption of "decisive influence"; it must be established by evidence. Thus, in Cases C-231/11P to C-233/11P, *European Commission v Siemens AG Österreich*, [2014] 5 CMLR 1, the Advocate General stated:

> "80 In that regard, I nevertheless consider that, in the case of an undertaking made up of various legal persons, the persons who have participated in the cartel, as well as the ultimate parent company which exercises a decisive influence over them, may be regarded as legal entities collectively constituting a single undertaking for the purposes of competition law which may be held responsible for the acts of that undertaking. Consequently, if the Commission establishes that the undertaking has, either intentionally or negligently, committed an infringement of EU competition rules, it may determine the personal and collective liability of all the legal persons who make up the economic unit and who, by acting together, have participated, directly or indirectly, in the commission of the infringement.
>
> 81 It is specifically for that reason that the Court has found it to be compatible with the principle of personal responsibility – as well as with the objective of the effective implementation of the competition rules – to require the legal persons who participated in the infringement and, along with them, the person who exercised decisive

> influence over them, to bear joint and several responsibility, specifically because those persons form part of a single economic unit and, therefore, form a single undertaking…"

The Court of Justice's judgment was rather terser, but appeared to endorse this view at paragraphs 49 to 51.

(9) In *Provimi Ltd v Aventis Animal Nutition SA* [2003] ECC 29, Aikens J (as he then was) had to consider for the purposes of founding jurisdiction for a private competition action what legal persons comprised an undertaking, and whether liability for an infringement by one company within an undertaking could be attributed to any and all other companies who formed part of it:

> "25 …The nature of the cause of action, characterised according to English law, is that of a private law claim for damages for the tort of breach of statutory duty…So the broad issue is: what are the ingredients of a cause of action (in English law) for damages for infringing [Article 101(1) TFEU]. It is clear that the cause of action is a mixture of EU Competition law and English "domestic" law. Thus, what is a breach of [Article 101(1) TFEU] is a matter of EU law. But a claim for breach can only be made against an entity recognised by English domestic law. That entity must be shown to have been in breach of [Article 101(1) TFEU]. And it must be shown, as a matter of English law, that the entity that is in breach of [Article 101(1)] is liable in damages to this particular claimant for that breach.
>
> …
>
> 30 Therefore, the point comes down to this: what knowledge of the infringing agreement by the legal entity being sued, if any, does a claimant have to plead and prove in order to succeed in a claim for damages for infringement of [Article 101(1) TFEU]? There are no cases or even textbook opinions to provide me with a ready answer. Moreover, there is a tension between English law and EU Competition law concepts. In English law the separate entity of corporations is respected and knowledge of one corporation will not readily be imputed to another. But EU Competition law maintains the concept of an "undertaking", which is more flexible than a legal entity. It can embrace a number of legal entities, so long as they act as a single economic unit and no legal entity acts independently for any relevant purpose.
>
> 31 It seems to me to be arguable that where two corporate entities are part of an "undertaking" (call it "Undertaking A") and one of those entities has entered into an infringing agreement with other, independent, "undertakings", then if another corporate entity which is part of Undertaking A then implements that infringing agreement, it is also infringing [Article 101(1) TFEU]. In my view, it is arguable that it is not necessary to plead or prove any particular "concurrence

> of wills" between the two legal entities within Undertaking A. The EU competition law concept of an "undertaking" is that it is one economic unit. The legal entities that are a part of the one undertaking, by definition of the concept, have no independence of mind or action or will. They are to be regarded as all one. Therefore, so it seems to me, the mind and will of one legal entity is, for the purposes of [Article 101(1) TFEU], to be treated as the mind and will of the other entity. There is no question of having to "impute" the knowledge or will of one entity to another, because they are one and the same."

(10) Thus, Aiken J found to be "arguable" an analysis that holds liable any company within a single undertaking which implements, however innocently, an infringing agreement entered into by another company within the same undertaking with third parties.

(11) This analysis obtains some support from the Court of Justice's decision in *Akzo Nobel*, but as we have seen, the latter case only specifically covers attribution to a parent (having decisive influence) of a subsidiary's infringing conduct. It does not, for example, cover the converse situation where the parent is the actual infringing member of the "undertaking" and attribution to a subsidiary is in issue.

(12) In *Cooper Tire v Dow Deutschland* [2010] EWCA Civ 864, the Court of Appeal was of the view that the *Provimi* point was also arguable in the opposite direction. Longmore LJ stated at paragraph 45 of his judgment:

> "45. As to the Provimi point, we can readily agree that, as Aikens J said, it is "arguable". We would, however, add that it is also arguable the other way. Although one can see that a parent company should be liable for what its subsidiary has done on the basis that a parent company is presumed to be able to exercise (and actually exercise) decisive influence over a subsidiary, it is by no means obvious even in an Article [101 TFEU] context that a subsidiary should be liable for what its parent does, let alone for what another subsidiary does. Nor does the Provimi point sit comfortably with the apparent practice of the Commission, when it exercises its power to fine, to single out those who are primarily responsible or their parent companies rather than to impose a fine on all the entities of the relevant undertaking. If, moreover, liability can extend to any subsidiary company which is part of an undertaking, would such liability accrue to a subsidiary which did not deal in rubber at all, but another product entirely? These and other difficulties have been ventilated by Mr Nicholas Khan in the 2003 volume of European Lawyer page 16 and Mr Brian Kennelly in the May 2010 issue of the CPI Anti-Trust Journal."

(13) It is perhaps relevant to comment that if, as postulated by Longmore LJ, a subsidiary "did not deal in rubber at all", it might well not be part of the same "undertaking" in any event. The Court of Appeal noted that if they had been obliged to decide the point (which they were not), a reference to the Court of Justice might well have been necessary.

(14) The *Provimi* point was again considered by the Court of Appeal in *KME Yorkshire v Toshiba Carrier* [2012] EWCA Civ 1190. In what was an *obiter* comment, the Court indicated that the decision of the Court of Justice in Case C-196/99 P *Siderurgica Aristrain Madrid SL v Commission* [2003] ECR I-11005 had determined the *Provimi* point against the analysis which Aikens J considered arguable.

(15) In *Aristrain*, at paragraph 99 of its judgment, the Court of Justice said:

> "The simple fact that the share capital of two separate commercial companies is held by the same person or the same family is insufficient, in itself, to establish that those two companies are an economic unit with the result that, under Community competition law, the actions of one company can be attributed to the other and that one can be held liable to pay a fine for the other."

(16) It is not clear why the Court of Appeal in *KME* thought that this decision decided the point against Aikens J's analysis. As the High Court has pointed out in a recent case,[221] *Aristrain* decided a rather different point, namely that simply because separate companies are owned by the same person or family, they are not *ipso facto* to be treated as a single economic unit so that the actions of one can be attributed to the other. Indeed, if anything, *Aristrain* could be said to support the point Aikens J held to be "arguable", as in paragraph 99 the Court of Justice does not express the attribution of liability within a single "undertaking" in terms of parent/subsidiary, but in more general terms.

(17) Support for a somewhat wider attribution of liability for infringements within a single economic unit is to be found in the decision of the

[221] *DSG Retail Ltd and Others v MasterCard Incorporated and Others* [2015] EWHC 3673 (Ch) at paragraph 64.

Court of First Instance in Case T-43/02 *Jungbunzlauer AG v Commission* [2006] ECR II-3435. There the Court held that the Commission had been entitled to attribute liability for an infringement committed by one subsidiary (A) of a holding company to another subsidiary (B) of the same holding company. Although the Commission was held to be correct in not relying upon any presumption of "decisive influence" of B over A in such circumstances, it was entitled to find on the evidence that the holding company had devolved the management of the group business entirely to subsidiary B, so that subsidiary A "did not decide independently its own conduct on [the relevant] market, but carried out, in all material respects, the instructions given by" subsidiary B. In those circumstances, the Commission was held to have been right to attribute the infringement to B (see paragraphs 125-130 of the judgment).

(18) It follows that there can be attribution of liability as between co-subsidiaries. However, in *Jungbunzlauer*, this was because subsidiary B had the equivalent of decisive influence over subsidiary A. We have not been shown any authority where liability has been held to be attributable to a company which does not have "decisive influence" over the other company, merely because they are both members of the same "undertaking". As far as we are aware, no court has yet determined the question which Longmore LJ said he might well have referred to the Court of Justice for a preliminary ruling (see above). This may well be because it is unlikely that, in the absence of decisive influence of one company over another in relation to conduct in the relevant market, the companies concerned will form the same, or a part of the same, economic unit.

(19) No one has suggested that we should make a reference to the Court of Justice on this or on any other issue of EU law raised in these proceedings. Nor do we consider a reference on this point necessary or appropriate in the light of our other findings.

(20) It appears that, conceptually, the question as to the existence of an "undertaking" and the question as to the attribution of liability between different companies within an "undertaking" are distinct. It is sometimes necessary to identify the nature of a particular undertaking for other reasons than attribution of liability, e.g. in the *Hydrotherm* type of case (see paragraph 356 above). However, although distinct, the two questions are very closely related, and, as can be seen from the Court of Justice case law discussed above, are sometimes conflated as if they were two sides of the same coin. That is hardly surprising, given that Article 101 TFEU expresses its prohibition by reference to an "undertaking", which may comprise several legal or natural persons.

(21) It is certainly tempting to apply the logic relied upon by MasterCard, and hold that each and every constituent person forming part of an "undertaking" should be liable for an infringement for which that undertaking is responsible. Yet, as we have seen, the Court of Justice has not stated the position in such wide terms. Nor in our view would it be appropriate to go so far. In our view the current state of the law in this regard is most clearly expressed in the Advocate General's Opinion (endorsed by the Court of Justice) in Case C-231/11 P to C-233/11 P *Commission v Siemens* (paragraph 363(8) above).

(22) On that basis a legal person may be liable for a breach of competition law:

(i) Because he, she or it has in some way participated in that breach, as a part of the single economic unit or "undertaking" that has infringed the law; and/or

(ii) Because he, she or it has exercised a decisive influence over one or more of the persons within the "undertaking" who have participated in the infringement.

(23) On the other hand, in our view a person is not *ipso facto* liable for an infringement of Article 101 by reason only of the fact that he, she or it

is a member of an undertaking responsible as a matter of EU law for the infringement, in circumstances where the person in question neither participated in the infringement nor had decisive influence over the conduct in the relevant market of other member(s) of the undertaking who did participate. We appreciate that in such circumstances it may well be unlikely that the person in question would in fact be held to be part of that "undertaking".

(24) It follows that we cannot accept the first of MasterCard's two propositions at paragraph 361(1) above. It is too widely expressed.

(25) As far as MasterCard's second proposition is concerned, in our view it would be odd to have an asymmetric form of breach of competition law, having a different scope according as to whether the breach was being used to advance a claim or to advance a defence. And we consider that any other approach would insufficiently address the principles of equivalence and effectiveness stressed by the Court of Justice in *Crehan*.

364. Accordingly, it is necessary to consider whether Sainsbury's and Sainsbury's Bank are part of the same "undertaking", and, if so, whether Sainsbury's participated in any infringement of Article 101 and/or whether the acts, knowledge and state of mind of Sainsbury's Bank are attributable to Sainsbury's as a matter of EU law. We consider that it would be both wrong and unnecessary to apply the English rules of attribution.

365. We turn to the question of whether Sainsbury's and Sainsbury's Bank are indeed parts of the same "undertaking".

(b) Sainsbury's and Sainsbury's Bank as part of the same undertaking

(i) The facts

<u>Sainsbury's Bank</u>

366. Sainsbury's Bank began trading in February 1997. Until 31 January 2014, Sainsbury's Bank was a joint venture between J Sainsbury plc and Bank of

Scotland (a subsidiary of HBOS plc and ultimate subsidiary of Lloyds Bank Group plc).[222] From 1997 to 2007 J Sainsbury plc held 55% and Bank of Scotland 45%. From 2007 to 2014 each held 50%.

367. Sainsbury's Bank became a wholly owned subsidiary of J Sainsbury plc on 31 January 2014.[223] Thus, from 31 January 2014 onwards, Sainsbury's and Sainsbury's Bank were "sister" companies, having a common parent in the form of J Sainsbury plc. Prior to that date, there was obviously a link between the two companies, but they were not 100% held by a common holding company.

368. We were told that up to 31 January 2014, although to a decreasing extent, "Sainsbury's Bank operated within the framework of the banking services that were provided and run by [Bank of Scotland] and within the constraints of the [Bank of Scotland] (and later Lloyds) standard offering. So, whatever [Bank of Scotland]/Lloyds were doing for their core brands, we typically sat on the same systems and could only offer products with different combinations of the same product features."[224] Mrs Bernard explained how from when she joined in 2007 concern about Sainsbury's Bank's autonomy related to the operational control exercised by Bank of Scotland/Lloyds and not J Sainsbury plc: "… J Sainsbury was not involved in any questions of pricing strategy".[225] At Board level the position was governed by a Shareholders' Agreement and Sainsbury's Bank's Articles of Association:

"Throughout my time at the Bank, it was not possible for any decisions to be made without the approval of one Class A shareholder and one Class B shareholder, where [Bank of Scotland] (later Lloyds) and J Sainsbury [plc] represented the two types of shareholder[…]Each shareholder was entitled to appoint 3 Directors…".[226]

Regulation

369. As a bank, Sainsbury's Bank was subject to regulation by the Financial Services Authority, Prudential Regulation Authority and Financial Conduct

[222] Bernard 1/§7 and §12 .
[223] Bernard 1/§7.
[224] Bernard 1/§40.
[225] Bernard 1/§43.
[226] Bernard 1/§48.

Authority. Mrs Bernard's evidence was that the regulatory requirements of these organisations obliged Sainsbury's Bank to operate autonomously and that the board of Sainsbury's Bank was responsible for managing the Bank's strategy, performance and risk management systems.[227]

Interaction between Sainsbury's and Sainsbury's Bank

370. Although Sainsbury's and Sainsbury's Bank were distinct legal entities and although – as we accept – Sainsbury's Bank was obliged to operate autonomously, there was nevertheless a close interaction between the banking business of Sainsbury's Bank and the supermarket business of Sainsbury's, usually mediated through J Sainsbury plc.

371. A suite of agreements were set up under "Project Squadron" to establish Sainsbury's Bank. Of particular importance was a Marketing and Retail Services Agreement and a Generic Services Agreement which are described in more detail below.

372. The interaction between Sainsbury's Bank and Sainsbury's can be described under two broad heads.

373. First, in order to carry out its business, Sainsbury's Bank was acutely reliant on Sainsbury's. Indeed, it is fair to say that without Sainsbury's co-operation, the business of Sainsbury's Bank could not have been carried on. Of course, there are many discrete undertakings which – in order to carry on their business – require the co-operation of other undertakings. However, such co-operation is purchased at arm's length. In the case of Sainsbury's Bank and Sainsbury's, the co-operation, whilst to some extent paid for, does not appear, in certain respects at least, to have been strictly at arm's length.

374. Secondly, certain decision-making on matters affecting the businesses of both Sainsbury's Bank and Sainsbury's involved active consideration (by both Sainsbury's Bank and Sainsbury's) of what was best for the group, though it is clear that there were intended to be mutually beneficial elements in the relationship between Sainsbury's Bank and Sainsbury's .

[227] Bernard 1/§45.

375. These points are considered in more detail below.

<u>Sainsbury's Bank's reliance on Sainsbury's in order to carry on its business</u>

Use of Sainsbury's brand

376. In paragraph 69 of Bernard 1, Mrs Bernard notes that "J Sainsbury [plc] allows Sainsbury's Bank to use the Sainsbury's brand and to benefit from that brand recognition. This is outlined in the Marketing and Ancillary[228] Services Agreement (and Generic Services Agreement) [the latter] signed as part of the Squadron Agreement". The first of these agreements (entered in June 1998) provides for the holding company to provide "marketing services" to Sainsbury's Bank. These are to be charged to the Bank at fully-allocated costs including overheads (the basis of charging to change to "reasonable commercial prices" if J Sainsbury plc ceased to be a shareholder in Sainsbury's Bank). The same agreement provides for Sainsbury's Bank to use the brand name of which the holding company is the proprietor. No express provision for payment for this licence is contained in the agreement so far as we can see.

Use of Sainsbury's premises to access customers and sell products

377. Apart from offices for administration, Sainsbury's Bank did not have branches or other premises from which it conducted its business.[229] It conducted its customer-facing business through Sainsbury's supermarket premises. In paragraph 69 of Bernard 1, Mrs Bernard states:

> "Sainsbury's Bank is also allowed to send representatives into Sainsbury's Supermarkets' stores and to talk to customers directly with Sainsbury's Supermarkets' permission. It is also permitted to use space in Sainsbury's Supermarkets stores to install ATMs and travel money desks, and hang promotional advertising in return for a space rental fee."

378. As already mentioned, all "marketing services" provided to Sainsbury's Bank by the holding company were charged to Sainsbury's Bank at J Sainsbury plc's "actual costs and expenses incurred in providing" the services. The

[228] In fact the word is "Retailing", not "Ancillary".
[229] Bernard 1/§10.

services included making available to Sainsbury's Bank "Reward Card[230] and Spend and Save databases" and processing of reward points for Sainsbury's Bank's customers, various "instore facilities", including provision of employees to man marketing stands, provision of space for promotional activities, training of staff, maintaining promotional literature in stores, providing support for helplines, providing space for ATMs and supporting the maintenance thereof, and undertaking market research for Sainsbury's Bank on request.

379. Selling Sainsbury's Bank's products involved Sainsbury's acting as an appointed representative of Sainsbury's Bank:[231]

> "Sainsbury's Bank employed a third party, ODM, to sell Sainsbury's Bank products in Sainsbury's Supermarkets stores. Sainsbury's Bank would sell mainly credit cards but at times in the past we have also sold pet insurance, home insurance and savings accounts. Section 19 of the Financial Services and Markets Act 2000 requires that all parties carrying out regulated activities on behalf of other entities be approved as an appointed representative. Due to the fact that the third party was selling on behalf of Sainsbury's Bank in Sainsbury's Supermarkets stores we had to make the supermarket an appointed representative of Sainsbury's Bank. In this role, Sainsbury's Supermarkets had input only into which stores and at what times Sainsbury's Bank could market its products but not into determining the products sold or their pricing."

Access to, and use of, data

380. Sainsbury's Bank had access to certain data about Sainsbury's customers pursuant to the reward points scheme and, later, the Nectar scheme:[232]

> "Sainsbury's Bank has access to customer data acquired through the Nectar reward scheme. This scheme allows Sainsbury's Bank to register or record customers' Nectar card details and to use the data to aid marketing, product design and risk assessment for its product strategies and operations. Sainsbury's Bank is able to cross refer to customers' Nectar data to give them a more targeted credit score in order to offer them preferential interest rates. Also, using the spending data from customers' Nectar cards, Sainsbury's Bank can target specific products in our marketing to those individuals. If they bought pet food, for example, we might offer them pet insurance. The Nectar data is held by the Bank, populated by a data feed from J Sainsbury."

381. Unsurprisingly, this enabled Sainsbury's Bank to make better product offerings to its customers.[233]

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[230] Ultimately Nectar Points, which Mrs Bernard said formed "the link" between Sainsbury's Bank and Sainsbury's (e.g. Day 6/p.16ff).

[231] Bernard 1/§72.

[232] Bernard 1/70.

Common decision-making for the benefit of the group

382. It is – in business terms – a minor point, but the allocation of control over ATMs between Sainsbury's and Sainsbury's Bank is illustrative of how these entities operated within the group. The facts are briefly set out in MasterCard's closing submissions, which we adopt (omitting footnotes):

> "921. In 2013, Sainsbury's Supermarkets was advised that there was likely to be a significant new rates liability as a result of ATMs located at its stores. Under the terms of the agreements between Sainsbury's and [Sainsbury's Bank], even though this liability would initially fall on [Sainsbury's Bank] (as the controller of the ATMs), Sainsbury's was liable to reimburse [Sainsbury's Bank] for that cost. Under the name "Project Baron", it was decided that this liability for rates could be reduced by transferring "paramount control" over the ATMs from [Sainsbury's Bank] to Supermarkets. The decision did not confer any advantage to Sainsbury's Bank at all, and in fact exposed it to new risks, both that its revenue from ATM interchange could fall, and regulatory risk. As Sainsbury's own internal analysis recognised, this transfer of control "could have a detrimental impact of the Bank (and therefore on the Group), both from a regulatory and financial point of view."
>
> 922. Mr Rogers was asked how it could be in [Sainsbury's Bank's] interests to agree to this decision. His only answer was that [Sainsbury's Bank] decided that it "might well lead to a benefit for the group as a whole"."

383. This was a hallmark of the group's approach to common questions affecting Sainsbury's and Sainsbury's Bank: what would benefit the group as a whole?

384. Strategy documents identified the prospect of generating mutual benefits by creating and reinforcing "a virtuous loyalty circle with offers for JS shoppers whereby they were:

- Rewarded for JS loyalty with special SB offers
- Rewarded for SB loyalty with special JS and/or SB offers".[234]

"JS" and "SB" obviously refer to "J Sainsbury" and "Sainsbury's Bank".

385. This approach of creating a circle of loyalty was evident in the way (for example) in which the group considered deploying rewards (in the form of "Nectar" points) to customers, rewarding *(i)* spend at Sainsbury's stores using *(ii)* Sainsbury's Bank's credit cards.

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[233] Day 6/p37.

[234] This was part of a "Planning Day" powerpoint presentation. Mrs Bernard was asked about it on Day 6/pp31*ff*.

386. In cross-examination by Mr Cook, Mrs Bernard said this about the relationship between bank and supermarket:[235]

Q (Mr Cook)	…And what the group was trying to do is was basically get a nice feedback loop between the bank selling products and the stores selling groceries?
A (Mrs Bernard)	Yes, this is more about – this is the customer proposition. So this is about Sainsbury's customers felt rewarded for being loyal to the supermarket, and then equally the bank customers were rewarded for being loyal to the bank. It was to make the brand reinforcement stronger between the Sainsbury's Bank or grocery shopping.
Q (Mr Cook)	But the end result of that was you hoped that that would give you more shopping at Sainsbury's Supermarkets and more people buying financial products?
A (Mrs Bernard)	Yes, although in 2009 I don't think we – we were kind of early steps as to whether we thought there was going to be massive benefit for Sainsbury's Supermarkets. It was over time that we managed to demonstrate that there was this retail spend uplift.
Q (Mr Cook)	So the retail spend is people taking out credit cards; for example, Sainsbury's Supermarkets were getting a retail spend uplift from people buying your credit cards?
A (Mrs Bernard)	What we found over time was taking out any bank products gave a kind of halo to that relationship, and so then they became more loyal to Sainsbury's. Over time it looked like they were actually spending more of their discretionary purchase in Sainsbury's, so petrol, entertainment, things like that. So we managed to kind of make them feel warmer about Sainsbury's so they spent more of their money with us. …
Q (Mr Cook)	So you got longer lasting relationships if people took out a credit card or loan agreement with Sainsbury's Bank?
A (Mrs Bernard)	Yes, there was always kind of – the debate we had with people in Sainsbury's agency as to whether or not it was kind of chicken and egg. So is the fact they have taken out a Sainsbury's Bank product because they are going to stay with you longer, or have we in some way given them such a good view of Sainsbury's and reinforced what they thought about Sainsbury's that it meant they

[235] Day 6/pp32-33.

> stayed with Sainsbury's Supermarkets for longer? So there was always a kind of debate.
>
> We spent a long time trying to demonstrate that it was us that was driving the uplift and not self-selection."

387. Given these synergies, it is altogether unsurprising that decision-making in such areas as they arose was to some extent co-ordinated. An example of this was the "Payments Scheme Steering Group", which had a membership drawn from both Sainsbury's and Sainsbury's Bank. The Steering Group was established on the initiative of Mr Brooks in February 2013, Mr Brooks' initiative being authorised by Mr Rogers. The Steering Group's aim was to enable the group to have a "joined up approach to our relationships which have several touch points across Finance, Development, Retail, Online and the Bank",[236] so that "we have a consistent strategy and that any decisions that impact our strategy are fully aligned"[237] and that such issues were "all being captured at Board level and we are in fact joined up".[238]

(ii) Analysis

A single economic unit

388. We consider first whether in the light of the discussion above Sainsbury's and Sainsbury's Bank constituted or were members of a "single economic unit" or "undertaking" within the meaning of Article 101(1) TFEU.

389. The first point to note is that despite the synergies to which reference has been made, the two subsidiaries operate in very different markets – groceries and banking services. While this does not mean that they cannot form a single economic unit, it is nevertheless a relevant factor which leans against that conclusion.

390. Second, we bear in mind that, although Sainsbury's has throughout the relevant period been a wholly-owned subsidiary of J Sainsbury plc, for the vast majority of the claim period (2007-2014) Sainsbury's Bank has been 50% owned by the Bank of Scotland. Thus, while there is a presumption of

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[236] Email from Mr Brooks to Mr Rogers.
[237] Email from Mr Brooks to Mr Rogers.
[238] Email from Mr Brooks to Mr Rogers.

decisive influence of J Sainsbury plc over its wholly-owned subsidiary Sainsbury's, that presumption does not apply as between the plc and Sainsbury's Bank. Although it is possible for two 50% shareholders to have "decisive influence" over a joint venture company[239], in the present case it is the relationship between the joint venture company (Sainsbury's Bank) and a wholly-owned subsidiary of one of the joint venturers which we are considering. In this connection, we note that MasterCard does not argue that "decisive influence" either exists or is required for this purpose on the part of Sainsbury's over Sainsbury's Bank. According to MasterCard, adoption of the same course of conduct on the market is sufficient.[240] The problem with this argument is that unity of conduct on the market is precisely the behaviour of cartels. If that were the only touchstone for an "undertaking" to exist, many cartels would escape sanction.

391. There are, additionally, the important regulatory constraints applicable to Sainsbury's Bank as a bank, which we have identified earlier. Again, we do not consider that these are conclusive of the existence of a degree of autonomy inconsistent with membership of a wider single "undertaking". But they are clearly relevant factors to consider.

392. As against these features must be placed: (i) the dependence of Sainsbury's Bank upon the plc and Sainsbury's for the use of supermarket outlets, marketing services and secondment of staff, as well as the use of the Sainsbury's brand name; (ii) the various mutually beneficial arrangements aimed at creating a "virtuous loyalty circle" of joint customers; and (iii) the fact that at least some decisions were made with a view to benefitting the J Sainsbury plc group as a whole.

393. It is to be noted that many of the features of factors (i) and (ii) could well exist in an arm's length relationship between separate commercial entities. Indeed, the joint venture agreement between J Sainsbury plc and Bank of Scotland contemplated as a possibility the divestment by J Sainsbury plc of its interest in Sainsbury's Bank. However, it is clear that the relationship between

[239] See e.g. Case C-179/12 P *Dow Chemical v Commission* [2014] 4 CMLR 6.
[240] Transcript Day 23/pp. 155-156.

J Sainsbury plc and Sainsbury's on the one hand, and Sainsbury's Bank on the other, is not purely arm's length. For example, Sainsbury's Bank did not pay an arm's length commercial price for the marketing services but rather cost-based prices (albeit fully-allocated, including overheads). Similarly, the trademark licence does not appear to have been subject to a specific fee. On the other hand, both shareholders (J Sainsbury plc and Bank of Scotland) brought something to the feast to enable their joint venture to develop a viable banking business, albeit one which has been centred on Sainsbury's supermarket outlets.

394. As well as pointing to Sainsbury's Bank's reliance upon Sainsbury's marketing services, its infrastructure and personnel, MasterCard has emphasised that Sainsbury's took an interest in the rewards benefits available on cards issued by Sainsbury's Bank, as driving additional spending in Sainsbury's stores, and also in the proportion of Interchange Fees emanating from Sainsbury's stores which were earned by Sainsbury's Bank as compared with other banks, including banks owned by Sainsbury's competitors e.g. Tesco.[241] This latter was an example of "group" considerations being taken into account. We have already referred to another very clear example of the group-oriented nature of some of the decisions, i.e. the decision by Sainsbury's Bank to take some (albeit a calculated and low) commercial risk in order to secure a substantial and continuing saving of business rates in respect of ATMs, for the benefit of the group as a whole.

395. Much emphasis is also placed by MasterCard upon the "Payments Scheme Steering Group" set up in 2013 and described earlier[242] as establishing that Sainsbury's Bank's strategy in relation to credit cards was decided upon collectively based on the interests of the group as a whole.

396. These are important considerations when one comes to determine whether there was in existence during all or part of the claim period a single economic unit comprising or including both subsidiaries.

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[241] See MasterCard Closing pp. 265-268 and documents referred to there.

[242] See above at paragraph 387, and also e.g. MasterCard Closing at pp. 268-274.

397. However, we have come to the conclusion on balance, and having regard to the evidence as a whole, that the test for an "undertaking" is not satisfied here. It is to be borne in mind that any relevant "undertaking" must relate to the restriction which is said to offend Article 101 TFEU – in this case the setting of the UK MIF (see *Hydrotherm*, at paragraph 356 above). Further, *Hydrotherm* emphasises the need for the persons within a single "undertaking" to have "identical interests". In *Akzo* (see paragraph 363(2) above), the General Court struck a similar chord when it referred to a "unitary organisation" pursuing "a specific economic aim". Even taking fully into account the synergies, co-ordination of some decision-making and overlapping interests relied upon by MasterCard, we do not consider that the two subsidiaries here satisfy these criteria. Although, as a group member and also as a retailer paying Interchange Fees, Sainsbury's naturally has an interest in the UK MIF, in its level and in who benefits from it, the setting and implementation of the MIF are very much within Sainsbury's Bank's sphere of interest. The interests of the two subsidiaries, although overlapping, are not identical, nor can they be described as forming a "unitary organisation". Although there are clear economic links between them, as members of the same group, these cannot be reduced to "a specific economic aim". It is also to be noted that for the vast majority of the claim period Sainsbury's Bank was 50%-owned by Bank of Scotland/Lloyds. On the evidence we conclude that, despite its close commercial connections with the J Sainsbury plc parent company and with Sainsbury's, Sainsbury's Bank's autonomy on the market as a separate and distinct banking business with its own fully-functioning board, was not compromised. One must, in that regard, also bear in mind the very significant regulatory overlay to which we have referred, and with which it was necessary for Sainsbury's Bank, as a bank, to comply strictly.

398. Although in the light of all the evidence the two subsidiaries do not in our view form (or form part of) a "single economic unit" as that concept is understood in EU law, as the case is one where this issue is finely balanced, we go on to consider the related question of attribution. We do so on the assumption that we are wrong in our conclusion, and that Sainsbury's and Sainsbury's Bank are part of the same "undertaking".

Is Sainsbury's responsible in law for an infringement by Sainsbury's Bank?

399. On the assumption that, contrary to our finding, the two subsidiaries are members of the same "single economic unit", it is necessary to consider whether, by reference to the principles of EU law discussed earlier, infringing conduct of Sainsbury's Bank falls to be attributed to its co-subsidiary, Sainsbury's.

400. In the light of our earlier discussion, we consider that Sainsbury's is not liable for an infringement committed by the "undertaking" of which it is assumed to be a member by reason only of its membership of that undertaking. To be liable, Sainsbury's must either (i) have decisive influence over another member (Sainsbury's Bank) which has participated in the infringement and/or (ii) have itself so participated. Neither of these criteria is satisfied here.

401. Despite the co-operative and close business relationship between the two subsidiaries, it is clear that Sainsbury's did not have decisive influence such that Sainsbury's Bank did "not decide independently upon its own conduct on the market, but carrie[d] out, in all material respects, the instructions given to it by" Sainsbury's. If that condition were satisfied it would be likely to mean that Sainsbury's Bank was in breach of the regulatory obligations imposed on a bank. In any event, the evidence does not begin to establish decisive influence in that sense, and, as already noted, it is not part of the case put forward by MasterCard (see paragraph 390 above).

402. If such influence were to exist on the part of the 50% (later, in 2014, 100%) shareholder, J Sainsbury plc, that would not assist MasterCard, since the claim is brought by Sainsbury's and not by its parent company, and the illegality defence would therefore need to succeed against Sainsbury's.

403. As for the alternative basis for attributing liability to Sainsbury's, namely that the supermarket subsidiary participated in the infringing conduct, this only needs to be stated to be rejected. It is MasterCard's case that membership of the same "undertaking" is the salient trigger for attribution, not that Sainsbury's was an actual participant in the alleged unlawful setting or

implementation of the UK MIF (see paragraphs 17(3), 292(3) and 361 above). We therefore do not consider this aspect further.

404. There is a further issue to consider on the assumption that we are wrong in holding that Sainsbury's and Sainsbury's Bank were not members of a "single economic unit" or "undertaking" and that Sainsbury's Bank's infringing conduct cannot be attributed to Sainsbury's. This issue relates to the circumstances in which, as a matter of EU law, a party to an infringing agreement can rely upon the infringement in order to recover damages.

(5) "Significant Responsibility" - The Illegality Defence as Between Parties to the Same (Anti-Competitive) Agreement

405. We have already referred to Case C-453/99, *Courage Ltd v Crehan*, [2001] ECR I-6297, [2002] 1 QB 507 in which the Court of Appeal referred various questions to the Court of Justice concerning the inter-relationship between directly effective EU rights under Article 101 and the illegality defence. One of the matters troubling the Court of Appeal was whether – because Mr Crehan was a party to an illegal beer tie agreement – his claim for damages and other relief against the brewer who was the counterparty to the beer tie agreement would automatically be barred by an illegality defence and – if so – whether this was consistent with EU law.

406. As is clear from the foregoing paragraphs, although the English law of illegality is in a state of considerable uncertainly, it is certainly not the case that participation in an illegal agreement automatically precludes a claimant party to that agreement from bringing a claim. That is self-evident from the "policy-oriented" approach; but it is also true of the "rule-based" approach. It is quite possible for one party to the agreement to have the requisite state of mind to render his, her or its conduct "turpitudinous", but for the other party <u>not</u> to have that state of mind.

407. In *Crehan*, the Court of Justice made clear that this nuanced approach was consistent with EU law.

> "31 Similarly, provided that the principles of equivalence and effectiveness are respected (see *Palmisani,* paragraph 27), Community law does not preclude

national law from denying a party who is found to bear significant responsibility for the distortion of competition the right to obtain damages from the other contracting party. Under a principle which is recognised in most of the legal systems of the Member States and which the Court has applied in the past (see *Commission of the European Communities v Italian Republic* (Case 39/72) [1973] ECR 101, 11:2, para 10), a litigant should not profit from his own unlawful conduct, where this is proven.

32 In that regard, the matters to be taken into account by the competent national court include the economic and legal context in which the parties find themselves and, as the United Kingdom Government rightly points out, the respective bargaining power and conduct of the two parties to the contract.

33 In particular, it is for the national court to ascertain whether the party who claims to have suffered loss through concluding a contract that is liable to restrict or distort competition found himself in a markedly weaker position than the other party, such as seriously to compromise or even eliminate his freedom to negotiate the terms of the contract and his capacity to avoid the loss or reduce its extent, in particular by availing himself in good time of all the legal remedies available to him."

408. It remains an open question as to whether the principles of illegality enunciated by the UK Supreme Court are, in all circumstances, compliant with the Court of Justice's statements regarding the need to establish "significant responsibility" and to take account of "respective bargaining power". It may well be that although differently formulated, they do.

409. In any event, given our conclusion that the conduct of Sainsbury's Bank – attributing that conduct to Sainsbury's – was insufficiently wrongful to amount to "turpitude" on either test, and given also our conclusions on "undertaking" and attribution, this is not a matter we need to decide: but we do in case this matter goes further.

410. We do not consider that it can be said that Sainsbury's Bank (whether its conduct is viewed together with that of Sainsbury's or in isolation) can be said to have significant responsibility for the distortion of competition:

411. We refer in this regard to the matters discussed above on the question whether MasterCard's infringement of Article 101 TFEU (and, *a fortiori*, any infringement by Sainsbury's Bank) amounts to turpitude for the purposes of the English domestic law of illegality (see paragraphs 313 to 335 above). Our conclusion that turpitude in that sense was not present, even on the part of MasterCard, and that the infringement was "innocent" in the sense of being

neither deliberate nor negligent, is a relevant factor when one comes to consider whether Sainsbury's Bank (and Sainsbury's by assumed attribution) bears "significant responsibility" for it.

412. Further, in the light of the guidance provided by the Court of Justice in *Courage* a relevant factor in assessment of "significant responsibility" is the relative bargaining positions of the parties to the offending agreement, and in particular whether the claimant was in a "markedly weaker position than the other party, such as to compromise or even eliminate his freedom to negotiate the terms of the contract…"

413. Mrs Bernard's undisputed evidence was that Sainsbury's Bank was a small bank with a balance sheet ranging from £3-5 billion over its history, beginning in 1997, as compared with its ultimate co-parent, Lloyds Banking Group plc, with a balance sheet of nearly £1.5 trillion. Mrs Bernard stated that Sainsbury's Bank's share of the total UK credit and issuing market was less than 1% at the end of 2013 (measured in terms of its share of total credit cards issued). According to the same witness, Sainsbury's Bank never had any role in setting the UK MIF and was not in a position to influence it.

414. Moreover, for most of the claim period, up to the beginning of 2014, Sainsbury's Bank was only an "affiliate" member of the MasterCard Scheme. As such, Sainsbury's Bank participated indirectly in the Scheme through the sponsorship of a Principal, namely Bank of Scotland/Lloyds.[243]

415. Thus, for almost the whole of the claim period, Sainsbury's Bank's participation in issuing MasterCard credit cards fell under the umbrella of its sponsor, Bank of Scotland/Lloyds, and was subject to the latter's relationships with MasterCard.

416. In these circumstances, it is unreal to argue that Sainsbury's Bank would have been in a position to influence, or negotiate with MasterCard, the setting of the UK MIF. MasterCard argue that Sainsbury's Bank made a "free choice to participate in the MasterCard scheme for its own commercial reasons". That

[243] See Bernard 1, §§8-22 and 75-80 and Abrahams 1, §20.

is true, but if one wishes to enter the UK market as an Issuing Bank, the choice of payment schemes is, and was, fairly limited, with MasterCard and Visa the two main choices. There is no reason to believe that Sainsbury's Bank would have been in any stronger bargaining position had it decided to participate in the Visa Scheme instead of MasterCard.

417. We conclude, in the light of the evidence, that Sainsbury's Bank's bargaining power to influence the level of the UK MIF set by MasterCard was in reality zero.

418. MasterCard also argues that Sainsbury's Bank could, instead of accepting what is a default fee, have negotiated a bilateral fee with acquirers. Whether or not such a course of action was realistic in the presence of a MIF set by the Master Card Scheme, we consider that it has little if any bearing on Sainsbury's Bank's responsibility for the infringement represented by the UK MIF. It must be remembered that it is the setting of an excessively high MIF which is the infringement relied upon by Sainsbury's. This MIF was set by MasterCard, not by Sainsbury's Bank who, as we have found, had no influence whatsoever over that process.

(6) Conclusion on Ex Turpi Causa

419. In the light of the above, MasterCard's *ex turpi causa* argument fails for the following reasons:

(1) There is no, or insufficient, turpitude on the part of Sainsbury's Bank.

(2) Sainsbury's Bank and Sainsbury's are not members of a relevant "single economic unit" or "undertaking" within the meaning of Article 101(1) TFEU.

(3) Even if these companies are each members of the same relevant "undertaking", any infringing conduct on the part of Sainsbury's Bank is not to be attributed to Sainsbury's so as to render the latter liable along with Sainsbury's Bank for any such infringement.

(4) In any event, Sainsbury's Bank (and Sainsbury's) does not bear "significant responsibility" for an infringement of Article 101 TFEU by MasterCard in relation to the setting of the UK MIF.

K. Damages and Interest On Damages

(1) Issues Arising

420. We have found that:

(1) The UK MIF infringes Article 101(1) TFEU, in that it is a restriction of competition by effect. Our reasoning in this regard is set out in Section H above.

(2) The UK MIF, as set during the claim period, was not exemptible under Article 101(3) TFEU, for the reasons we give in Section I above.

(3) In the counterfactual world that we used to assess the effect of the UK MIF, bilateral Interchange Fees would have been agreed, resulting in Interchange Fees of (the equivalent of[244]) 0.50% for credit cards.[245] Absent the likelihood of a bilaterally agreed Interchange Fee, we consider that a MIF of 0.46% for credit cards might potentially be exemptible.[246] However, we consider that given the prospect of a bilaterally agreed Interchange Fee, then only a MIF at a far lower rate than 0.50% would be exemptible.[247]

(4) The bilaterally agreed Interchange Fee for debit cards would be 0.27%.[248] Apart from the difference in rate, our conclusions regarding exemptible MIF, as we have expressed them in relation to credit cards, apply equally to debit cards.

(5) MasterCard's illegality defence fails for the reasons we give in Section J above.

[244] As we have stated in paragraph 197(3)(ii) above, we consider that the Interchange Fees paid to Issuing Banks would be calculated altogether differently.
[245] See paragraph 226(4) above.
[246] See paragraphs 226(4) and 289(8) above.
[247] For the reasons we give in paragraph 271 above.
[248] See paragraph 233.

421. In these circumstances, Sainsbury's claim for breach of statutory duty succeeds, and it is necessary to assess what (if any) damages flow from MasterCard's breach of that duty.

422. A number of issues arise. We consider them under the following heads:

(1) *The overcharge.* It is necessary to consider the extent to which Sainsbury's has been overcharged. As to this:

(i) It was common ground between the parties that the starting point for calculating the overcharge was the difference between the UK MIF actually paid by Sainsbury's and the highest lawful Interchange Fee that would have been charged in the counterfactual world.[249]

(ii) In determining whether there had been an infringement of Article 101(1) TFEU in Section H above, we had cause to consider both what Sainsbury's actually paid in Interchange Fees, and what the highest lawful Interchange Fee would have been. We draw on the conclusions we reached in Section H to inform our assessment of the overcharge for the purposes of assessing damages.

(iii) In theory, there might have had to be some further adjustment to the damages awarded to reflect the fact that, if the highest lawful Interchange Fee were <u>too low</u>, there might be some cut-back in terms of the benefits provided by Issuing Banks pursuant to the MasterCard Scheme, which would have to be reflected in any damages awarded. However, we concluded – in paragraphs 264 and 265 above – that there would be no such contraction of benefits, and so this particular question does not arise.

[249] Of course, the highest lawful Interchange Fee that could have been paid would be unlimited if paid pursuant to a bilateral agreement. But this would be constrained by what the relevant parties (Issuing Banks, Acquiring Banks and Merchants) would have agreed. The "highest lawful Interchange Fee" thus refers to the higher of an exemptible MIF or the bilateral rate that would have been agreed in the counterfactual world.

We consider the extent to which Sainsbury's was overcharged in Section K(2) below.

(2) *The pass-on "defence" and mitigation of loss.* Given the way MasterCard put its case on pass-on and mitigation, it is appropriate to consider these points together. We do so in Section K(3) below.

(3) *"Benefits"*. It was common ground between the parties that if, and to the extent that, Sainsbury's was better off by reason of the wrong committed by MasterCard, it would have to give credit for this. Although the parties agreed that Sainsbury's had benefits from higher (unlawful) MIFs received by it over the claim period, the extent of the benefit was hotly contested. This point is considered in section K(4).

(4) *Interest.* Although there was no dispute that Sainsbury's was entitled to interest on the damages awarded to it, the rate at which interest should be calculated and whether interest should be compounded were both matters in dispute. Interest is considered in Section K(5) below.

(2) The Extent of the Overcharge as the Measure of Damages

423. There are a few general principles which inform the assessment of damages:

(1) First, the court should award as damages "that sum of money which will put the party who has been injured, or who has suffered, in the same position as he would have been in if he had not sustained the wrong for which he is now getting his compensation or reparation".[250] Obviously, this involves assessing the injury that the claimant has sustained measured against what would have happened had the wrong to the claimant never occurred.

(2) Secondly, in carrying out such an assessment, it is necessary to bear in mind the distinction drawn by Lord Diplock in *Mallett v McMonagle*:[251]

[250] *Livingstone v Rawyards Coal Co* (1880) 5 App Cas 25 at 39.
[251] [1970] 1 AC 166 at 176.

> "In determining what did happen in the past a court decides on the balance of probabilities. Anything that is more probable than not it treats as certain. But in assessing damages which depend upon its view as to what will happen in the future or would have happened in the future if something had not happened in the past, the court must make an estimate as to what are the chances that a particular thing will or would have happened and reflect those chances, whether they are more or less than even, in the amount of damages which it awards."

(3) Thirdly, when carrying out such an assessment, where there is an element of estimation and assumption – as frequently there will be – restoration by way of compensation is often accomplished by "sound imagination" and a "broad axe".[252]

424. As we have already noted, computation of the overcharge involves an assessment of two values, Sainsbury's damages being the difference between the two:

(1) First, precisely what Sainsbury's actually paid by way of UK MIF during the claim period.

(2) Secondly, what Sainsbury's would have paid by way of Interchange Fees had the wrong not been committed by MasterCard.

425. As we have noted, both of these values have already been computed for the purposes of determining whether there has been an infringement of Article 101(1) TFEU.

426. What Sainsbury's paid by way of UK MIF over the claim period was considered in paragraphs 200 to 210 above and (in particular) <u>Table 3</u> (which set out the MIFs actually paid by Sainsbury's in respect of MasterCard credit card transactions) and <u>Table 4</u> (which set out the MIFs actually paid by Sainsbury's in respect of MasterCard debit card transactions).

427. As regards the highest lawful Interchange Fee that could have been paid by Sainsbury's, we concluded that the highest lawful Interchange Fees that

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[252] *Watson Laidlaw & Co Ltd v Pott Cassels & Williamson* [1914] SC(HL) 18 *per* Lord Shaw at paragraphs 29-30; *Devenish Nutrition Ltd v Sanofi-Aventis SA* [2007] EWHC 2394 (Ch) *per* Lewison J at paragraphs 27 to 29 and [2008] EWCA Civ 1086 *per* Arden LJ at paragraph 110 and Longmore LJ at paragraph 159.

Sainsbury's would have paid would have been (the equivalent of[253]) 0.50% in the case of credit cards[254] and 0.27% in the case of debit cards.[255]

428. We note that it was common ground that, under the Scots law on limitation, Sainsbury's is permitted to claim for transactions taking place in Scotland only for a period of 5 years (not 6 years, as is the case for England and Wales). The figures we have used take account of these different limitation periods in England and Wales, and in Scotland.[256] No further adjustment on account of this issue is therefore needed.[257]

429. Using the figures from Tables 3 and 4 to populate the data contained in Columns (2), (3) and (4) of the table below (Table 13), the overcharge in Column (6) of Table 13 is calculated as:

(1) The MIF actually paid, as set out in Column (2),

(2) Less the bilateral Interchange Fee that would have been paid – which, as we have noted was 0.50% in the case of credit cards and 0.27% in the case of debit cards. The amount to be deducted from the amount in Column (2) is calculated by applying the percentage in Column (5) to the value of sales in Column (3).

(1) Year	**(2) MIF paid**	**(3) Value of sales**	**(4) Rate of MIF paid**	**(5) Bilateral IF**	**(6) Overcharge**
MasterCard credit card transactions					
2006-2007	£2,302,513	£275,410,520	0.84%	0.50%	£925,460
2007-2008	£14,962,024	£1,777,950,170	0.84%	0.50%	£6,072,273
2008-2009	£18,698,170	£2,216,775,457	0.84%	0.50%	£7,614,293
2009-2010	£21,558,954	£2,515,172,861	0.86%	0.50%	£8,983,090
2010-2011	£24,912,372	£2,787,497,679	0.89%	0.50%	£10,974,884
2011-2012	£28,894,110	£3,144,136,186	0.92%	0.50%	£13,173,429

[253] As we have stated in paragraph 197(3)(ii) above, we consider that the Interchange Fees paid to Issuing Banks would be calculated altogether differently.
[254] See paragraph 226(4) above.
[255] See paragraph 233(3).
[256] Mr von Hinten-Reed confirmed at paragraph 5 of his memorandum dated 10 March 2016 and paragraph 2 of his memorandum dated 11 March 2016 that he had adjusted his figures to take account of the different limitation period in Scotland.
[257] Subject to paragraph 547 below.

2012-2013	£31,610,756	£3,296,436,234	0.96%	0.50%	£15,128,575
2013-2014	£33,227,251	£3,461,902,873	0.96%	0.50%	£15,917,737
2014-2015	£34,735,049	£3,552,791,403	0.98%	0.50%	£16,971,092
2015-2016	£19,241,532	£2,442,964,615	0.79%	0.50%	£7,026,709
All years					**£102,787,541**
Source: Table 3 above.					
Debit MasterCard transactions					
2006-2007	£0	£11	0.00%	0.27%	-£0.03
2007-2008	£5	£534	0.94%	0.27%	£3.56
2008-2009	£3	£146	2.05%	0.27%	£2.61
2009-2010	£44,778	£19,507,757	0.23%	0.27%	-£7,892.94
2010-2011	£229,539	£97,660,078	0.24%	0.27%	-£34,143.21
2011-2012	£327,130	£128,141,809	0.26%	0.27%	-£18,852.88
2012-2013	£302,954	£108,837,589	0.28%	0.27%	£9,092.51
2013-2014	£550,505	£138,570,021	0.40%	0.27%	£176,365.94
2014-2015	£821,172	£195,021,136	0.42%	0.27%	£294,614.93
2015-2016	£848,361	£187,831,755	0.45%	0.27%	£341,215.26
All years					**£760,406**
Source: Table 4 above.					

Table 13: The overcharge

430. We conclude that the overcharge, over the period referred to above, was £102,787,541 in the case of MasterCard credit cards and £760,406 in the case of MasterCard debit cards. Two further points arise in relation to this conclusion:

(1) As noted earlier, we formed the strong impression that it was common ground, or at least not contested, that the claim period ends on 9 December 2015, with the commencement of the 2015 Interchange Fee Regulations (see paragraph 17(4)(iii) above).[258] To the extent that Sainsbury's is maintaining a claim for damages beyond 9 December 2015 (which does not in fact appear to be the case), it is clear from our findings above that no damages would in any event be

[258] We note that on Day 23/p12, Mr Hoskins stated that "[…] the claim period is December 2006 to December 2015 […]", and this was not challenged by Sainsbury's. See also footnote 259 below.

recoverable because no overcharge would have existed at the regulated MIF.

(2) We understand that the figures in Table 13 contain data only up to November 2015, notwithstanding the reference to the years 2015-2016.[259] Therefore, for the present, we have calculated damages on the basis that the 2015-2016 figures in Table 13 should be included in their entirety. In case this is not correct, we reserve the question of the extent of any irrecoverable amount within the 2015-2016 figure for further argument, if the matter cannot be agreed by the parties.

431. We have considered the extent to which the approach we took in Section H needs modification in light of the principles for the assessment of damages summarised in paragraph 423 above, and have concluded that the assessment in Section H is fit for this purpose, and requires no modification.

(3) Pass-on and Mitigation of Loss

(a) An economist's understanding of mitigation and pass-on

432. We found an exchange between Dr Niels and Mr Brealey during the course of Dr Niels' cross-examination illuminating as regards the arguments of the parties in the (related areas) of pass-on and mitigation of loss. The exchange concerned how any overcharge (e.g. by way of unlawfully large Interchange Fees) was to be analysed:[260]

Q (Mr Brealey)	Now, this is what Mr Harman is doing here. He is looking at the cost savings that Sainsbury's make and trying to work out whether the overcharge could have been absorbed in these cost savings. That's the relevance of it. Do you understand that?
A (Dr Niels)	That seems to be the case, yes.
Q (Mr Brealey)	Clearly, if Sainsbury's absorbs an increase in interchange fees, it is not passing it on to the consumer in the form of higher prices,

[259] The Second Addendum to Von Hinten-Reed 2 and Mr von Hinten-Reed's two memoranda dated 10 and 11 March 2016 refer to November 2015 as the end point for the data provided.
[260] Day 16/pp42*ff*.

is it?

A (Dr Niels) Yes. If the interchange fee is absorbed and therefore leads to a lower profit margin, then that's not pass on, correct.

Q (Mr Brealey) Forget a lower profit margin. What about if it absorbs it into other cost savings, so it reduces? What Mr Harman is saying here is that you may make a saving elsewhere in order to absorb the increase in the interchange fee.

A (Dr Niels) Yes, I can't really comment on that from an economic perspective. I think here it becomes a bit more complicated what one means by absorption or pass-on.

Normally, as an economist, you think about MIF, MSCs as a cost. How is that cost reflected in price? I think here the analysis also turns to, well, how does one cost change maybe affect another cost change or a cost saving? So a higher cost here, would that lead to a cost saving here? And whether that's pass-on or not, I think from an economic perspective I can't really comment.

I think if there is a causal relationship between the two, as there also has to be with pass-on, here the cost goes up, and therefore – not the price changes, but this other cost changes causally, then that is a form of pass-on perhaps, but it's not necessarily the way I look at pass-on.

Q (Mr Brealey) You may as an economist say it is a form of pass-on, that's for the Tribunal to decide, but it is not pass-on in the form of lower prices or higher prices?

A (Dr Niels) Indeed. Instead of pass-on in prices, it is through another mechanism.

…

Q (Mr Brealey) [Quoting from Coupe 1/§§15-16.] "Should interchange fees go up or, indeed, any other costs in our business go up, our start point would not be to look to recover the money through the trading account, i.e. through the gross margin by raising prices. Our approach would always be to look at how we could absorb that increase in our cost base more widely. Of course, as I have said, as interchange fees are a tiny proportion of our overall costs it would be expected that any increase would be absorbed one way or another."

Now, I suggest to you that if Sainsbury's did absorb an increase in interchange fees into its overall cost base, that's not an indication of pass-on. Do you accept that?

A (Dr Niels) I think it is – one needs to be clear what is meant by "absorb" here, because there is scope for confusion. When you say absorb in the cost base, is it you just add it to the cost base, or do you reduce costs somewhere else? So maybe the question should be clarified?

Q (Mr Brealey) Let's assume it is reduce the costs somewhere else.

A (Dr Niels) So, again, from an economic perspective, if that's the case, I can't comment on it. I would say logically if there is a causal link between the two, so costs go up here and therefore you reduce costs elsewhere, then that's a form of pass-on, but also absorption. I think it is still a little bit confusing, the concepts here.

Q (Mr Brealey) You were here when, in opening, I gave my example of the sweetshop?

A (Dr Niels) I read that in the transcript.

Q (Mr Brealey) So, again, you've got a sweet shop, obviously buys the sweets wholesale, sells the sweets to the children, the wholesale price goes up by 10p because of someone's cartel, and rather than passing on the price – that 10p increase – to the children, the sweet shop reduces its marketing budget by 10p.

So, it makes the same profit, the prices have not gone up, but it has just spent less on marketing. I suggest to you that is not pass-on, whether in economics, in law, whatever. That is just simply not pass-on?

A (Dr Niels) I think it is an interesting question. I find it difficult to comment on. Absorption or pass-on usually, as an economist, I would think of does it come out of the profit margin or not? So in this example actually the profit margin is still the same. So whether you increase the price or reduce the other – your marketing spend, for example, your profit margin stays the same.

So from that perspective, you have not absorbed it in your profit margins, you have just cut costs somewhere else. I have to say it is an interesting question, but I haven't formed an opinion on whether one should label that pass-on, as an economist.

Q (Prof Beath) Would it help to clarify our minds if we phrased the question more in terms of who bears the burden of a change? If it is the consumer, I think that's what you would mean by pass-on. But if, for example, rather than marketing, the sweet shop paid its worker a pound less an hour, then in some sense the labourer would be bearing the burden of the change.

That might be a rather more helpful way of thinking about it.

A (Dr Niels) Yes, that is a good way of thinking about it.

Q (Mr Brealey) But even there, who bears the burden? The consumer in the marketing example is not bearing the burden of higher prices to the extent to which it extinguishes the loss to the sweet shop.

A (Dr Niels) That I agree with. In that example, so clearly here the children don't bear the burden. Unless the cost saving by the sweet shop was in some other bit of the service they offer to the children, like the shop is less clean or something.

Q (Mr Smith) I think what you are saying is that in Mr Brealey's example, the 10p increase in the wholesale price, if that results in a cut equivalent in the wages of the workers in the sweet shop, it has been passed, but has been passed on to the worker rather than to the purchasers of the sweets in the sweet shop?

A (Dr Niels) Yes, correct. But I'm not labeling that – as an economist, I'm not labeling that as pass-on for legal purposes. But yes, that would be a way of passing it on, true, yes.

Q (The Chairman) So in economic terms the only pass on that's relevant is when it comes out of the profit?

A (Dr Niels) That's how we – yes.

Q (The Chairman) The only thing that's not a pass on, which is true absorption, is if it actually comes out of the margin?

A (Dr Niels) Yes, indeed.

433. As this exchange illustrates, the notion of "passing-on" of a cost is a familiar concept in economics but that what is less clear is its practical implications. It will depend on conditions in both the demand for the product or service and the supply of inputs in its production. What this interchange is about is the practical issue of incidence: which party or parties bear the burden of absorbing the cost increase. Given that an efficient firm must – in order to turn a profit – pass its costs (one way or another) on to its consumers or else go out of business, pass-on might be said to be a fact of economic life (at least over time), occurring in relation to each and every cost, including an illegitimate or illegal overcharge like the UK MIF.

434. The problem is that it can be very difficult to ascertain whether and, if so, how, a given cost has been passed-on. The manner in which an enterprise might react to an overcharge was something that was explored in opening.[261] When faced with an unavoidable increase in cost, a firm can do one or more of four things:

(1) It can make less profit (or incur a loss or, if loss making, a greater loss).

(2) It can cut back on what it spends money on – reducing, for example, its marketing budget; or cutting back on advertising; or deciding not to make a capital investment (like a new factory or machine); or shedding staff.

(3) It can reduce its costs by negotiating with its own suppliers and/or employees to persuade them to accept less in payment for the same services.

(4) It can increase its own prices, and so pass the increased cost on to its purchasers.

435. The picture becomes even more complex when it is borne in mind that an enterprise is unlikely to react to an unavoidable increase in costs immediately. In the short term, a firm may well bear an unavoidable increase in costs by making less profit (or incurring a loss or a greater loss), but that is most unlikely to be the firm's response in the medium or long term. In the medium or long term, the firm will seek to maximise its profit in one of the ways enumerated in paragraph 434(2) to (4) above.

436. The manner in which Sainsbury's in fact reacted to the overcharge was an important part of MasterCard's case regarding pass-on and mitigation of loss. In its written closing submissions, MasterCard said:

> "424. The possible effects of a MIF overcharge on Sainsbury's are identified at [Von Hinten-Reed 2/§973] as follows:

[261] Day 2/pp109-110.

"As a result of any overcharge, it is possible that, relative to a scenario in which there was no overcharge:

- Sainsbury's prices might have been higher; and/or
- Spend in other areas might have been lower; and/or
- Profits might have been lower.""

Pausing there, we note that Mr von Hinten-Reed's schema is similar to the one we describe in paragraph 434 above. However, Mr von Hinten-Reed does not differentiate between cutting back on spending and reducing costs, a distinction which we consider to be important in the assessment of any damages. To carry on with MasterCard's written closing submissions:

"425. **Pass on** Under the first scenario, Sainsbury's is not entitled to claim damages in respect of any MIF which it passed on.

426. **Offsetting cost cuts** Under the second scenario, Sainsbury's is not entitled to claim damages to the extent that any part of the MIF overcharge was mitigated by cutting costs elsewhere.

427. **Reduced profits** Under the third scenario, Sainsbury's would be entitled to claim damages for lost profits. Sainsbury's has not, however, provided any analysis to suggest what any loss of profits as a result of a MIF overcharge was. It has simply denied any pass through and ignored that it is not entitled to claim for any loss which has been mitigated through cost cutting."

437. In order to evaluate these submissions, it is necessary to state and analyse the factual position, before considering the law relating to pass-on and mitigation and stating our conclusions.

(b) The facts and analysis of the facts

(i) Setting the Budget

438. Prior to its annual budget process, in the summer/early autumn of each year, Sainsbury's reviews its strategic or corporate plan. This is a rolling, five-year, "high level" plan, which is presented to the "Operating" and "PLC" boards around mid-October of each year.[262]

439. In around November/December of each year, Sainsbury's determines its capital expenditure ("capex") for the year ahead. This will determine, for

[262] Rogers 1/§16.

example, new store investment, including the type of new store or store extension.[263]

440. The expected sales for the coming year are then assessed. In his witness statement, Mr Rogers explained the process as follows:[264]

> "We develop various scenarios, reflecting different assumptions, for example, for "like-for-like" sales, and for direct marketing spend and its estimated impact on sales. These scenarios are used to generate a sales forecast which is issued to the responsible directors in the business in November/December. So, we will start at the top of the P&L, with where we expect sales to land. From that sales number, broken down broadly speaking by category and channel, we will then have a view as to the gross margin that should be delivered, taking account of any price investments that we believe we need to make during the year. Each Category Manager will then have a gross margin target for the year. The business, by Division, then has to construct its own Divisional budget based on the forecast sales number and reflecting the cost expectations set against the sales forecast."

441. Sainsbury's budgeting process is, thus, driven by anticipated sales, which gives a gross margin target for the year, which then informs the budget. Mr Rogers explained this as follows:[265]

> "The key determinants in establishing a Budget are the total and "like-for-like" sales and the gross margin on the one hand, and store labour and logistics costs on the other, simply because these are the big numbers. In essence, you start with the top-down assumptions on sales and volumes, the impact those have on margins and the costs required to deliver those sales; again, the big line items being store labour and logistics costs. Then, hopefully, your numbers stack up against internal and market expectations. If the numbers don't stack up, you'll typically go to one of the three or four key line items to make up the difference. You may drill down into the detail from time to time. For example, you might go to Central costs and give a one million pound challenge there or you might go to your bonus line and give a challenge there. But, when push comes to shove, it's the big cost line items that will bear the brunt of the challenge, unsurprisingly, because they are the biggest cost-line items."

442. Of course, the Divisional budgets are very detailed. Sainsbury's keeps close track of its costs, and whilst (when seeking to balance revenue and costs to reach the desired margin) no doubt the focus is on the big items, it is always possible to "drill down" to obtain much more granular detail.

443. The cost of goods sold ("COGS") – an enormous item – is handled through commercial trading teams.[266] These teams "set retail prices and are effectively

[263] Rogers 1/§16.
[264] Rogers 1/§17.
[265] Rogers 1/§18.
[266] Rogers 1/§19.

responsible for delivering their gross margin number. They do not have regard to the cost of interchange fees when setting their prices. Our gross margin used in pricing does not contain MSCs, or indeed any other costs apart from COGS and wastage. We need to focus on gross margin because, if we start to put other costs that the Buyers are not able to influence into the margin, that is demotivating. We want to keep it "clean" so that Buyers are given specific gross margin targets."[267]

444. The retail prices charged by Sainsbury's "are governed in principle by a multitude of factors, but in the main by direct input prices, competitor pricing and customer expectations."[268] Mr Coupe explained the relationship between COGS and the Sainsbury's selling price as follows:[269]

> "19 [Sainsbury's] does not operate on a cost-plus basis. To my knowledge none of our major competitors works on a "cost-plus" model to set prices. By cost-plus I mean I bought a product for a pound, I want to make a fixed 40% mark up so I sell it for £1.40.
>
> 20 The reason for that is that there are so many moving parts. I think it would actually be impossible to manage on a cost-plus basis, and, in the end (and it is sometimes quite difficult to get your head round), on an individual product basis, there is no relationship between the buying price and the selling price. That is because the markets operate separate to each other. So commodity price markets for wheat do not affect retail pricing in supermarkets in a direct way: indirectly, yes, but directly, no. Therefore, we are always looking for competitive advantage against each other, which means you get a very large amount of volatility in retail pricing, not least driven by things like promotion. So, there is a healthy paranoia in this consumer market. Because it is a very transparent market, which is heavily advertised, retail pricing is very obvious, and there is a constant desire for competitors to out-compete each other through, quite often, short-term price movements."

The manner in which Sainsbury's priced is considered in greater detail below.

445. Costs of operations – including the MSC – are generally handled through retail and logistics.[270] The MSC is regarded by Sainsbury's as a retail cost: they are included in the "Costs of Sales" lines of J Sainsbury plc's audited

[267] Rogers 1/§14.
[268] Rogers 1/§15.
[269] Coupe 1.
[270] Rogers 1/§19.

accounts and in the Retail Controllable Costs part of Sainsbury's management accounts.[271]

446. There is an unsurprising effort each year to reduce costs. "Every year we give the business a costs challenge in terms of efficiency savings when setting the Budget. So, historically, we would, for example, save between £100 million and £130 million per annum as a consequence of savings initiatives that we have taken within the business…".[272] These savings and efficiencies are "baked into" the Budget.

447. This is an iterative process:[273]

> "If the first numbers in the combined P&L's of all the Divisions fall short of where we think we need to be in the light of our aspirations and City expectations or, indeed, if there is an excess, we will go through a number of iterations to resolve this."

Often, a "star chamber" process is used, where Mr Coupe and Mr Rogers would meet the Divisional teams and go through the individual budgets.[274] In the end, the Budget would be presented to the Operating Board around the end of February each year and – once approved – to the PLC Board in March.[275]

448. MSCs – and specifically the Interchange Fee element – were regarded by Sainsbury's as a cost over which it had little or no control.[276]

449. One of the aims of the Budget is "to deliver profits in line with expectations, if at all possible".[277]

(ii) Monitoring and managing actual performance against Budget

450. Just as no battle plan ever survives contact with the enemy, so any budget will be challenged by what actually happens in the budgeted-for year. Sainsbury's monitors and manages actual performance against Budget throughout the year

[271] Rogers 1/§11.
[272] Rogers 1/§19.
[273] Rogers 1/§20.
[274] Rogers 1/§21.
[275] Rogers 1/§22.
[276] Rogers 1/§11; Brooks 1/§15.
[277] Rogers 1/§23.

and takes action to deliver profits in line with expectations, if that is possible.[278] Mr Rogers explains this as follows:[279]

> "24 I receive the "Latest View" each Period (we operate 13 four week Periods per year), which rolls up a forecast for the full financial year. I also receive the detailed Management Accounts for each Period. In addition, we have a mid-year review, the so-called Quarter Two Forecast, or "Q2F" process, in which we compare actual performance against the Budget and re-set the Budget as required. This may involve another "Star Chamber" process. All of this information and these processes involve broadly the same issue: how best to close any gap between actual projected profit performance and the profit we need to deliver to meet our own and the City's expectations."
>
> 25 The scale of the challenge may differ throughout the year: it is typically biggest when trying to set the Budget, but we may realise for example, through the Q2F process, that we cannot get to the right number just by improving the margin position through lower COGS and/or an increase in prices. This could then involve a challenge being made to other non-trading parts of the business, such as logistics, to save £x million, or a general requirement across the business to cut back costs like travel for the remaining part of the financial year.
>
> 26 Clearly, a profit gap can arise for any number of reasons during the year. For example, sales may be down, competitor pricing may be more aggressive than anticipated or a variety of costs may have increased beyond expectations.
>
> 27 If we are not on track we would be looking at ways of closing the gap, either through managing our margin or managing our operating cost base. The extent to which we felt we could manage either would drive how we might split any challenge across the business.
>
> 28 If, for example, we were better than expected on price versus our competitors then we may be comfortable in pushing our prices up a little bit. If we are out of line versus our competitors on price i.e. our prices are too high, we would not want to pull that lever. We would also ask our buyers to negotiate with suppliers in pushing for deeper discounts or additional promotional monies. We might also look to reduce our cost base, whether it is taking hours out of stores or managing other costs that we have an influence over to get to the right profit number. This would typically be an iterative process that we would be managing all the time as we go through the year, looking at our Latest View versus our Budget versus where the City is expecting us to outturn, all these things thrown into the mix, lots of moving parts, trying to land on a sixpence at the year-end with the right number…".

(iii) Pricing

451. Most of Sainsbury's business is food (grocery). About 10% is non-food.[280] In terms of its food pricing, Sainsbury's aims to be price competitive with its

[278] Rogers 1/§23.
[279] Rogers 1.
[280] Coupe 1/§18.

rivals (either or both Tesco and Asda) and would seek to price its products in line with (albeit not necessarily at exactly the same prices) these rivals. Historically, but less so now, Sainsbury's prices have been a little more than Tesco's and Asda's, with Sainsbury's seeking to focus on better quality and service than its competitors. The particular detail – which was fully described by Mr Coupe[281] – is not material for the purposes of this Judgment. What matters is that Sainsbury's – like its rivals – kept a very close eye on what prices the competition were charging on a daily basis, and would adjust 100s or even 1000s of prices to keep Sainsbury's prices "in line". Quite what "in line" means, so far as Sainsbury's was concerned, varied over time: what matters, however, is that these fluctuations would be driven not by COGS or indeed other costs, but by the prices of rivals.

452. The pricing of Sainsbury's non-food goods was similar. Mr Coupe states that "[a]s a general rule we have stuck with the concept of "High Street style at supermarket prices". The implication of this is that we must compete with the likes of Asda and Tesco on prices but in certain areas we shall benchmark against the High Street on price".[282] Clothing – because of its seasonality and the peculiarities of fashion – might fluctuate even more.[283] But, just as with groceries, there is a detachment between the price as sold by Sainsbury's and the cost paid for that good.

(iv) Sainsbury's cash balances and debt

453. During the claim period, Sainsbury's had substantial cash balances available to it, as well as debt facilities and monies raised from sale and lease-back arrangements. These are described by Mr Harman in Harman 2. Essentially:

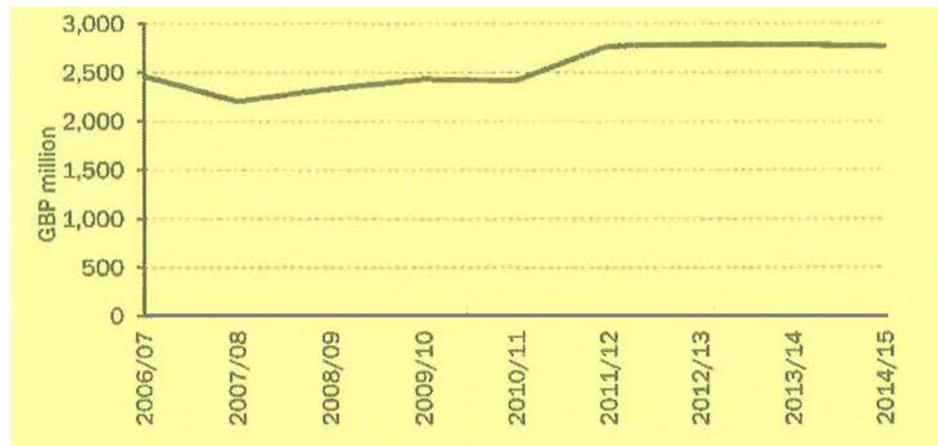
(1) The cash balances available to Sainsbury's over time were as follows[284]:

[…][✂]

[281] Coupe 1/§§21-42.
[282] Coupe 1/§44.
[283] Coupe 1/§46.
[284] This is a modified version of the graph at Harman 2/§5.4.

As can be seen, although these cash balances fluctuated considerably over time, they were never less than […][✂] and on occasion exceeded […][✂].

(2) Sainsbury's debt was, throughout the claim period, comfortably above £2 billion, dipping below £2.5 billion in the period to 2010/2011, and then rising to a plateau of about £2.8 billion.[285]



As to the nature of this debt, Mr Harman says that it was a mixture of bank loans, overdrafts and revolving credit facilities.[286]

(3) Throughout the claim period, Sainsbury's raised funds through sale and leaseback arrangements. Mr Harman describes these as follows:[287]

> "[Sainsbury's] raised funds throughout the claim period through sale and leasebacks arrangements. A sale and leaseback transaction involves cash being raised through the sale of an asset, with the seller immediately entering into an agreement to lease the asset from the buyer (typically over a long period). Over the claim period, [Sainsbury's] raised over £1.9bn through the sale and leaseback of its stores and depots…Sainsbury's used the funds raised through sale and leasebacks to finance the acquisition of new freehold property."

(4) Finally, J Sainsbury plc raised £242 million by issuing equity in June 2009 to fund the expansion of Sainsbury's space growth.[288]

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[285] This is a modified version of the graph at Harman 2/§5.10.
[286] Harman 2/§5.12.
[287] Harman 2/§§5.18 to 5.19.
[288] Harman 2/§5.23.

Sainsbury's experts did not seek to gainsay Mr Harman's figures (as opposed to his analysis of them), nor were they challenged in cross-examination. We accept them.

(v) Sainsbury's profits

454. The dividend that Sainsbury's has returned to its parent, J Sainsbury plc, has remained constant over the claim period.[289] It would appear that Sainsbury's seeks to make a constant return to its parent; any surplus is invested in the businesses; and, no doubt, a deficit would result in greater borrowing.

(vi) Analysis

455. In paragraph 434 above, we noted that, when faced with an unavoidable increase in cost, an enterprise can do one or more of four things:

(1) It can make less profit (or incur a loss or, if loss making, a greater loss).

(2) It can cut back on what it spends money on – reducing, for example, its marketing budget; or cutting back on advertising; or deciding not to make a capital investment (like a new factory or machine); or shedding staff.

(3) It can reduce its costs by negotiating with its own suppliers and/or employees to persuade them to accept less in payment for the same services.

(4) It can increase its own prices, and pass the cost on to its purchasers. (We should stress that here we are using "pass-on" in its economic sense of a producer recovering the costs of production from its customers: we consider whether this amounts to "pass-on" in the legal sense further below.)

456. The same questions pertain when considering – year-on-year – how to deal with an on-going cost that (for whatever reason) cannot be negotiated down by

[289] Reynolds 1/§22.

the payer. An enterprise's options are exactly the same. However, those options are informed by the market in which that enterprise is operating.

457. In this case, Sainsbury's operated in a highly competitive market. What is more, at all material times, the UK MIF was an industry-wide cost. Indeed, given the fact that MasterCard's MIFs were the same whoever the Merchant, it is a fair assumption that the rate of blended MIF paid by Tesco or Asda or Waitrose would have been materially the same as that of Sainsbury's.

458. We appreciate that the UK MIF was one of a multitude of individual cost items that Sainsbury's had to consider in its Budget. Indeed, although the UK MIF was a significant amount, there were many more significant costs that the Sainsbury's enterprise had to bear and to account for. In none of what follows do we suggest that there is anything special in the UK MIF that would require Sainsbury's budgeting team to accord it special attention: the UK MIF was a cost, like any other.

459. Like any firm, Sainsbury's would have been concerned to make a profit. By definition, and as we have noted, this involves setting a price for the goods and services it sells that at least covers its actual costs. *Prima facie*, therefore, we anticipate that – just as with any cost – Sainsbury's would have sought to pass the cost of its UK MIF on to its customers. Of course, given the range of products sold by Sainsbury's, and the multitude of costs incurred by Sainsbury's in doing so, it would be impossible to say what part of the price of any given product was attributable to the UK MIF. As Sainsbury's witnesses explained, and as we accept, Sainsbury's did not operate on a "cost-plus" basis. In this, Sainsbury's business is readily to be distinguished from that of Acquiring Banks, who obviously did price on a "cost-plus" basis: the MSC comprised essentially the MIF plus a little extra. But it was always possible for a Merchant to disaggregate the elements of the MSC.

460. Sainsbury's would not have been unconstrained in its ability to pass on the cost of its UK MIF to its customers. This is because of the circumstances of competition that existed between Sainsbury's and its supermarket rivals. Sainsbury's would be concerned to ensure that its prices remained in-line with

those of its rivals. That might well mean that Sainsbury's would not be able to pass-on all of the UK MIF to its customers, depending on what its rivals did (or, indeed, if Sainsbury's was minded to try to steal a march on its rivals).

461. At the same time, Sainsbury's would have *(i)* considered its own spending and *(ii)* sought to reduce its costs by negotiating reductions in price with its own suppliers and/or employees. We consider that Sainsbury's thinking would have been different in respect of these two forms of expenditure:

(1) *Reducing costs.* Each year, Sainsbury's would seek to reduce costs and become more efficient.[290] In terms of keeping costs down, we find that this is something that Sainsbury's would do as a matter of course and in any event. Such efforts would be unrelated to any particular unavoidable cost or cost increase: Sainsbury's would simply seek, year-on-year, to become more efficient.

(2) *Spending*. As regards spending, we consider that Sainsbury's approach would be more nuanced. Sainsbury's would appreciate that whereas negotiating reductions to its costs base involves persons other than Sainsbury's bearing or absorbing the cost, cutting back on spending – unless that spending is inefficient – will result in some reduction in the service being provided. Thus, for example, Sainsbury's could certainly avoid spending a great deal of money by not refurbishing its stores: but that is a course that is unlikely to recommend itself when considering the enterprise's medium and long-term future.

Once again, however, we consider that Sainsbury's efforts to reduce costs and spending decisions would not be capable of being related back to any given cost, whether that cost is the UK MIF or some other cost.

462. Of course, there is an on-going and continuous dynamic relationship between price and cost, an interplay that is constantly changing over time. It is to be inferred that Sainsbury's rivals are just as keen on reducing costs and avoiding unnecessary expenditure as Sainsbury's itself, and it may be that either

[290] See paragraph 450 above.

Sainsbury's or one of its rivals would consider it prudential in business terms to pass some costs savings on to customers – in which case, no doubt the others would follow suit.

463. As a last resort, Sainsbury's would make less profit. It is to be inferred that this did not in fact occur over the claim period. Over this period, Sainsbury's returned a constant dividend to its parent, J Sainsbury plc.[291] Sainsbury's profit margin was also reasonably stable over that period.[292]

464. We therefore conclude that exactly how Sainsbury's dealt with the costs that constituted the UK MIF is unknowable, but that (viewing matters at a high level of abstraction) Sainsbury's would have passed on to consumers what it could, made whatever cost-savings it could and – to the extent that its draft Budget returned a profit that was different to market expectations – adjusted its spending (e.g. by cutting back on or expanding capital projects) so as to return the expected profit. This approach, we find, is exactly what one would expect of a complex business selling multiple product lines in a competitive market.

465. Because the way in which the costs constituting the UK MIF were dealt with is unknowable, it is our conclusion that it is impossible to say what proportion of this cost was *(i)* passed on in the form of higher prices; or *(ii)* paid out of cost-savings; or *(iii)* paid for by reducing expenditure and so service levels.

466. MasterCard sought to persuade us that the level of pass-on was high. In paragraph 574 of its written closing submissions, MasterCard stated:

> "Accepted economic theory indicates that there will have been pass on of between 50 and 100% in the present case. There is overwhelming factual evidence that pass on by Sainsbury's will have been at the high end of this scale, i.e. closer to 100% than 50%".

467. If, by this, MasterCard was simply referring to the economist's understanding of pass-on – namely that an enterprise that is seeking to make a profit will endeavour to recover its costs (plus its profit) – then that may well be right. As MasterCard pointed out, and as we accept, the UK MIF was a cost common to

[291] See paragraph 454 above.
[292] Harman 1/§3.22, Table 3-4.

all supermarkets and so all supermarkets would endeavour to recover it. The UK MIF is not the sort of asymmetric cost that affects only Sainsbury's and not, for example, Tesco. In the case of an asymmetric cost, given the competitive market that supermarkets operate in, Sainsbury's might well not be able to pass that cost on to its customers. We agree that the likelihood that the UK MIF would be passed on increases because it is a cost that is (to put it neutrally) not insignificant and, moreover, is one that is monitored by Sainsbury's (and no doubt by its rivals).

468. But we do not need the sort of extensive submission such as is contained in paragraphs 454 to 573 of MasterCard's written closing submissions to tell us this. It is, with great respect to MasterCard's careful and detailed submissions, blindingly obvious that this must be the case. If Sainsbury's did not seek to recover the inevitable costs of its business from its customers, it would rapidly lose more than it made, and become an ex-business.

469. If that is the full extent of MasterCard's submission, then we accept it. Indeed, Sainsbury's did not seriously seek to challenge the analysis. However, if MasterCard, by its submissions, was seeking to assert that it was possible to link a given cost incurred by Sainsbury's to a specific price charged by Sainsbury's for a product sold by it or to a specific saving, then that is a submission that we have to reject as unarguable. It is obvious from the manner in which Sainsbury's carried on its business that such a nexus does not exist. It is quite simply impossible to say that of the price for Sainsbury's Loose Fairtrade Bananas – which at the time of this Judgment sell for 68p per kilogram – 0.1p (or any other amount) is attributable to the UK MIF and is the means by which Sainsbury's recovers the cost of the UK MIF. Given the manner in which Sainsbury's does business, the proposition that such a nexus exists would be a frankly absurd one.

470. To be clear, we do not consider that MasterCard was in fact advancing this contention: but it is important to be clear about the point, for then the question before us becomes whether the abstract "passing on" of cost – whether by way of cost savings or through prices to customers – is sufficient to entitle

MasterCard's reliance on mitigation and pass-on to succeed. That is the question to which we now turn.

(c) The law and our conclusions

471. We consider mitigation first, and then pass-on.

(i) Mitigation

472. It was MasterCard's case that "where an injured party takes action quite naturally arising out of the circumstances in which it was placed by the breach and in the ordinary course of business, where that action formed part of a continuous dealing with the situation in which it found itself and was not an independent or disconnected transaction, then any benefit arising from that action must be taken into account in the assessment of damages."[293]

473. The authority that MasterCard relied upon in support of this proposition was the decision of the House of Lords in *British Westinghouse Electric and Manufacturing Company Ltd v Underground Electric Railways Company of London Ltd* [1912] 1 AC 673. Although *British Westinghouse* is a case of breach of contract, it was accepted by both parties – and we agree – that the principles articulated are equally applicable in cases of breach of statutory duty.[294]

474. In that case:

(1) By a contract dated 12 March 1902, British Westinghouse agreed to provide to Underground Electric[295] eight steam turbines and eight turbo alternators at a defined contractual specification. These machines were duly delivered by British Westinghouse, but proved to be defective according to the terms of the contract with respect to their economy and steam consumption.

(2) Underground Electric accepted the machines and used them for the purposes of their railway, but reserved their right to damages in respect

[293] MasterCard Closing/§432.
[294] See *McGregor on Damages* paragraphs 9-109; *The Liverpool (No. 2)* [1963] Probate 64 at pp 77-78.
[295] The contract was originally with the Metropolitan District Electric Traction Company Ltd. By a subsequent agreement, Underground Electric was substituted. Nothing turns on this.

of the breaches of contract. Efforts were made – subject to this reservation – to bring the machines into conformity with the terms of the contract, but these failed.

(3) Thereafter, Underground Electric determined to replace the machines with new machines of a different design and manufacture – the so-called "Parsons" machines. The Parsons machines had a greater capacity and a much smaller steam consumption than the British Westinghouse machines, even if these had been contractually compliant.

(4) Thereafter, pursuant to an arbitration clause in the contract, the contractual dispute (for such it became) was referred to arbitration. The arbitrator found that the machines were defective. The importance of the case lies in relation to principles relating to damages. In this respect, there were a number of matters before the arbitrator:

(i) A claim by British Westinghouse for the balance of the contract price (83,293*l*). This claim failed because of the set-off of Underground Electric's counterclaim for damages, considered further below.[296]

(ii) A counterclaim claim by Underground Electric for:

(a) 280,987*l* odd, being the estimated loss caused by the excess in coal consumption for a period of 20 years, the estimated life of the British Westinghouse machines. This claim was not pressed at the arbitration.

(b) In the alternative, 78,186*l*, being the cost of installing the Parsons machines (including their purchase). The arbitrator found as a fact "that the purchase of the Parsons machines by [Underground Electric] was a reasonable and prudent course, and that it mitigated or prevented the loss and damage which would have been

[296] At 677 and 688.

recoverable from [British Westinghouse] if [Underground Electric] had continued to use the defective machines in the future. He further found that the purchase of the Parsons machines was to the pecuniary advantage of [Underground Electric], and that the superiority of the Parsons machines in efficiency and economy over those supplied by [British Westinghouse] was so great that even if [British Westinghouse] had delivered to [Underground Electric] machines in all respects complying with the conditions of the contract it would yet have been to the pecuniary advantage of [Underground Electric] at their own cost to have replaced the machines supplied by [British Westinghouse] by Parsons machines so soon as the latter were to be obtained."[297] The arbitrator referred this claim to the court by way of case stated, and in his award followed the response of the court, which was that the cost of and of installing the Parsons machines was recoverable.

(c) A claim for approximately 42,000*l*, the estimated loss caused by the excess in coal consumption (by reason of the breach of contract) during the time Underground Electric was using the British Westinghouse machines. The arbitrator upheld this claim.

(5) The award was appealed. There were issues as to the jurisdiction of the court to review an award following provisions by the courts of an answer to a case stated by the arbitrator, which are irrelevant for present purposes and which we disregard. On the issues of quantum, the House of Lords (Lord Haldane LC giving the only opinion) noted that Underground Electric's claim for the costs of the purchase and installation of the Parsons machines was based upon the contention

[297] At 676.

that this was a necessary cost and expense incurred by them in mitigating their loss.[298]

(6) Lord Haldane summarised the arbitrator's findings of fact as follows:[299]

> "The arbitrator appears to me to have found clearly that the effect of the superiority of the Parsons machines and of their efficiency in reducing working expenses was in point of fact such that all loss was extinguished, and that actually [Underground Electric] made a profit by the course they took. They were doubtless not bound to purchase machines of a greater kilowatt power than those originally contracted for, but they in fact took the wise course in the circumstances of doing so, with pecuniary advantage to themselves. They had, moreover, used [British Westinghouse's] machines for several years, and had recovered compensation for the loss incurred by reason of these machines not being during these years up to the standard required by the contract. After that period the arbitrator found that it was reasonable and prudent to take the course they actually did in purchasing the more powerful machines, and that all the remaining loss and damages was thereby wiped out."

(7) Lord Haldane then sought to articulate certain well-established propositions relating to the assessment of damages, noting however that "[t]he quantum of damage is a question of fact, and the only guidance the law can give is to lay down general principles which afford at times but scanty assistance in dealing with particular cases."[300]

(8) As to these principles:

(i) He noted that the fundamental basis for the assessment of damages was compensation for pecuniary loss flowing from the breach (although Lord Haldane described the contractual test for this, since this was a case of breach of contract). He went on to say that:[301]

> "…this first principle is qualified by a second, which imposes on a plaintiff the duty of taking all reasonable steps to mitigate the loss consequent on the breach, and debars him from claiming any part of the damage which is due to his neglect to take such steps."

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[298] At 684.
[299] At 688.
[300] At 688.
[301] At 689.

(ii) He went on:[302]

> "…this second principle does not impose on the plaintiff an obligation to take any step which a reasonable and prudent man would not ordinarily take in the course of his business.[303] But when in the course of his business he has taken action arising out of the transaction, which action has diminished his loss, the effect in actual diminution of the loss he has suffered may be taken into account even though there was no duty on him to act.
>
> …
>
> …provided the course taken to protect himself by the plaintiff in such an action was one which a reasonable and prudent person might in the ordinary conduct of business properly have taken, and in fact did take whether bound to or not, a jury or an arbitrator may properly look at the whole of the facts and ascertain the result in estimating the quantum of damage."

(iii) However, when looking at the "whole of the facts" it is necessary to leave out of account matters that are *res inter alios acta*:[304]

> "Recent illustrations of the way in which this principle has been applied, and the facts have been allowed to speak for themselves, are to be found in the decisions of the Judicial Committee of the Privy Council in *Erie County Natural Gas and Fuel Co. v. Carroll* and *Wertheim v. Chicoutimi Pulp Co.* <u>The subsequent transaction, if to be taken into account, must be one arising out of the consequences of the breach and in the ordinary course of business.</u> This distinguishes such cases from a quite different class illustrated by *Bradburn v. Great Western Ry. Co.*, where it was held that, in an action for injuries caused by the defendants' negligence, a sum received by the plaintiff on a policy for insurance against accident could not be taken into account in reduction of damages. The reason of the decision was that it was not the accident, but a contract wholly independent of the relation between the plaintiff and the defendant, which gave the plaintiff his advantage. Again, it has been held that, in an action for delay in discharging a ship of the plaintiffs' whereby they lost their passengers whom they had contracted to carry, the damages ought not to be reduced by reason of the same persons taking passage in another vessel belonging to the plaintiffs: *Jebsen v. East and West India Dock Co.*, a case in which what was relied on as mitigation did not arise out of the transactions the subject-matter of the contract.
>
> The cases as to the measure of damages for breach of a covenant by a lessee to deliver up the demised premises in repair illustrate yet another class of authorities in which the qualifying rule has been

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[302] At 689-690.

[303] This sentence needs to be read cautiously. Of course, there is no <u>obligation</u> to mitigate. But a failure to do so may affect the damages recoverable.

[304] At 690-692 (emphasis added).

excluded. In *Joyner v. Weeks* the lessor had made a lease to another lessee by way of anticipation, to commence from the expiration of the term of this lease, and the new lessee had made no claim to be reimbursed the cost which he had incurred in repairing after the expiration of the demised lease. Wright J. held that the true test was the amount of diminution in value to the lessor, not exceeding the cost of doing the repairs. The Court of Appeal, including Lord Esher and Fry L.J., took a different view. They thought that there had been a constant practice of laying down the measure of damages as being the cost of putting into repair, and that in the particular class of cases with which they were dealing it was a highly convenient rule which ought not to be disturbed. Any other measure appeared to involve complicated inquiries. Moreover, the arrangement between the lessor and the new lessee was *res inter alios acta* with which the original lessee had nothing to do and which he was not entitled to set up.

I think the principle which applies here is that which makes it right for the jury or arbitrator to look at what actually happened, and to balance loss and gain. The transaction was not *res inter alios acta*, but one in which the person whose contract was broken took a reasonable and prudent course quite naturally arising out of the circumstances in which he was placed by the breach. Apart from the breach of contract, the lapse of time had rendered the appellants' machines obsolete, and men of business would be doing the only thing they could properly do in replacing them with new and up-to-date machines.

The arbitrator does not in his finding of fact lay any stress on the increase in kilowatt power of the new machines, and I think that the proper inference is that such increase was regarded by him as a natural and prudent course followed by those whose object was to avoid further loss, and that it formed part of a continuous dealing with the situation in which they found themselves, and was not an independent or disconnected transaction."

475. The issue is thus akin to one of causation. In order to be relevant as a benefit to be taken into account in the assessment of damages, that benefit must bear some relation to the damage suffered by the claimant as a result of the breach, whether that breach be a breach of contract or a breach of statutory duty, as here. Unless that relationship exists, the benefit is a collateral one.

476. Clearly, what constitutes a related benefit is very fact driven. Nevertheless, in this case, we were considerably assisted by one of the cases cited by Lord Haldane in *British Westinghouse*: *Jebsen v East and West India Dock Co* (1875) LR 10 CP 300. This, again, was an action for the breach of a contract for the quick discharge of a ship. Because the ship – the *Peter Jebsen* – was not discharged quickly, the plaintiffs lost the use of the ship, and so lost the passage money payable by certain emigrants that would otherwise have been

transported by the *Peter Jebsen*. The defendants took the point that a large number of these emigrants had, in fact, availed themselves of transportation on two other steamers – the *Harold Harfager* and the *S Olaf*. The plaintiffs had an interest in both these vessels, and the defendants sought to reduce the plaintiffs' claim for damages by the amount of the profit made by transporting these emigrants.

477. The court considered that there was a short answer to this point, namely that the interest of the plaintiffs in the three vessels was different: there was no identity of ownership.[305] However, even assuming such an identity of interest, Denman CJ held that the claim had to fail:

> "Now, it is said the *Harold Harfager* and the *S. Olaf* profited by the loss of the *Peter Jebsen*; they carried emigrants whom they would not have carried but for the detention of the *Peter Jebsen*; some of the plaintiffs, therefore, gained by the default of the defendants; and such gain to individual plaintiffs, which, though with difficulty, is yet capable of being ascertained, must therefore be taken in reduction of the damages which the whole body of plaintiffs is entitled to.
>
> The statement of such a proposition in its bare simplicity is perhaps a sufficient answer to it. We need not insist upon the difficult and complicated inquiries which in a multitude of easily suggested cases (some were suggested in the ingenious argument before us) would render any result being arrived at by a jury practically impossible.
>
> The absence of authority for a claim by defendants like this, which yet if well founded must have arisen in many cases, affords a strong presumption against its having any legal foundation. It is true that there must be a first instance in every claim, and that ingenuity often for the first time suggests a point which has escaped observation, and which yet, when brought to the test of argument, is found to be a sound one. But this is a point which must have arisen so frequently that it is to us incredible that, if sound, it never should have been taken."[306]

478. Although we accept that Sainsbury's was, as a matter of course, concerned to effect what saving it could in its overall costs, we do not consider that such costs savings can be regarded as a "benefit" to be set off against the overcharge. We reach this conclusion for the following reasons:

(1) Most fundamentally, any costs savings sought and achieved by Sainsbury's would have been sought and would have been achieved <u>whatever</u> the level of the MIF. As a rational and efficient firm in a highly competitive market, Sainsbury's would be (and, as a matter of

[305] At 305-306.

[306] At 304.

fact was) concerned to ensure that its costs were, year-on-year, as low as possible. That approach was a fundamental (but unsurprising) part of Sainsbury's business model and we consider that this approach would have pertained whether the overcharge had been made or whether it had not been made.

(2) To put the same point differently, using *British Westinghouse* as an analogy, we consider that the overcharge to be the same as the excess coal consumption caused by the British Westinghouse machines prior to their replacement by the Parsons machines. It was uncontroversial that these costs were recoverable, and it is easy to see why: they flowed directly from (in *British Westinghouse*) the breach of contact. So too here: the UK MIF was a cost directly incurred by Sainsbury's, which (absent any point of mitigation) Sainsbury's ought to be able to recover. The difference between the present case, and *British Westinghouse*, is that in *British Westinghouse* it was possible to identify exactly what had caused the loss to the plaintiff to cease: it was the purchase of the Parsons machines. There is <u>no such factor</u> in the present case: the overcharge continued, and there was no way that Sainsbury's could avoid it: in this case, there is no *deus ex machina* like the Parsons machines.

(3) We do not consider that the "subsequent transaction" – being any cost saving achieved by Sainsbury's – to be one arising out of the consequences of MasterCard's breach of statutory duty. Although we certainly accept that, in the ordinary course of business, Sainsbury's was concerned to keep costs as low as possible, that desire was unrelated to the overcharge.

(4) Because we have concluded that the way in which the costs constituting the UK MIF were dealt with by Sainsbury's is unknowable, in that it is impossible to say what proportion of the overcharge was *(i)* passed-on in higher prices; or *(ii)* paid out of cost-savings; or *(iii)* paid for by reducing expenditure and so service levels, we also conclude that MasterCard's mitigation case should fail for this

reason alone. As Lord Denham CJ noted in *Jebsen*, the approach suggested by MasterCard involves "difficult and complicated inquiries which in a multitude of easily suggested cases…would render any result being arrived at by a [court] practically impossible". By way of example, MasterCard is simply unable to say what proportion of the overcharge was dealt with by way of pass-on, or cost-savings, or reduction in expenditure. Yet the latter case (reduction in expenditure) is a case where Sainsbury's business may suffer real harm. The effect of MasterCard's argument is effectively to transfer the burden of showing that a loss has <u>not</u> been mitigated from MasterCard to Sainsbury's.[307]

(ii) Pass-on

479. The so-called "pass-on" defence was recognised by the Court of Justice in *Courage v Crehan*,[308] and this recognition of the defence has been reiterated in a number of subsequent cases.[309]

480. It is plain that the ambit of the defence – like the illegality defence – is one for the national laws of the Member States, subject always to the principles of effectiveness and equivalence and any other requirements of EU law. Before considering the defence as a matter of English law, the following points emerge:

(1) The basis for the defence is said to be the principle of "unjust enrichment".[310] This is probably because many of the cases in the Court of Justice involving pass-on issues have been claims for the recovery of sums levied on the claimant in breach of EU law, rather than claims for damages. In the context of such cases, the Court has stipulated that the scope of the defence must be interpreted restrictively

[307] MasterCard's premise was that in the case of overcharge absorbed by employees, they would have a claim: Day 23/pp43-44. Of course, if the overcharge was absorbed elsewhere, employees would not have a claim. Given that these matters are essentially unknowable, MasterCard ends up in the happy position of being able to play all ends against the middle, if its contention is correct.

[308] See paragraph 30 of the *Courage* judgment, quoted at paragraph 348(5) above.

[309] Case 295/04 *Manfredi v Lloyd Adriatico Assicurazioni SpA* [2006] ECR I-6619, [2006] 5 CMLR 17; Case C-199/11 *European Commission v Otis NV* [2013] 4 CMLR 4; Case C-536/11 *Bundeswettbewerbsbehorde v Donau Chemie AG* [2013] 5 CMLR 19; Case C-557/12 *Kone AG v OBB-Infrastruktur AG (Re Elevators and Escalators Cartel)* [2014] 5 CMLR 5.

[310] See, for example, Case 68/79 *Hans Just I/S v Danish Ministry for Fiscal Affairs* [1980] ECR 501.

as "that exception is a restriction on a subjective right of recovery of the tax levied contrary to EU law derived from the Community legal order…" (See Case C-147/01 *Weber's Wine World Handels-GmbH and others v Abgabenberufungskommission Wien* [2003] ECR I-11385). In another such case, *Lady & Kid A/S and others v Skatteministeriet* (Case C-398/09) [2012] All ER (EC) 410, the Court of Justice stated:

> "20. None the less, since such a refusal of reimbursement of a tax levied on the sale of goods is a limitation of a subjective right derived from the legal order of the European Union, it must be interpreted narrowly. Accordingly, the direct passing on to the purchaser of the tax wrongly levied constitutes the sole exception to the right to reimbursement of tax levied in breach of European Union law"

Thus, in that context Community law limits the pass-on defence to instances where the tax unlawfully levied has been directly passed on to the claimant's purchaser

However, "unjust enrichment" is an inapt label in the present case, for it is obvious that claims based upon anti-competitive wrongs are tortious or delictual and not restitutionary. The victim of a defendant's anti-competitive conduct does not seek the restitution of a benefit conferred, but compensation for an injury suffered.

(2) The real thrust of the defence is, at least in this case, to do with compensation:

 (i) It is to prevent the over-compensation of a claimant; and

 (ii) It is to ensure that the defendant does not pay damages for the same wrong twice over.

(3) These two points are linked. Where a claimant has (for example, by reason of a breach of Article 101 TFEU) overpaid for a good or service, that claimant (a "direct" purchaser) would be over-compensated where the overpayment has been passed-on to a party "downstream" of the claimant (an "indirect" purchaser). EU law

recognises that a claim for damages for breach of competition law may be brought not only by those who have directly suffered harm as a result of anti-competitive conduct, but also those who have been indirectly affected by the same conduct. Where there can be both direct and indirect purchasers – or multiple classes of indirect purchasers – it is important to ensure both that these classes are properly compensated <u>and</u> that the defendant pays only compensatory and not what are in effect multiple damages.

(4) These difficulties emerge very clearly in Directive 2014/104/EU on certain rules governing actions for damages under national law for infringements of the competition law provisions of the Member States and of the European Union ("the Damages Directive"). Although the Damages Directive is to be transposed into the national laws of the Member States by (at the latest) 27 December 2016 (Article 21(1)), it is nevertheless a document worth referring to:

(i) Article 13 requires that Member States "ensure that the defendant in an action for damages can invoke as a defence against a claim for damages the fact that the claimant passed on the whole or part of the overcharge resulting from the infringement of competition law. The burden on proving that the overcharge was passed on shall be on the defendant, who may reasonably require disclosure from the claimant or from third parties."

(ii) Article 14 provides:

> "1. Member States shall ensure that, where in an action for damages the existence of a claim for damages or the amount of compensation to be awarded depends on whether, or to what degree, an overcharge was passed on to the claimant, taking into account the commercial practice that price increases are passed on down the supply chain, the burden of proving the existence and scope of such a passing-on shall rest with the claimant, who may reasonably require disclosure from the defendant or from third parties.
>
> 2. In the situation referred to in paragraph 1, the indirect purchaser shall be deemed to have proven that a passing-on to

that indirect purchaser occurred where that indirect purchaser has shown that:

(a) the defendant has committed an infringement of competition law;

(b) the infringement of competition law has resulted in an overcharge for the direct purchaser of the defendant; and

(c) the indirect purchaser has purchased the goods or services that were the object of the infringement of competition law, or has purchased goods or services derived from or containing them…"

(iii) Article 15 provides:

"1. To avoid that actions for damages by claimants from different levels in the supply chain lead to a multiple liability or to an absence of liability of the infringer, Member States shall ensure that in assessing whether the burden of proof resulting from the application of Articles 13 and 14 is satisfied, national courts seized of an action for damages are able, by means available under Union or national law, to take due account of any of the following:

(a) actions for damages that are related to the same infringement of competition law, but that are brought by claimants from other levels in the supply chain;

(b) judgments resulting from actions for damages as referred to in point (a);

(c) relevant information in the public domain resulting from the public enforcement of competition law…"

481. The fact that the Damages Directive spends two full Articles dealing with the burden of proof and the need to avoid over- or under-compensation between rival claimant levels or groups and potential defendants is a clear demonstration of the difficulties inherent in the pass-on defence.

482. These difficulties were articulated by White J in the decision of the US Supreme Court in *Hanover Shoe Inc v United Shoe Machinery Corporation*.[311] In that case, the US Supreme Court denied the pass-on defence in its entirety and so barred the potential for overcharge claims by indirect purchasers. As we go on to describe, that is not the position under English law: but the difficulties identified by White J remain pertinent:

[311] 392 US 481 at 491-494.

> "United seeks to limit the general principle that the victim of an overcharge is damaged within the meaning of section 4 to the extent of that overcharge. The rule, United argues, should be subject to the defense that economic circumstances were such that the overcharged buyer could only charge his customers a higher price *because* the price to him was higher. It is argued that in such circumstances the buyer suffers no loss from the overcharge. This situation might be present, it is said, where the overcharge is imposed equally on all of a buyer's competitors and where the demand for the buyer's product is so inelastic that the buyer and his competitors could all increase their prices by the amount of the cost increase without suffering a consequence decline in sales.
>
> We are not impressed with the argument that sound laws of economics require recognizing this defense. A wide range of factors influence a company's pricing policies. Normally the impact of a single change in the relevant conditions cannot be measured after the fact; indeed, a businessman may be unable to state whether, had one fact been different (a single supply less expensive, general economic conditions more buoyant, or the labor market tighter, for example), he would have chosen a different price. Equally difficult to determine, in the real economic world, rather than an economist's hypothetical model, is what effect a change in a company's price will have on its total sales. Finally, costs per unit for a different volume of total sales are hard to estimate. Even if it could be shown that the buyer raised his price in response to, and in the amount of, the overcharge and that his margin of profit and total sales had not thereafter declined, there would remain the nearly insuperable difficulty of demonstrating that the particular plaintiff could not or would not have raised his prices absent the overcharge or maintained the higher price had the overcharge been discontinued. Since establishing the applicability of the passing-on defense would require a convincing showing of each of these virtually unascertainable figures, the task would normally prove insurmountable. On the other hand, it is not unlikely that if the existence of the defense is generally confirmed, antitrust defendants will frequently seek to establish its applicability. Treble-damage actions would often require additional long and complicated proceedings involving massive evidence and complicated theories.
>
> In addition, if buyers are subjected to the passing-on defense, those who buy from them would also have to meet the challenge that they passed on the higher price to *their* customers. These ultimate consumers, in today's case the buyers of single pairs of shoes, would only have a tiny stake in a lawsuit and little interest in attempting a class action. In consequence, those who violate the antitrust laws by price-fixing or monopolizing would retain the fruits of their illegality because no-one was available who would bring suit against them. Treble-damage actions, the importance of which the Court has many times emphasized, would be substantially reduced in effectiveness."

483. As yet, there has been no case under English law substantively dealing with the pass-on defence, although the existence of the defence has been recognised on a number of occasions.[312] The scope and nature of that defence remains unascertained.

[312] *Devenish Nutrition Ltd v Sanofi-Aventis SA* [2007] EWHC 2394 (Ch), [2008] EWCA Civ 1086, [2009] Ch 390 at [147] and [151]; *Emerald Supplies Ltd v British Airways plc* [2009] EWHC 741 (Ch), [2010] 1 Ch 48 at [37]; *WH Newson Holding Ltd v IMI plc* [2013] EWCA Civ 1377, [2014] Bus LR 156 at [40].

484. We consider the following points to represent the position under English law:

(1) English law recognises overcharge claims by indirect purchasers. Indeed, it is worth bearing in mind that Sainsbury's claim is itself an indirect claim. It is simply that the passing-on, by Acquiring Banks, of the UK MIF via the Merchant Service Charge to Merchants such as Sainsbury's has so formed part of the "background" facts of this case – and has at no point been challenged by MasterCard – that the indirectness of Sainsbury's claim can easily be overlooked. Nevertheless, this is a case where the overcharge that we have identified has been 100% passed on by Acquiring Banks to Sainsbury's.

(2) From this, it follows that there must be a pass-on "defence". Absent such a "defence", a defendant guilty of overcharge would be liable to compensate directly and indirectly overcharged purchasers many times over, which would be entirely contrary to the principle of compensatory damages. In this case, it would lead to the perverse outcome that MasterCard would have no defence to a claim brought by the Acquiring Banks.

(3) We agree with the submissions of MasterCard, that the pass-on "defence" is no more than an aspect of the process of the assessment of damage. The pass-on "defence" is in reality not a defence at all: it simply reflects the need to ensure that a claimant is sufficiently compensated, and not over-compensated, by a defendant. The corollary is that the defendant is not forced to pay more than compensatory damages, when considering all of the potential claimants.

(4) We have already noted that whilst the notion of passing-on a cost is a very familiar one to an economist, an economist is concerned with how an enterprise recovers its costs, whereas a lawyer is concerned with whether a specific claim is or is not well-founded. We consider that the legal definition of a passed-on cost differs from that of the economist in two respects:

(i) First, whereas an economist might well define pass-on more widely (i.e. to include cost savings and reduced expenditure), the pass-on defence is only concerned with identifiable increases in prices by a firm to its customers.

(ii) Secondly, the increase in price must be causally connected with the overcharge, and demonstrably so.

There is danger in presuming pass-on of costs to indirect purchasers (*pace* Article 14 of the Damages Directive), because of the risk that any potential claim becomes either so fragmented or else so impossible to prove that the end-result is that the defendant retains the overcharge in default of a successful claimant or group of claimants. This risk of under-compensation, we consider, to be as great as the risk of over-compensation, and it informs the legal (as opposed to the economic) approach. It would also run counter to the EU principle of effectiveness in cases with an EU law element, as it would render recovery of compensation "impossible or excessively difficult".[313]

(5) Given these factors, we consider that the pass-on "defence" ought only to succeed where, on the balance of probabilities, the defendant has shown that there exists another class of claimant, downstream of the claimant(s) in the action, to whom the overcharge has been passed on. Unless the defendant (and we stress that the burden is on the defendant) demonstrates the existence of such a class, we consider that a claimant's recovery of the overcharge incurred by it should not be reduced or defeated on this ground.

485. It follows that MasterCard's pass-on defence must fail. No identifiable increase in retail price has been established, still less one that is causally connected with the UK MIF. Nor can MasterCard identify any purchaser or class of purchasers of Sainsbury's to whom the overcharge has been passed who would be in a position to claim damages.

[313] Case C-453/99, *Courage Ltd v Crehan*, [2001] ECR I-6297, [2002] 1 QB 507 at [29].

(iii) The level of Sainsbury's profit

486. From time-to-time it was suggested by MasterCard that <u>even if</u> the unlawful overcharge had not been made, so that Sainsbury's costs would have been lower by that amount, Sainsbury's should not recover any damages unless it could be shown that Sainsbury's profits would have been higher by that amount.

487. In the light of this suggestion a question was raised by the Tribunal as to whether - assuming that an unlawful overcharge was established, but which was neither passed on nor a benefit within the *British Westinghouse* rule on mitigation considered above - it is permissible or necessary for the Tribunal to consider in what way the fund represented by the overcharge would have been used by Sainsbury's had it not been imposed.

488. If and to the extent that it was suggested by MasterCard that no damages were recoverable by Sainsbury's <u>unless</u> it could be shown that the absence of the unlawful overcharge would have caused Sainsbury's profits to be higher, we reject that contention.

489. As we have noted, the tortious measure of damages is the amount of money that would put the claimant in the position he/she/it would have been in, had the tort never been committed. In this case, had the tort not been committed, Sainsbury's costs would have been reduced by the amount of the overcharge. That, we consider, is the *prima facie* measure of Sainsbury's loss. What Sainsbury's would have done with that money is, absent the application of a specific rule to the contrary, irrelevant.

490. Of the rules that might serve to reduce the quantum of Sainsbury's claim, two (related) ones have been prayed in aid by MasterCard: passing on and mitigation. For the reasons given, we consider that neither of these principles applies in the circumstances of the present case. Having reached this conclusion, the fact that Sainsbury's may have used the extra money it would have had by spending more on its stores or competing more aggressively on price with its competitors is *nihil ad rem*.

(4) Collateral Benefits

491. MasterCard contended that damages should put a claimant in the position in which it would have been had the wrong not occurred. An award of damages should not result in a claimant being better off than if the wrong had not occurred. Sainsbury's did not disagree with this, as a broad statement of principle.

492. In the real world, Sainsbury's Bank received a higher level of Interchange Fees than it would have done in the counterfactual world. We have set out the Interchange Fees actually received by Sainsbury's Bank in paragraph 331 above. On any view, these sums are substantial: they amount to £66,511,244 from 2009 to 2014.

493. Of course, in the counterfactual world, Sainsbury's Bank would have been paid Interchange Fees, just at a lower rate. Since Sainsbury's Bank did not issue debit cards, the Interchange Fee that Sainsbury's Bank would have received in the counterfactual world would have been (the equivalent of) 0.50%.[314] Basing ourselves on what Sainsbury's paid,[315] in respect of all MasterCard credit card transactions, we find that Sainsbury's Bank was paid a "blended" UK MIF of 0.90%. Sainsbury's Bank thus received an unlawful excess of 0.40%.

494. MasterCard contended that as a result Sainsbury's benefited from higher rewards that Sainsbury's Bank would have been able to offer during the claim period. As MasterCard put it in paragraph 619(a) of its written closing submissions, Sainsbury's Bank

> "offered credit cards with generous rewards (mainly Nectar points) which were specifically tailored to encourage [Sainsbury's Bank's] credit card customers to spend money at Sainsbury's. Sainsbury's own figures show that the more generous the rewards on [Sainsbury's Bank's] credit cards, the greater the incremental spending generated, with the most generous rewards resulting in hundreds of millions of pounds of additional spending at Sainsbury's".

495. The manner in which the experts sought to quantify this benefit is described in MasterCard's written closing:

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[314] See paragraph 226(4) above.
[315] See Table 8 above.

"621. Both Mr von Hinten Reed and Mr Harman considered what would have happened in the counterfactual scenario in which [Sainsbury's Bank] had issued MasterCard credit cards with a materially lower UK MIF during the claim period. This counterfactual gives rise to two possibilities:

a. Sainsbury's would have had to provide increased funding to [Sainsbury's Bank] in order to persuade it to maintain the same level of rewards and consequently to allow Sainsbury's to continue receiving the same incremental spending as a result of those rewards.

b. Alternatively, [Sainsbury's Bank] would have reduced the rewards on its credit cards to maintain the profitability of this business in light of the reduced MIF. A reduction in rewards offered by [Sainsbury's Bank] would have meant that [Sainsbury's Bank] cardholders would have spent less money at Sainsbury's, which in turn would have reduced Sainsbury's profits.

622 On this basis, the experts have identified two different ways of measuring the detriment which Sainsbury's would have suffered in the counterfactual with lower interchange fees than the actual position:

a. **The 'cost' approach**: This approach considers the additional financial support that Sainsbury's would have had to offer to [Sainsbury's Bank] to maintain its level of rewards in the low interchange counterfactual.

b. **The 'lost benefits' approach**: This approach considers what reduction in rewards would have been required for reward credit cards to remain profitable to [Sainsbury's Bank] without additional funding from Sainsbury's and then calculates the effect that this reduction in rewards would have had upon the level of spending in Sainsbury's stores and consequently Sainsbury's profits."

496. On the "cost" approach, MasterCard calculated the benefit to Sainsbury's at £54.6 million (based on an assumed MIF of 0.15%), which it reckoned was an under-estimate of the true scale of the benefit.[316] On the "lost benefits" approach, MasterCard calculated the benefit to Sainsbury's at £33.3 million.[317]

497. These figures were highly controversial: Mr von Hinten Reed's calculation in relation to the "cost" approach was £4.06 million (based on an assumed MIF of 0.15%).[318]

498. We accept that if Sainsbury's is not to be over-compensated, account needs to be taken of the inflated UK MIF received by Sainsbury's Bank which – to an

[316] MasterCard Closing/§§ 631-634 and 667.
[317] MasterCard Closing/§696.
[318] MasterCard Closing/§§ 634 and 697.

extent that we have to determine – will have been used to benefit the Sainsbury's group, and specifically Sainsbury's through the use of rewards to encourage spending in its stores.

499. However, given the conclusions we have reached as to the level of Interchange Fee that would have been agreed in the counterfactual world, we consider that our starting point in terms of calculating the benefit to Sainsbury's ought to be the extent of the overcharge received by Sainsbury's Bank.

500. The following table (Table 14) sets out:

(1) In Column (2), the overcharge paid by Sainsbury's in relation to credit cards that we found to exist in Table 13 above.

(2) Column (3) sets out the Interchange Fees in fact received by Sainsbury's Bank as set out in paragraph 331 above. Unfortunately, the information provided to us did not cover the whole of the claim period.

(3) Column (4) identifies the unlawful element within the Interchange Fees received by Sainsbury's Bank. That element is the difference between the 0.90% MIF charged and the counterfactual 0.50% i.e. 0.40%. The bracketed percentage in Column (4) represents the overcharge received by Sainsbury's Bank as a percentage of the overcharge paid by Sainsbury's in the relevant year. The average of these figures (which is 43%) has been used to derive assumed unlawful Interchange Fees received by Sainsbury's Bank for the years 2006-2007, 2007-2008, 2014-2015 and 2015-2016, for which years we have no data. We have applied 43% to the figure in Column (2) to reach an assumed figure for the unlawful element of the Interchange Fees received by Sainsbury's Bank. These assumed figures are shaded grey in Table 14.

(1) **Year**	**(2)** **Overcharge paid by Sainsbury's (credit cards)**	**(3)** **Interchange Fees actually received by Sainsbury's Bank from all sources** (per paragraph 331	**(4)** **Unlawful amount of the Interchange Fees in Column (3)** **(expressed as a % of overcharge paid by**

	(per Table 13)	above)	Sainsbury's)
2006-2007	£925,460		£394,006
2007-2008	£6,072,273		£2,585,215
2008-2009	£7,614,293	£8,815,310	£3,917,916 (51%)
2009-2010	£8,983,090	£10,196,556	£4,531,803 (50%)
2010-2011	£10,974,884	£10,309,835	£4,582,149 (42%)
2011-2012	£13,173,429	£10,665,779	£4,740,346 (36%)
2012-2013	£15,128,575	£12,004,188	£5,335,195 (35%)
2013-2014	£15,917,737	£14,519,576	£6,453,145 (41%)
2014-2015	£16,971,092		£7,225,288
2015-2016	£7,026,709		£2,991,558
All years	**£102,787,541**		**£42,756,620**

Table 14: Unlawful element of the UK MIFs received by Sainsbury's Bank

501. We consider that – using a broad axe – an appropriate way to calculate the benefit to Sainsbury's of the unlawful excess in the UK MIF received by Sainsbury's Bank is to assume that a proportion of this excess would have been spent by Sainsbury's Bank for the benefit of Sainsbury's, for which Sainsbury's must give credit if it is not to be overcompensated. In our view the appropriate proportion is 80%. A high proportion is indicated given that Sainsbury's Bank offered MasterCard credit cards with generous rewards in the form of, in particular, Nectar points, which were designed in such a way as to encourage credit card customers of Sainsbury's Bank to maximise their spending at Sainsbury's. The evidence before us was that, for example, in 2015 Sainsbury's Bank's credit cards offered customers the chance to earn two Nectar points for every £1 spent at Sainsbury's and one Nectar point for every £5 spent at other retailers.[319] The evidence also indicates that the rewards incentive was effective and that Sainsbury's did benefit significantly.[320] The

[319] Harman 1/§10.4.
[320] Harman 1, section 10 generally.

remaining 20% of the unlawful excess we consider would have been retained by Sainsbury's Bank, and would have been of no benefit to Sainsbury's.

502. We have, of course, taken no account of Sainsbury's Bank's costs as an Issuing Bank: this is because these would have been covered, as we have found, by the 0.50% bilateral Interchange Fee that Sainsbury's Bank would have received in any event in the counterfactual world.

503. Accordingly, the amount of the overcharge that Sainsbury's can recover is reduced by 80% of the amounts set out in Column (3) of Table 14. The outcome is set out below:

(1) **Year**	**(2)** **Overcharge paid by Sainsbury's (credit cards)** (per Table 13)	**(3)** **Unlawful amount of the Interchange Fees received by Sainsbury's Bank**	**(4)** **80% of the figure in Column (3)**	**(5)** **Recoverable amount of the overcharge** (ie Column (2) – Column (4))
2006-2007	£925,460	£394,006	£315,205	£610,255
2007-2008	£6,072,273	£2,585,215	£2,068,172	£4,004,101
2008-2009	£7,614,293	£3,917,916	£3,134,332	£4,479,960
2009-2010	£8,983,090	£4,531,803	£3,625,442	£5,357,648
2010-2011	£10,974,884	£4,582,149	£3,665,719	£7,309,164
2011-2012	£13,173,429	£4,740,346	£3,792,277	£9,381,152
2012-2013	£15,128,575	£5,335,195	£4,268,156	£10,860,419
2013-2014	£15,917,737	£6,453,145	£5,162,516	£10,755,221
2014-2015	£16,971,092	£7,225,288	£5,780,231	£11,190,861
2015-2016	£7,026,709	£2,991,558	£2,393,246	£4,633,463
All years	**£102, 787, 541**	**£42,756,620**	**£34,205,296**	**£68,582,245**

<u>Table 15</u>: Unlawful element of the UK MIFs received by Sainsbury's Bank and recoverable amount of the overcharge

504. Accordingly, we find that, subject to any effect of taxation which is required to be taken into account, Sainsbury's is entitled to recover from MasterCard

£68,582,245 in respect of the overcharge in relation to credit cards and £760,406 in respect of the overcharge in relation to debit cards, plus interest.

505. We were not addressed by the parties on the extent to which this amount will be taxable in the hands of Sainsbury's. Nor did the parties address us on the extent to which the amount of the overcharge we consider to be recoverable would (or would not) have been taxable in the hands of Sainsbury's, and the relevance of this.[321]

506. Equally, although the parties provided us with various rates of interest, differentiating between rates gross and rates net of tax, we were not addressed on which particular rate should be preferred.

507. We make no criticism: the taxation of damages and interest, and the need to ensure that Sainsbury's is fully compensated and not over-compensated, are difficult questions that can only properly be addressed when the approach to damages has been laid out and determined.

508. Accordingly, this Judgment does not take into account issues of taxation, and all calculations have been done gross and not net of tax. We reserve all questions of taxation and - unless the matter can be agreed between the parties - will hear further argument in due course.

(5) Interest

(a) Introduction

509. At common law, the position for a long time was that interest was not payable on damages: *London, Chatham and Dover Ry Co v South Eastern Ry Co* [1893] 1 AC 429. Although, over time, various exceptions were created to this rule, and equity (in respect of purely equitable claims) always took a different view, the law on this point remained substantially unchanged until the decision of the House of Lords in *Sempra Metals Ltd v Commissioners of Inland Revenue* [2007] UKHL 34, [2008] 1 AC 561. In *Sempra Metals*, the House of Lords limited the effect of the *London Chatham* rule to those cases

[321] Various information was provided (for example in Harman 2 and in the Second Addendum to Von Hinten-Reed 2).

where the claimant does not plead or prove any losses arising as a result of the late payment.

510. Thus, in a case such as this, whilst there can (apart from an award of simple interest under section 35A of the Senior Courts Act 1981) be no award of damages for an unparticularised or unproved claim for interest losses, a claimant may recover his actual interest losses, including a loss of compound interest, provided the claim is particularised and proved,.

511. Sainsbury's claim to interest is pleaded as follows in the Amended Particulars of Claim:

> "61 Sainsbury's is entitled to complete compensation for all of its losses, including for lost return on investments and/or for additional financing costs and/or for interest losses incurred as a result of having to pay unlawful overcharges in respect of payment card transactions involving MasterCard branded credit cards and debit cards and having been kept out of and denied the commercial use of monies.
>
> 62 Over the period of its Claim, Sainsbury's undertook substantial capital expenditure, including investments in new stores and extensions to existing stores. Sainsbury's financed its capital expenditure and operations from equity, debt and the sale and leaseback of its property assets. The Defendants' breaches of their statutory duties have caused additional damage to Sainsbury's. In the absence of MasterCard's establishing, setting and imposition of the unlawful UK MIFs, Sainsbury's would have reinvested a substantial proportion of the sums claimed above in its business, thereby generating further profits, and/or Sainsbury's would have needed to borrow less and/or raise less equity capital than it did to finance its capital expenditure and operations, and it has suffered a loss of return on investment and/or additional financings costs and/or interest losses as a result. In the circumstances, Sainsbury's is entitled to and claims complete compensation, including interest on a compound basis as a separate head of damages. Compound interest falls to be calculated on a conventional basis, reflecting the cost of borrowing of claimants in general, at a rate of 2% *per annum* above Bank of England Base Rate; alternatively, on the basis of Sainsbury's cost of borrowing; further alternatively, on the basis of Sainsbury's weighted average cost of capital ("WACC") or Sainsbury's lease adjusted WACC; further alternatively on such other basis and at such other rate as the Court determines is appropriate, and in any event, for such period and at such frequency of compounding as the Court determines is appropriate.
>
> 63 Further or alternatively, Sainsbury's claims simple interest pursuant to section 35A of the Senior Courts Act 1981, at such rate and for such period as the Court considers appropriate."

512. MasterCard contended that Sainsbury's had failed to plead and prove any interest losses. In the course of MasterCard's oral closing submissions,

Mr Cook put MasterCard's point this way: "The pleading is a range of possibilities. The evidence is a range of possibilities. Nothing specific is pleaded and proved."[322]

513. In the following paragraphs, we therefore consider first what the requirements are in order to recover compound interest under the rule in *Sempra Metals*. We then consider the evidence and the extent to which Sainsbury's has met the requirement of the rule in *Sempra Metals*. Finally, we consider the rate of interest which should be applied to Sainsbury's damages.

(b) The requirements of the rule in *Sempra Metals*

514. In support of its contention that Sainsbury's had failed sufficiently to plead or prove its claim for interest, MasterCard relied heavily on certain passages from *Sempra Metals* and contended that a strict standard of proof was to be applied to establish the specific loss suffered by the claimant. Mr Cook also relied upon the judgment of Teare J in *JSC BTA Bank v Ablyazov* [2013] EWHC 867 (Comm), which he contended supported a strict standard of proof. Mr Spitz, junior counsel for Sainsbury's, argued that Sainsbury's had sufficiently pleaded and proved damage. Mr Spitz also referred us to *Equitas Ltd v Walsham Brothers* [2013] EWHC 3264 (Comm), and contended that this case established that it was open to the Tribunal to award compound interest at a conventional rate without the necessity of having to prove actual losses.

515. In *Sempra Metals*, there are a number of statements which stress the need for a claim to interest to be pleaded and proved. Thus, Lord Hope said:[323]

> "…the loss on the late payment of a debt may include an element of compound interest. But the claimant must claim and prove his actual interest losses if he wishes to recover compound interest, as is the case where the claim is for a sum which includes interest charges."

Lord Nicholls said:[324]

> "…an unparticularised and unproved claim simply for 'damages' will not suffice. General damages are not recoverable. The common law does not *assume* that delay in payment of a debt will of itself cause damage. Loss must be proved."

[322] Day 23/p134.
[323] At paragraph 17.
[324] At paragraph 96.

Lord Scott said:[325]

> "…interest losses caused by a breach of contract or by a tortious wrong should be held to be in principle recoverable, but subject to proof of loss, remoteness of damage rules, obligations to mitigate damage and any other relevant rules relating to the recovery of alleged losses."

516. In *Ablyazov*, Teare J dismissed a claim for compound interest on the basis that the claimants had failed to plead or prove its actual interest losses. Teare J observed that:[326]

> "…in none of the actions is there any allegation of the use to which the monies paid away would have been put had there been no fraud. There is no allegation of losses the Bank had suffered in addition to having paid away the principal sums. Thus the Bank, in my judgment, has not alleged "its actual interest losses." It may be that the monies paid away would have been lent to bona fide borrowers but that has not been alleged. It may be that the sums would have been used to augment the Bank's capital base and so reduced the extent of the Bank's own borrowings but whether that was done and if so what savings would have been made (and therefore lost) has not been alleged. It may be that but for the fraud the monies would not have been borrowed by the Bank in the first place and so the interest it paid has been thrown away but that has not been alleged."

Teare J went on to state that:[327]

> "To require actual interest losses to be specifically pleaded might be regarded by the Bank as unrealistic and unduly formalistic. But Lord Nicholls expressly accepted this "reproach" to the common law and said that in the absence of a specific plea of actual interest losses the remedy lay in the statutory provisions for interest. This is clear guidance for trial judges which I must follow."

517. In *Equitas*, Males J conducted an extensive examination of *Sempra Metals*, the circumstances in which compound interest can be awarded, and what is meant by proof of loss in such circumstances. *Equitas* concerned a claim for non-payment of insurance premia and a claim for lost investment income on those premia. Males J found that:[328]

> "…there is no evidence of the investment returns achieved by the syndicates before September 1996, or of the rates at which they were able to borrow money, nor was there any evidence positively to suggest that they did in fact borrow money in order to replace the payments which [the Defendant] failed to remit to them. It was, however, part of [the Defendant]'s own evidence that as a broker it came under considerable pressure from syndicates to ensure the prompt collection of claims and

[325] At paragraph 132.
[326] At paragraph 12.
[327] At paragraph 18.
[328] At paragraph 107.

to fund claims where payment had not yet been made by reinsurers, all because of the supreme importance of cash flow to those syndicates."

518. Males J concluded that the court was entitled to award compound interest, despite the near total absence of evidence of loss actually suffered. He suggested that a similar approach might have been taken in *Sempra Metals*:[329]

> "Sempra Metals was a case where, despite what was said about the need to plead and prove a loss, the damages actually awarded were determined by taking a conventional rate and awarding compound interest. This did not depend on any evidence as to the taxpayer's actual loss, but was simply the interest which a substantial commercial company would have to pay to borrow the amount in question in the market at the relevant time, regardless of what the taxpayer had actually done. Although it may be that this approach was not the subject of specific argument in the House of Lords, it was clearly an approach which the House endorsed."

This reading of *Sempra Metals* was disputed by MasterCard. Mr Cook submitted that, on a proper reading of *Sempra Metals*, the requirement of proof was actually met and that the House of Lords had not relaxed the requirement of proof. He pointed to the speech of Lord Mance:[330]

> "The judge had before him extensive evidence about Sempra's financial position at the relevant times, which showed that it was in a net borrowing position. He was evidently satisfied that Sempra had incurred properly recoverable loss of interest on a compound basis. On one view he should or might have sought to assess Sempra's actual loss by detailed calculation. He decided instead that 'full compensation' would be achieved by taking a conventional rate and by compounding that. There has been no challenge in this connection to his decision to take a conventional rate."

519. Males J concluded his analysis of *Sempra Metals* at paragraph 123 (emphasis added):

> "i) First, it is clear that damages are in principle recoverable, subject to ordinary principles of remoteness and mitigation, for breach of an obligation to remit money, where the failure to remit has caused a loss.
>
> ii) <u>Second, unless there is some positive reason to do otherwise, the law will proceed on the basis, at any rate in the commercial context, that a claimant kept out of its money has suffered loss as a result. That represents commercial reality and everyday experience. Specific evidence to that effect is not required and, even if adduced, may well be somewhat hypothetical and thus of little assistance.</u> For example, a businessman may well be unable to say precisely what he would have done differently if a particular payment had been made to him when it ought to have been, especially if (as apparently in this case) he was unaware that the money was being withheld. Extensive disclosure, which would no doubt be demanded by the defendant, is unlikely

[329] At paragraph 118.
[330] At paragraph 226.

to assist. But that does not mean that no loss has been suffered. In the present case the general evidence of the importance attached in the market to prompt remittance of funds is more than sufficient to justify the conclusion that the syndicates did suffer a loss by being kept out of their money. Accordingly the question in such a case is not whether a loss has been suffered, but how best that loss should be measured.

…

iv) …I consider that it is not necessary for the claimant to produce specific evidence of what it would have done with the money or what steps if any it took to borrow or otherwise to replace the money of which it was deprived. As noted above, it may often be impossible or at any rate extremely difficult to produce such evidence, especially if that would mean attempting to disentangle a claimant's overall business operations in an artificial attempt to attribute specific activity such as borrowing to the non-remittance of specific funds. Instead, at any rate in commercial cases and unless there is some positive reason to do otherwise, the law will proceed on the basis that the measure of the claimant's loss is the cost of borrowing to replace the money of which the claimant has been deprived regardless of whether that is what the claimant actually did. A conventional rate will be used which represents the cost to commercial entities such as the claimant and is not necessarily the rate at which the claimant itself could have borrowed or did in fact borrow. This avoids the need for protracted investigation of the particular claimant's financial affairs. As with other conventional measures (for example, the assessment of damages by reference to a market price in sale of goods cases) this approach has the advantage of certainty and predictability which is always important in the commercial context, as well as being broadly fair in the great majority of cases and avoiding expensive and often ultimately unproductive litigation.

v) If a conventional borrowing cost is to be adopted in this way, the question whether interest should be simple or compound answers itself. While simple interest has the virtue of simplicity as Lord Hope observed, it also has the certainty of error and injustice. As their Lordships noted, it is impossible to borrow commercially on simple interest terms. I respectfully agree with Lord Nicholls that the law must recognise and give effect to this reality if it is to achieve a fair and just outcome when assessing financial loss. To conclude that, at least in a typical commercial case, the normal and conventional measure of damages for breach of an obligation to remit funds consists of compound interest at a conventional rate is therefore both principled and predictable, as well as being in accordance with what was actually awarded in Sempra Metals."

520. We consider that it is clearly established by *Sempra Metals* that interest losses are in principle recoverable, but subject to proof of loss and any other relevant rules relating to the recovery of damages. It is important to be clear about this: the point about the decision in *Sempra Metals* is that a claim for interest is a loss like any other, recoverable according to the usual rules. There is not any "special" rule for interest.

521. Precisely what must be pleaded and proved in order for a claim to interest to succeed must depend upon the facts of the individual case. In *Equitas*, Males J found "general evidence" sufficient to satisfy himself that the syndicates had suffered loss by being kept out of their money. This evidence related to the importance attached in the market to prompt remittance of funds. In *Ablyazov*, the claimants did not proffer any pleading as to the use to which the monies would have been put, as is quite clear from the paragraph 12 of the judgment. In such circumstances, Teare J was unable to award compound interest.

(c) Sainsbury's pleading and the evidence

522. We find that Sainsbury's claim for interest is sufficiently pleaded in paragraphs 61 to 63 of its Amended Particulars of Claim. We turn to the evidence. In general terms, Sainsbury's factual witnesses provided the following evidence as to what would have happened if Interchange Fees had been lower. In his statement, Mr Rogers said:[331]

> "It is very difficult to say what would have happened if we had had lower MSCs of say tens of millions, in the context of a business where costs run into billions of pounds. All things being equal, tens of millions would have reduced our net debt. Net debt alongside any equity issues, funds from sale and leasebacks, and cash flows generated by the business are used to help fund our Capex which has historically been around one billion pounds per annum."

523. Mr Coupe stated:[332]

> "By contrast, if there is a lowering of a cost item, there are a myriad of ways that that cost saving may benefit the business. That ranges from simply not reducing other cost items (in other words, they get balanced out) to various forms of investment. Lower cost allows us to invest in business growth. For example, this could include new stores, store expansion, new business (e.g. mobile, energy) or price investment. Lower costs would allow us to maintain or increase discretionary spend (e.g. advertising) or a lower cost base could simply allow us to give a greater return to our shareholders in the form of a dividend or higher profits. Equally a lowering of costs could be used to reduce our debt. There are a myriad of things in between, all in a strategic context, and that is a consideration that the Operating Board would make at the time depending on the market context."

524. Mr Rogers was briefly cross-examined on his statement, with reference to his statement quoted above. He agreed that "invariably all things are never equal. Things are moving around all the time in our industry…".[333]

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[331] Rogers 1/§29.
[332] Coupe 1/§82.

525. We derived a great deal of assistance as to precisely what would have happened had the overcharge not been demanded, from the detailed description Sainsbury's provided of its budget process, and the way in which it monitored costs and adjusted prices. We have set out our findings in this regard at paragraphs 459 to 465 above. We concluded that:

(1) *Prima facie*, Sainsbury's would have sought to pass the cost of its UK MIF on to its customers.[334] Although Sainsbury's would not have been unconstrained in its ability to pass this cost on,[335] because the UK MIF was a cost common to Sainsbury's and its supermarket rivals, we consider that a substantial amount of the UK MIF – 50% – would have been passed-on (albeit not in a manner which would have amounted to a "defence" of pass-on, for the reasons given at paragraphs 484 to 485). It follows that had the overcharge not been made, Sainsbury's would not have received any interest: it would simply have not passed-on the overcharge.

(2) The rest of the overcharge would be funded by Sainsbury's in other ways. Although we consider that Sainsbury's would seek to cut costs where it could and would adjust its spending in order to maintain the profit level it felt the market expected, we do not consider that this approach was in any way causally related to the overcharge. In other words, Sainsbury's would seek efficiencies overcharge or not. It follows that that portion of the overcharge that was not passed-on, would have resulted in Sainsbury's:

(i) Having lower cash balances in the bank. Therefore, if the overcharge had not been made, these cash balances would have been higher, and Sainsbury's would have received interest on these sums, which as a result of the overcharge it has lost.

(ii) Requiring less borrowing. Again, it follows that if the overcharge had not been made, Sainsbury's borrowing needs

[333] Day 6/pp134-135.
[334] See paragraph 459 above.
[335] For the reasons given in paragraph 460 above.

would have been less, and it would not have incurred the costs of borrowing.

We do not consider that Sainsbury's sale and leaseback arrangements would have been affected by the overcharge; our conclusion is the same, as regards any equity issued by Sainsbury's. We conclude that of the 50% of the overcharge that would have been retained by Sainsbury's, 20% would have resulted in higher cash balances, and 30% in lower borrowing.

526. We consider that, although we have had to make assumptions, and have applied a broad axe, these losses have been sufficiently established by the evidence, and that Sainsbury's is entitled to interest at a compounded rate on 50% of the overcharge. Taking the compensatory approach to lost interest that underlies the rule in *Sempra Metals*, we consider that Sainsbury's is not entitled to any interest in respect of that portion of the overcharge that was passed-on (in the non-legal sense). That is because Sainsbury's has suffered no loss in this regard: see paragraph 525(1) above. We have considered whether there should be an award of statutory interest in respect of this portion of the overcharge, pursuant to section 35A of the Senior Courts Act 1981. We do not consider that it would be an appropriate exercise of our discretion to do so: we consider that the amounts of the overcharge in respect of which compound interest will be payable by MasterCard pursuant to the rule in *Sempra Metals* will compensate Sainsbury's in respect of the losses it has actually suffered; and that to make any further award under section 35A would result in over-compensation.

(d) Rate of interest

(i) Introduction

527. The issue of the appropriate rate of interest was heavily contested by the parties and raises certain novel issues. The position of the parties can be summarised briefly:

(1) Sainsbury's – through its expert Mr Reynolds – contended that the Tribunal should award interest by calculating the cost to Sainsbury's of

raising additional external finance. Mr Reynolds suggested that a reasonable approximation of such costs would be to J Sainsbury plc's Weighted Average Cost of Capital ("WACC").

(2) MasterCard – through its expert Mr Harman – contended that the effect of the overcharge would have been that Sainsbury's funded the overcharge from its available cash and/or from its debt. Mr Harman suggested that the Tribunal should calculate interest by reference to the rates earned on its cash balances and by reference to the interest saved from lower net borrowing costs.

528. Both experts had been instructed to assume that the impact of the overcharge was that Sainsbury's had made lower profits.

529. In order to appreciate the difference between the approach of the two experts, it is necessary to understand what WACC actually is.

(ii) The WACC

530. Mr Reynolds explained in his evidence that the WACC represents the average cost of funding facing the Sainsbury's group from debt, equity and sale-and-leaseback arrangements. Mr Reynolds' evidence was that Sainsbury's damages should be uplifted at the WACC rate irrespective of which of Sainsbury's particular funding sources were directly affected by the unlawful overcharge. In other words, the actual rate at which Sainsbury's was able to borrow money was not decisive at all. His opinion was based on an application of the Modigliani-Miller theorem. The theorem is well-established in finance literature and is described as "a cornerstone of modern corporate finance" by the New Palgrave Dictionary of Economics.

531. The Modigliani-Miller theorem posits that every firm has a fundamental level of risk attached to the activity in which it engages. This risk can be "parceled up" in different ways by using different mixes of debt and equity. However, this parceling up does not fundamentally alter the underlying level of the risk itself; and so the average cost of those funding types will remain constant. Modigliani and Miller demonstrated that – under certain restrictive

assumptions – if financial markets are efficient and there are no transaction costs, any reduction in the cost of debt will be perfectly offset by a higher cost of equity. In short, the level of risk attached to the activity will always properly be reflected in a firm's financing costs. Under these assumptions, a firm's capital structure will have no effect on its WACC.

532. Mr Reynolds quite properly made clear that his opinion was based on an explicit assumption that a company such as Sainsbury's could be expected to have optimised its mix of financing (i.e. to have minimised its cost of capital), though he did not suggest that he had enquired into the evidence to establish that this assumption was borne out in reality. If Sainsbury's paid the overcharge by raising cheap external debt, this would have increased the gearing (*i.e.* the debt/equity ratio) of the company. Increasing gearing would in turn lead to Sainsbury's equity (or further debt) becoming more risky and in consequence this would:

(1) Increase the cost of raising any further debt in subsequent debt raising rounds; and

(2) Increase the cost of raising further equity finance.

Thus, even if Sainsbury's had funded the overcharge directly by relatively cheap debt, on Mr Reynolds' view, in order to fully compensate Sainsbury's, account must also be taken of not just the interest payable on that cheap debt raised but also of *(i)* the higher rate of interest on Sainsbury's other debt and *(ii)* its higher costs of equity. If the assumption that Sainsbury's had optimised its mix of financing was correct, then these additional costs would approximately offset any saving Sainsbury's might otherwise have made by relying on the "relatively cheap debt".

533. Mr Reynolds provided a helpful analogy to assist the Tribunal to understand why it is that the level of underlying risk remains invariant despite different gearings:[336]

[336] Reynolds 1/§49.

> "An analogy might be to consider the level of risk in a firm as like the air in a balloon. Squeezing one end of a balloon does not reduce the amount of air that is inside – it just shifts it to 'the other end'. In much the same way, issuing debt does not reduce the overall level of risk – it simply shifts it somewhere else – in this case, to equity."

To calculate Sainsbury's WACC, Mr Reynolds used its parent company, J Sainsbury plc, as a proxy. Mr Reynolds noted that, over the claim period, J Sainsbury plc's profits were predominantly derived from the retailing activities of Sainsbury's, from which he inferred that parent and subsidiary were likely to have similar costs of capital because, fundamentally, they each have exposure to the same overall market risk.[337] Mr Reynolds estimated the group's WACC over the course of the claim period at between […][✂] and […][✂] (after tax).[338]

534. Mr Harman did not agree that the WACC was an appropriate means to estimate the rate at which Sainsbury's interest losses should be calculated. His position was that the approach was highly theoretical and did not measure Sainsbury's real loss. Mr Harman's two main criticisms were as follows:

   (1) There was no evidence to support Mr Reynolds' assumption that Sainsbury's achieved the optimal mix of funding, such that any move away from that would sub-optimal.

   (2) That in any event, the overcharge would have had an immaterial impact on Sainsbury's gearing, so it was fanciful to suggest that it would have actually changed shareholder expectations as to the underlying level of risk relating to Sainsbury's retail activities. In short, whether the overcharge was paid by Sainsbury's or not, the level of Sainsbury's gearing would materially be the same.

535. We consider these points in turn below.

<u>Whether Sainsbury's had optimised its mix of funding</u>[339]

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[337] Reynolds 1/§57.
[338] Reynolds 2/Table C1.
[339] See Harman 2/§§4.12-4.16; Reynolds 2/§§43-52; Harman 4/§§3.13-3.14; Reynolds 3/§19.

536. Mr Harman noted that Mr Reynolds could point to no factual evidence to support his assumption that Sainsbury's had optimised its mix of funding. He stated that, in practice, firms find it difficult to optimise their capital structure and that finance theory also suggests reasons why a firm might not optimise its capital structure. For example, according to the "pecking order" theory, firms prefer internal finance over external finance, when that is available, and also prefer debt over equity. This minimises transaction costs (which the Modigliani-Miller theorem disregards) and avoids sending signals to the market which might be misread by investors (which the theorem also disregards). There is also no single, accepted, way to finance a firm: this means that it is often the case that firms conducting the same business in the same markets have very different capital structures. By way of example, Mr Harman pointed to the UK's six largest energy companies, which each have different capital structures.

537. Mr Reynolds was not able to point to documents which indicated that Sainsbury's had optimised its capital structure. He did highlight certain statements in annual reports (and similar documents) which indicated that Sainsbury's was seeking to optimise its funding mix. Mr Reynolds also explained that the fact that different firms in the same industry had different capital structures might be accounted by either *(i)* firm-specific factors, such as size and profitability or *(ii)* there being a range of different levels of gearing in an industry which do not affect the companies' underlying WACC. Similarly, Mr Reynolds explained that financial theory indicates that across a moderate range of gearing a company's WACC is near optimal. Thus, a financial manager does not need absolute precision to achieve an effectively optimal capital structure. Mr Reynolds also stated that the "pecking order" theory supported his argument that, if the overcharge had not been levied, the additional "internal finance" received by Sainsbury's would have been used instead to avoid the use of more expensive external equity and debt.

538. On the evidence available to us, we find ourselves unable to conclude that Sainsbury's had achieved an optimal or near optimal funding mix, and certainly not at all times throughout the claim period. It may be that

Sainsbury's was striving to optimise its capital structure: but that does not lead to the conclusion that that optimisation had in fact been achieved. Indeed, the considerable fluctuations in Sainsbury's cash balances at the bank strongly suggest a non-optimal funding mix. We conclude that this element of the Modigliani Miller theorem was not met in this case.

Whether the impact of the overcharge on Sainsbury's gearing was material[340]

539. Mr Harman accepted that a large change in a firm's funding mix could lead to a change in that firm's existing cost of equity or debt. This would be the case, in his opinion, in situations where a company needed to raise a significant amount of debt, such as might affect the creditworthiness of the company. However, he considered that "small" changes in input variables would be unlikely to change shareholder expectations. Mr Reynolds disputed this, stating that the argument was unsustainable despite its intuitive appeal. In 2014/2015, J Sainsbury plc's equity was approximately £5,443 million: given this huge sum, even a very small percentage change in Sainsbury's gearing could result in a significant change in Sainsbury's cost of equity. Mr Reynolds stated that this would hold true, provided that capital markets eliminate arbitrage opportunities. He went on to explain that J Sainsbury plc's accounts disclose the company's level of debt to the nearest million pounds and that equity analysts would rely on these actual debt figures in their valuation models. J Sainsbury plc's cost of equity changes constantly by fractions of a penny each day, so even small changes could and would affect J Sainsbury plc's cost of equity.

540. On this point, we prefer Mr Harman's evidence to that of Mr Reynolds. We do not consider that the evidence establishes that the increase in gearing caused by the overcharge affected J Sainsbury plc's or Sainsbury's costs of equity. The capital markets are not perfect arbitrageurs of the relative costs of different forms of finance (they reflect many other factors), nor do they operate in a world with perfect informational transparency. In our view, a change in gearing even many times larger than the overcharge would not

[340] See Harman 2/§§4.8-4.9; Reynolds 2/§§33-42; Harman 4/§§3.11-3.12.

mechanistically lead to a change in a company's cost of equity in the real world.

(iii) A rate of interest based on the factual circumstances of Sainsbury's loss

541. It may well be that the WACC has its place in the assessment of what would be an appropriate price for the raising of large scale future capital for a firm. But it is a wholly inappropriate measure in the present case. The Modigliani-Miller theorem is so based on assumptions that do not pertain in the real world, that it seems to us *prima facie* fundamentally unsuited to an assessment of damages. Even disregarding these difficulties of meshing a theory with the real world, we have found that the Sainsbury's mix of funding was sub-optimal (so that a change in gearing would not have adverse effects) and that the extent of the overcharge was such that (even if Sainsbury's mix of funding was optimal) the presence or absence of that overcharge would make no difference to that optimal position.

542. We consider that an assessment of the appropriate rate of interest must be based on the specific facts as we have found them to be. The cost of capital is the minimum expected rate of return that an investor will require to invest in a firm. *Sempra Metals* requires that the court quantifies the actual losses suffered by a firm. As noted above, in this case, Sainsbury's did not raise any equity during the claim period.[341] An increase in the theoretical cost of equity does not equate to any actual loss paid out by the company in real life. We consider that, even if any changes in the cost equity had occurred (contrary to the conclusions we have reached), these would have been too remote to be attributable to the overcharge.

543. We turn, therefore, to the assessment of what rate of interest would be appropriate given the findings we made in paragraph 525 above. In the light of these findings, we consider that interest should be awarded:

(1) At the rate of cash earnings on 20% of the total overcharge; and

(2) At the rate of Sainsbury's new debt on 30% of the total overcharge.

[341] J Sainsbury plc raised equity only once in June 2009.

This reflects the factual position that we have found to exist.

544. The rate of interest earnings on cash held by Sainsbury's was not in dispute. However, the cost of debt to Sainsbury's was at issue between the parties. Sainsbury's cost of debt fell over the course of the claim period. Mr Reynolds and Mr Harman disagreed as to the impact this decline in the rate of interest would have had on the rates that Sainsbury's actually paid. Mr Reynolds considered that it would be more appropriate to calculate the cost of debt to Sainsbury's using a trailing average.[342] This approach assumed implicitly that debt taken out by Sainsbury's could not be re-financed at cheaper rates in subsequent years. Mr Reynolds defended this approach on the basis that this reflected the reality of costs facing Sainsbury's. He noted that a far larger share of Sainsbury's capital was financed through 25-year sale and leaseback agreements than was financed by ordinary debt. He also noted that the sale-and-leaseback agreements were relatively expensive and so it would have been rational for Sainsbury's to have relied less on this more expensive form of debt if it had greater profits at its disposal. By contrast, Mr Harman implicitly assumed that the debt, which would have been paid down by Sainsbury's had the overcharge not occurred, would have been new debt taken either at a variable rate or on terms permitting regular refinancing. Thus, the cost of debt fell much more swiftly on Mr Harman's approach compared to Mr Reynolds' approach.

545. We prefer the approach of Mr Harman. We consider that the sale and leaseback agreements had nothing to do with the overcharge, and should be left out of account.[343] We also consider that it is better to calculate interest based on the cost of new debt as suggested by Mr Harman. This reflects the reality of the situation that we must consider when assessing damages: absent the overcharge, Sainsbury's would have found itself with additional funds, which it could have used to increase its cash balances or to pay down its existing debt obligations.

[342] Day 15/pp73-75.
[343] See paragraph 525 above.

(e) Conclusion on interest award

546. On interest, our conclusions are as follows:

(1) We will award interest on a compound basis on 50% of Sainsbury's assessed damages (see paragraph 504 above), to be compounded with quarterly rests for the claim period.

(2) In relation to that 50%, we will award interest on 20% of the overcharge at the rate that Sainsbury's would have earned on its cash balances. We will award interest on 30% of the overcharge at the rate that Sainsbury's would have saved by taking out less new debt.

(3) The relevant interest rates to be applied are:

(i) On the 20% amount, the figures set out in Harman 2/§5.8, using the pre-tax figures. Where Mr Harman has not provided a figure – as for 2015/2016 – the figure for the preceding year should be used.

(ii) On the 30% amount, the figures set out in Harman 2/§5.16, using the pre-tax figures. Where Mr Harman has not provided a figure – as for 2015/2016 – the figure for the preceding year should be used.

547. On this basis, the parties are invited to calculate the interest recoverable by Sainsbury's.

L. CONCLUSIONS AND DISPOSITION

548. For the reasons given in this Judgment, we unanimously find and hold that:

(1) The setting of the UK MIF was an agreement or agreements between undertakings, being between MasterCard and its licensees (paragraph 95 above, which licensees included Sainsbury's Bank (paragraph 325 above)).[344]

[344] See also paragraph 86 and footnote 69 above.

(2) The setting of the UK MIF was not a restriction of competition by object for the purposes of Article 101(1) TFEU and equivalent domestic provisions (paragraph 102 above).

(3) The setting of the UK MIF was a restriction of competition by effect (paragraph 267 above). But for the UK MIF, bilaterally agreed Interchange Fees would have been agreed in place of the UK MIF (paragraph 266 above). These bilaterally agreed Interchange Fees would have been:

(i) In the case of MasterCard credit card transactions, the equivalent of 0.50% (rather than 0.9%) (paragraph 226 above).

(ii) In the case of MasterCard debit card transactions, the equivalent of 0.27% (rather than 0.36%) (paragraph 233(3) above).

(4) The UK MIF as set is not exemptible under Article 101(3) TFEU (paragraph 288 above). Although it is possible for some level of UK MIF to be exemptible under Article 101(3) TFEU, on the facts of this case that level would inevitably be lower than the bilaterally agreed Interchange Fees described in sub-paragraph (3) above (paragraph 289(8) above).

(5) MasterCard's illegality defence fails for the reasons given in paragraph 419 above.

(6) For the reasons set out in detail in Section K above, Sainsbury's is entitled to recover:

(i) An amount equivalent to the extent to which the UK MIF paid by Sainsbury's in the claim period exceeded the amount that Sainsbury's would have been charged absent the UK MIF, this being the difference between the amount of the UK MIF for MasterCard credit and debit cards and the bilateral Interchange Fees set out in sub-paragraph (3) above.

(ii) Less credit for the amount identified in paragraph 503 above.

(iii) Plus interest.

(7) The total amount that Sainsbury's recovers is £68,582,245 in respect of the overcharge in relation to credit cards and £760,406 in respect of the overcharge in relation to debit cards (plus interest determined in accordance with paragraph 546 above). However, the extent, if any, to which the amount of damages and/or interest must be varied to take account of (i) the issue of limitation (as noted at paragraph 96 above); and/or (ii) any irrecoverable amount included in the figures for 2015-2016 (as noted at paragraph 430 above); and/or (iii) taxation (as noted at paragraph 508 above) is expressly reserved for further argument if necessary, and no findings are made in this regard.

549. Accordingly, we order that MasterCard pay to Sainsbury's the sum of £68,582,245 in respect of the overcharge in relation to credit cards and £760,406 in respect of the overcharge in relation to debit cards, plus interest as indicated above within 28 days of the date hereof. If and to the extent that this involves an overpayment because of the matters reserved for further argument, if necessary, pursuant to paragraph 548(7) above, then Sainsbury's will be obliged to repay that overpayment, plus interest, to MasterCard.

550. We invite the parties to seek to agree the terms of an order reflecting these conclusions, which should then be submitted to us for approval.

M. Postscript

551. Finally, we would like to express our thanks to counsel and their respective teams for the help they have provided to us in the course of the hearing.

The Hon. Mr Justice Barling Chairman	Prof. John Beath OBE	Marcus Smith QC

Charles Dhanowa OBE QC *(Hon)* Registrar	14 July 2016

ANNEX 1

(paragraph 1 footnote 2 of the Judgment)

TERMS AND ABBREVIATIONS USED IN THE JUDGMENT

TERM	**MEANING**	**FIRST REFERENCE IN THE JUDGMENT**
THE PARTIES		
Sainsbury's	Sainsbury's Supermarkets Ltd	§1
MasterCard	A collective reference to the Defendants: MasterCard Incorporated, MasterCard International Incorporated and MasterCard Europe SA	§4
OTHER ENTITIES		
Amex	American Express	§28(1)
LBG	Lloyds Banking Group	§122
OFT	The Office of Fair Trading	§21
RBS	Royal Bank of Scotland plc	§114
S2	S2 Card Services	§244
Sainsbury's Bank	Sainsbury's Bank plc	§17(3)
LEGISLATION, CASES AND OTHER MATERIALS		
2015 Interchange Fee Regulations	The Payment Card Interchange Fee Regulations 2015, S.I. 2015 No. 1911	§17(4)(iii)
Commission Decision	The Decision of the European Commission of 19 December 2007 in case COMP/34.579 MasterCard	§14
Damages Directive	Directive 2014/104/EU of the European Parliament and of the Council of 26 November 2014 on	§480(4)

<table>
<tr><td></td><td>certain rules governing actions for damages under national law for infringements of the competition law provisions of the Member States and of the European Union</td><td></td></tr>
<tr><td>EEA Agreement</td><td>Agreement on the European Economic Area</td><td>§1</td></tr>
<tr><td>EU Interchange Fee Regulation</td><td>Regulation (EU) 2015/751 of the European Parliament and of the Council of 29 April 2015 on interchange fees for card-based payment transactions</td><td>§165</td></tr>
<tr><td>OFT Decision</td><td>The Decision of the OFT of 6 September 2005 in case No. CA98/05/05</td><td>§98(2)(ii)</td></tr>
<tr><td>TFEU</td><td>Treaty on the Functioning of the European Union</td><td>§1</td></tr>
<tr><td>Visa I Decision</td><td>The Decision of the European Commission of 9 August 2001 in case COMP/29.373 – Visa International (2001/782/EC)</td><td>§128(1)</td></tr>
<tr><td>Visa II Decision</td><td>The Decision of the European Commission of 24 July 2002 in case COMP/29.373 – Visa International – Multilateral Interchange Fee (2002/914/EC)</td><td>§98(2)(i)</td></tr>
<tr><th colspan="3">OTHER TERMS USED</th></tr>
<tr><td colspan="2">Acquiring Bank</td><td>§6</td></tr>
<tr><td colspan="2">Agreed List of Issues</td><td>§17(4)</td></tr>
<tr><td colspan="2">Amex GNS</td><td>§58</td></tr>
<tr><td colspan="2">Cardholder</td><td>§6</td></tr>
<tr><td colspan="2">Claim period</td><td>§17(4)(iii)</td></tr>
<tr><td colspan="2">CNP / card not present transactions</td><td>§6</td></tr>
<tr><td colspan="2">Four-party system</td><td>§42</td></tr>
<tr><td colspan="2">HACR / Honour All Cards Rule</td><td>§9(4)</td></tr>
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Interchange Fee	§8(5)
Interchange System	§45(7)
Issuing Bank	§6
MasterCard Scheme	§4
MasterCard Scheme Rules	§7
Merchant	§6
Merchant Services Agreement	§8(1)(ii)
MIF	§4
MIT / Merchant Indifference Test and MIT-MIF	§13(5)(i), §188 and §289(3)
MMF MIF	§98(2)(ii)
MSC / Merchant Service Charge	§8(6)
Nectar Scheme	§18(6)(iii)(b)
Visa Scheme	§44

ANNEX 2

(paragraph 20 of the Judgment)

OVERVIEW OF UK AND EU REGULATORY DECISIONS

1241/5/7/15(T): ANNEX 2 TO JUDGMENT

OVERVIEW OF UK AND EU REGULATORY DECISIONS INVOLVING MASTERCARD AND VISA