IN THE COMPETITION APPEAL TRIBUNAL 1517/11/7/22

Salisbury Square House
8 Salisbury Square
London EC4Y 8AP

Monday 24 March – Friday 4 April 2025

Before:

The Honourable Justice Michael Green
Ben Tidswell
Professor Michael Waterson

Merchant Interchange Fee Umbrella Proceedings

A P P E A R AN C E S

Matthew Cook KC, Sonia Tolaney KC & Owain Draper on behalf of Mastercard
(Instructed by Jones Day and Freshfields
LLP)

Daniel Jowell KC, Jessica Boyd KC, Isabel Buchanan, Ava Mayer & Aislinn Kelly-Lyth
on behalf of Visa (Instructed by Linklaters LLP and Milbank LLP)

Kieron Beal KC, Philip Woolfe KC, Reuben Andrews, Flora Robertson & Oscar Schonfeld on behalf of the SSH Claimants

Wednesday, 26 March 2025

(10.30 am)

THE CHAIRMAN: Good morning.

MR JOWELL: Good morning.

I call Mr Derek Holt.

THE CHAIRMAN: Yes.

Good morning, Mr Holt. You will need to be sworn in again.

WITNESS: Yes.

MR DEREK JAMES HOLT (affirmed)

Examination-in-chief by MR JOWELL

MR JOWELL: Mr Holt, could I ask you to see {RC-F1.4/2/1}. I think that may be in front of you --

A. Yes.

Q. -- or if not, it can be pulled up. This is your 13th report as originally filed?

A. Yes.

Q. Now, there were certain amendments made to that report subsequently which one can see if one goes to the markup which, just for everyone's reference, is at {RC-F1.4/6/1}. But if I could show you then the amended version in a clean version, it is in {RC-F1.4/5/1} do you have that in front of you? I think you should.

A. I have -- yes, I do now, yes.

Q. If I could ask you to go, please, to the declaration,

which is on {RC-F1.4/5/138-139}.
A. Yes.
Q. Over the page.
Is that your signature?
A. It is.
Q. Is that report true to the best of your knowledge and belief?
A. It is.
Q. If I could ask you now to go to {RC-G1.3/2/1}, please. I think you have a copy of this report in front of you. This is your 14th expert report.
A. Yes.
Q. If we could go to {RC-G1.3/2/129}. Again, we see the declaration.
Over the page, please {RC-G1.3/2/130}, again, is that your signature?
A. It is.
Q. Is that report also true to the best of your knowledge and belief?
A. Yes, it is.
MR JOWELL: Thank you.
Please wait there, Mr Beal will have some questions for you.
THE CHAIRMAN: You have a hard copy of your report --
A. I do.

THE CHAIRMAN: -- as well.

A. Yes, I do, thank you.

Cross-examination by MR BEAL

MR BEAL: Mr Holt, can I make the usual declaration that I will not be putting every point in our case to you because we do not have time, but that does not mean that we accept every element of your evidence.

A. I understand.

Q. What I will be doing is putting the key points as we see them to you and inviting you to give us your response.

You have been a busy man, have you not? You have been involved in the Kent trial; is that right?

A. Yes.

Q. You were instructed in some of the other collective proceedings that are going on at the moment?

A. Yes.

Q. Have those other collective proceedings had deadlines in February and March?

A. Well, I am trying to think. Well, certainly the Kent trial happened, including part of February, yes.

Q. Now, as my learned friend Mr Jowell has just made clear, there was a mistake in the original version of your 13th report?

A. That's correct.

Q. You were nonetheless prepared to sign the declaration

that it was true and accurate to the best of your knowledge and belief?
A. At the time, yes, of course.
Q. It was a substantial error, was it not?
A. It had -- it had some substantial implications, yes.
Q. Well, your evidence changed for large merchants such that you had previously concluded that there was incomplete pass-on and you now recognise that for large merchants there is complete pass-on?
A. Yes, that was my updated, in the round, assessment.
Q. And on average, when one looks at the maths, your underlying estimates for smaller merchants based on acquirer data have increased by some 40%?
A. Yes, I think that might be -- I haven't re-examined the detail, but that -- that seems fair.
Q. Whereas your underlying estimate for the acquirer pass-on or APO for smaller merchants only increased by 20 percentage points, did it not, from 55% to 75%?
A. Yes.
Q. It also increased your economy-wide pass-on rate by five percentage points; that is right, is it not?
A. Yes.
Q. If we take Mr Cook's suggestion that the economy-wide pass-on rate has to be applied to a claim that he puts at £2 billion, in true Austin Powers style --

MR COOK: I do not make that suggestion at all. Of course the CICC claim is the opt-out claim is for merchants under 100 million, that is not economy-wide.
MR BEAL: Well, I got the 2 billion figure from my learned friend's opening.
THE CHAIRMAN: Footnote 8, I seem to remember.
MR BEAL: Wherever it came from, it is not a figure I am setting any store by, I am simply trying to work out the size of the magnitude of the mistake.
I mean, if you have got 5% of 2 billion, then one imagines that is a £100 million mistake, is it not?
A. Yeah, I think it's fair to say that the increase in the estimate of the average pass-on rate would lead to an increase in the value of the claim, of course assuming all the other Trial 1 caveats would apply. Of course, further, you'd need to think about the Trial 2A implications. But I would agree, at least for the purpose of assessing acquiring pass-on, it would have a not immaterial impact on the rate.
Q. Your 13th report, remind me, that went in at the beginning of February, did it not?
A. Yes, I think so.
Q. I can give you the specific date. It has escaped my -- I thought it was 9 February, but I may be wrong -- 7 February, sorry, and the mistake was not discovered

until 28 February; is that right?
A. I can't recall the exact date, but, yes, I think when we -- I think that -- that is correct, and I think we identified that when the correction was identified.
Q. It then took several days, I think until 3 March, for the mistake to be notified to the Tribunal and the parties?
A. Yes. Having sort of identified that there was a potential issue, we obviously needed to understand that in more detail and understand what the implications were and then update the report.
Q. Can I suggest you had left it to your team to conduct the granular analysis lying behind your 13th report?
A. I think I would certainly acknowledge that I had a great deal of support from the team, which I acknowledged in my -- in -- as I have done in other reports as well, and that was certainly the case in this regard.
Q. Did the finding that there was incomplete pass-on of price increases not give you pause for thought?
A. As -- the finding of potential incomplete pass-on of price increases as per the original pre-amended --
Q. Yes.
A. -- report?
Not necessarily, in the sense that I was looking at all the evidence I had in the round, I was looking at

both decreases and increases, I had recognised that there would be an expectation of material pass-on based on the economic principles, but that the actual amount would be an empirical issue, and at the time of the filing of Holt 13, I engaged on the empirical analysis as I understood it at that point.

Q. You had been instructed for Visa in the *Sainsbury's* litigation, had you not?

A. Yes, I was.

Q. Could we look, please, at {AB-D/21/5}. This is part of the Supreme Court's judgment in the *Sainsbury's v Mastercard* decision. Could we look, please, at paragraph (v) there. It says:

"The MSC is negotiated between the acquirer and the merchant. Typically, it is set at a level that reflects the size and bargaining power ..."

I appreciate your screen has gone off --

A. Sorry, yes, it has gone off.

Q. -- my laptop has not. I am blessed with a separate connection to the screens. Let me just carry on reading, you can catch up:

"Typically, it is set at a level that reflects the size and bargaining power of the merchant, the level of the acquirer's costs (including scheme fees ... and any interchange fees ...), and the acquirer's margin."

So that is a recognition, is it not, that typically the MSC will reflect the scheme fees, interchange fees and then the acquirer's margins, the three main components of the MSC?

A. Well, I think that's just a simple description as to what the MSC must be recovering. There are various costs, there are interchange fees, there are scheme fees and then there are any other costs and profit margin that go on top. So I think that's just a -- a recognition that those are the components.

Q. Could we then please go to {AB-D/21/7}, (x), at the top of the page. The Supreme Court held:

"For most of the claim period, the MIF typically accounted for some 90% of the MSC."

So that is suggesting it is a very significant component cost of the MSC, you would agree with that?

A. Yes, I'd agree that 90% is a material amount.

Q. Well --

A. On average.

Q. -- I am asking a different question. Would you accept that throughout the claim period, the MIF, the Multilateral Interchange Fee, has accounted for a very material part of the MSC as a price -- as a cost, sorry, a cost component?

A. Yes, it does. It actually varies, I think, a little bit between merchant size groups. I think that's something that figure 2, or graph 2 of the hot tub debate indicated, that the MSCs vary quite a lot across merchant size groups, and given that the interchange fees are essentially set commonly across size groups, that does suggest that the size of the increment of the MSC above the interchange fee can be quite variable, it can be quite high in some cases and lower in others.

Q. It then says, back to (x):

"Acquirers pass on all of the MIF, and the scheme fee, to merchants through the MSC, with negotiation between acquirers and merchants ... being limited to the level of the acquirer's margin."

Can you see that?

A. Yes.

Q. So in *Sainsbury's*, it was recognised and indeed it was stated to be common ground, that there was 100% pass-on of the MIF into the MSC?

A. Well, I think what that seems to be focusing on in that -- my understanding was that was debating a liability point.

Q. Well, it says "acquirers pass on all of the MIF" --

A. Yes, I think what I'm saying is that --

Q. -- and one sees recognition at the beginning of paragraph (x) that this reflected the common ground between the parties?

A. Yes, okay, it might well be that -- I haven't gone back to look at the base on which the Supreme Court made that particular statement. What I've done in Trial 2B is to actually look at the data as we have it, as well as the economic theory, and then to actually try and work out what is the degree to which pass-on would be expected.

Q. So when I said to you did your finding of incomplete pass-on for a MIF, certainly in response to price increases, give you pause for thought, what I am going to suggest to you is that given that it had been common ground in *Sainsbury's* that there was indeed 100% acquirer pass-on full stop, that would have been a result that called out for an explanation.

A. Well, I think the whole purpose of Trial 2B was to test that proposition as to what was the degree of pass-on. Obviously, had it been agreed amongst all the parties at this stage that that held, I don't think we would be having Trial 2B. Also one needs to distinguish between the potential of 100% incomplete pass-on in certain circumstances, such as for IC++, and that might not hold in all other contexts.

Q. Could you turn, please, within this document to {AB-D/21/3} and look at paragraph 3. The outline facts are described as being:

"... helpfully set out in the parties' statement of facts ..." --

A. Yes.

Q. -- "... and issues, as summarised below."

You were acting for Visa at the time. I do not want to go into the details of the internal dynamics of the Visa team, but I am going to suggest to you that Visa would not have signed off on the statement of facts if it had not been common ground that acquirer pass-on was complete at 100%.

A. Just -- I'm not sure how relevant it is, but my involvement as an expert on behalf of Visa during the *Sainsbury's* case focused essentially primarily on the first instance trial, which addressed both liability issues and exemption issues. Then there were some appeals and I didn't have any particularly material role in giving any evidence during the appeals, so --

Q. You were involved at the CAT stage; correct?

A. It was actually the High Court, *Asda and others v Visa* was in the High Court, whereas I think it was the *Sainsbury's v Mastercard* that was before the CAT from my recollection.

Q. Could we look, please -- you are quite right. We will

look at the decision you were involved in then, that is the judgment of Mr Justice Phillips; is that right?
A. That's the one, yes.
Q. {AB-D/15.2/27}, paragraph 103. Sorry, paragraph 102, there is a section there, halfway down -- well, sorry, four or five lines up from the bottom. It says:
"As all Acquirers are in the same position, Merchants have no ability to negotiate with them as to the MIF element of the MSC, which is passed on in full. Witnesses called by each of the Merchants (12 in total) gave evidence that their respective Acquirers refused to negotiate the MIF element of their charge treating it as a pass-through cost set by the Scheme."
So that was a trial you were involved in --
A. Yes.
Q. -- and that was the conclusion that was reached by Mr Justice Phillips?
A. Yes, I can see that that was the decision or judgment that he reached, and again, I think all I can comment is that, for the purpose of Trial 2B, I was simply investigating what does the evidence say based on the range of evidence before the court in this trial.
Q. Please could we look at your third report in these proceedings. That is {RC-K/6.1/9}. Could we look, please, at paragraph 20. You are dealing there with

the sixth fact as identified by the Supreme Court. You recall the nomenclature that we have for Trial 2A?

A. Yes.

Q. It says:

"The applicability of the sixth fact would need to be tested in individual cases. If my understanding of the Supreme Court's judgment was correct, the sixth fact would not hold if acquirers did not pass on any counterfactual reduction in MIFs to merchants."

So you did not, at that point, address the issue of whether or not there would be pass-on of a counterfactual -- sorry, of an increase in MIFs to the merchants?

A. I think it's fair to say that my understanding of the counterfactual as described there was that there would have been a counterfactual reduction in the MIF at -- at a point in time. What I was doing in -- and this is sort of the liability -- sorry, this is the discussion, I think, ahead of the summary application relating to some issues, but it was part of essentially the liability trial, was addressing the sixth fact and trying to understand what evidence might one look at to understand whether my interpretation of the Supreme Court's sixth fact would potentially hold for different interchange fees than it had been already held to hold for domestic and inter-regional, so i.e. inter-regional and commercial, for example.

Q. Paragraph 21 then says you:

"... have reasons to believe that the degree of acquirer pass-on for commercial card transactions may be lower than for consumer cards."

In fact, as I understand it, your position is now exactly the opposite, is it not?

A. Well, so I think that's a -- that's a fair statement in the sense that at that point in time -- and this was obviously a very preliminary report ahead, if my timing is correct, this is the third expert report I think ahead of a summary application to address whether there's even a worthwhile question to ask whether there was pass-on to the level required by the Supreme Court test of commercial. Now, at the time, I identified that there were some distinctive features -- it would presumably be in section 4 of this report -- that might distinguish the situation as between commercial and other -- and domestic --

Q. Let us look, please --

A. -- but that -- sorry, but that wasn't reaching a finding based on the evidence, that was later in the liability trial that we began to address that, and I ultimately, I think, agreed that there may well be some relationship between changes in MIFs and MSCs such that that might not necessarily suggest the sixth test would always hold.

Q. The factors you start looking at, we can see the culmination of your analysis on these points at {RC-K/6.1/16}, and you will see at paragraph 55 you say:

"As explained in section 2.2, the Supreme Court's sixth fact may only apply if acquirers would have passed on a reduction in MIFs to cardholders. This is a factual question that would need to be answered with regard to all transaction and card types. The answer may be particularly uncertain with regards to commercial cards, as they account for a relatively small share of overall transactions. According to data from Visa, commercial cards accounted for only 2.3% of transaction volume, 8.6% ... of value and 15.1% of total MIFs ... Depending on how acquirers reflect commercial cards transactions in their pricing, it may be that a reduction in MIFs would not have translated into a reduction in MSCs."

So you recognised, did you not, that you needed to look at evidence about acquirer passing -- acquirer pricing, sorry, in order to help decide the empirical question of APO?

A. So, again, this was for the purpose of understanding whether the sixth test would potentially apply to commercial cards and inter-regional cards. What I was doing was interpreting the Supreme Court's sixth test, which I think themselves stemmed from an analysis of the 2007 *Mastercard* decision and -- and the ultimate Court of Justice findings in that regard, and the Commission relied on evidence of this type in terms of assessing issues such as was there a floor and was there a change in MSCs as a result of the change in inter-regional MIFs.
Q. With respect, it is quite a straightforward question. Do you accept or not that looking at acquirer pricing is relevant to the analysis of APO?
A. Yes, I think it is, to answer quickly, because there are issues, such as blending, that might be important to take into account in the assessment.
Q. Do you accept that acquirers price on the basis of the cost of the MIF when setting their MSCs?
A. I think all I would accept in that regard is that, at least for standard contracts as opposed to IC++ ones, the MIF would be one of the factors that they would take into account. Exactly what extent of a change in MIF would translate through to MSCs is a matter for empirical assessment.

Q. But it directly feeds into the pricing mechanism of setting the MSC?
A. Well, it -- it does for IC++, because the pricing mechanism in that case is -- is a literal, you know, change in MIF would translate directly to the change in MSC. I think the whole purpose of Trial 2B is that that is understood not to be the case for standard contracts and that's why I think the focus of this is on the empirical assessment of standard contracts.
Q. Well, we have seen that the component cost of the MIF varies somewhere between, I think, on Ms Webster's evidence, 40% and what we have seen in the Supreme Court of 90%. That is a very substantial cost component of the MSC, is it not, for the acquirer?
A. Well, I agree that it's substantial. It may, in many cases, even be the single largest component. I think that range that you just described suggests that there is some potentially significant variation in that and I would suggest that one obvious reason for variation is that for smaller merchants, the margins and the MSC prices relative to MIFs tend to be higher by respect to -- to larger merchants.
Q. Imagine that you are the chief executive officer of a large acquirer for a day and you are trying to set the prices for the MSC for the coming month. Are you

saying that you would not look at and take into account expressly the very, very high variable cost component of the MSC, which is the MIF?

A. I would agree with you that I would take into account the -- the nature of the MIF, and indeed I would agree with you that it's a variable cost. I would even go further to say that it's an industry-wide cost, which is why I do expect that there would be material pass-on. As to the actual degree of it, well, it's simply wrong to say because it's variable, or indeed because it's variable and industry-wide, that necessarily suggests there must be complete pass-on. The reason for that is that --

Q. I was not asking about complete pass-on --

A. Oh.

Q. -- I was asking whether it was expressly taken into account in the pricing dynamic in the pricing mechanism?

A. Well, it is for IC++, but it is not for standard. I think, for standard contracts, there's a range of issues that are taken into account: it's offered as a bundle, you're obviously also offering a range of non-pricing components as well. So I -- I'm not disagreeing that the MIF would be one of the factors to take into account, but I would disagree if the suggestion is that that automatically implies anything about the degree of pass-on.

Q. Well, in Trial 2A, I seem to remember having quite a lot of discussion with you about the Cost Of Goods Sold and the component element of the cost that that was, and your, as I understood it, unshakable position was that Cost Of Goods Sold would be -- as a very high marginal cost component of the overall price of goods sold as to the overall cost of supplying a good, would be taken into account in setting the price by a merchant?

A. Well, what I agreed is that it would be an important factor and that, in the long term, I would expect both the economic theory to point to material pass-on, but that the actual degree, again, would be something for the empirical analysis, and that's still my view.

Q. Can we look, please, at {RC-I4/53/4}. I am not going to mention the merchant covered in this report. It is a procurement exercise that was conducted by a company for another company. Could we look at page 4, please. We see that in paragraph 1:

"Significant five figures annual savings from reduced merchant acquiring costs while retaining current suppliers ... have been identified through this procurement exercise."

Can you see that?

A. Sorry, can you remind me, which point are you looking at?

Q. Paragraph 1 of page 4.

A. Paragraph 1, okay, it summarises -- yeah.

Q. Then {RC-I4/53/5}, we have a breakdown of how those savings have been calculated, and in the left-hand side, we have a descriptive narrative.

The final paragraph on the left-hand column says that the company that is conducting the exercise:

"... is delighted with the final result in this project, saving 37% on [the merchant's] annual costs above interchange. The increased visibility over the supplier arrangements and additional non-quantifiable benefits have also contributed to an extremely successful outcome."

If you look on the right-hand side, there is a table, of which the fourth row -- sorry, the third row identifies "Interchange", and you will see that it is a common variable, regardless of the various different acquirers that are essentially putting forward pricing options for this pricing inquiry. Can you see that?

A. Yes.

Q. So it is right, is it not, that when procurement exercises are conducted, the interchange fees are an unmovable object?

A. I agree that the interchange fees should be common essentially across acquirers given the transactions that the merchant will have, yeah.

Q. It is common, is it not, to find acquirers reaching out to merchants to offer them better rates or indeed a move to IC+ pricing if it is available to them?

A. I don't think I could agree to the degree of commonality of that, or at least that the degree of commonality of offering better rates and switching to IC++, at the very least, likely depends on the -- the merchant size. So I think, for large merchants, I think when there is switching, my understanding from the PSR evidence is that often the switching can go to an IC++ contract, and of course, as a result, I would assume in my analysis for the economy-wide or the average MIF, that that would be 100%.

Q. Could we look, please, in {RC-I4/57/1}. Again, I am going to deal with this without names seeing as we are in open. There is an offer there from -- sorry, a letter there from acquirer B to a particular client. It does not matter the name of the client. We see in the second paragraph on that page -- sorry, the first paragraph on that page, after "Dear" and then there is an individual name, that there had been communications the previous year relating to changes to interchange fees for consumer credit and debit transactions, and the acquirer is now advising the client of some further changes to the fees to be applied?

A. Yes.

Q. They provide:

"A summary of these changes is enclosed, but for clarity we would like to provide the following explanation: The total amount you pay for card is made up of 3 components 1) Interchange, 2) Card Scheme fees and 3) the fee which you pay to [the acquirer] ... The regulatory fees [then] associated with using the Visa and MasterCard networks have recently increased ..."

If we then please turn to {RC-I4/57/2}, there is a reference under, "Revised Schedule of Fees" to:

"As a result of these changes, we need to amend the Fees we charge ... This letter constitutes notice of the amended Fees ..."

Then in "Schedule 1" {RC-I4/57/3}, the existing pricing remains unchanged save to the extent amended in the schedule and then you have a break out of the interchange, scheme and acquirer fee giving a "Total MSC". Can you see that? Visa and Mastercard consumer credit and debit?

A. Yes, I see. I see that, yes.

Q. That is an example, is it not, of an acquirer notifying a particular merchant of changes that are being made to interchange fees, and you would accept, I think, that the Visa consumer credit and Visa consumer debit elements of those charges are broken out so that they are on an IC+ -- IC++ pricing basis; would you accept that?

A. Well, I'm not sure it's necessarily an IC++ pricing structure as opposed to they happen to have broken out for the purpose of this letter what the three components are. So -- yeah, sorry.

Q. This could still reflect, therefore, a blended contract?

A. It could. I haven't seen the full --

Q. No.

A. -- detail of this particular merchant's contract, so --

Q. That is a fair point. The point I am about to make to you is that in fact we can infer, can we not, from Mastercard's summary that the Mastercard transactions are indeed conducted on a blended basis because the individual fees are not broken out, only the total headline figure is given for those particular transactions?

A. Yes, again, I'm not -- yes, that -- I think all I can see here is that, for Mastercard, a particular value for the total MSC is given in this particular information cited to this one merchant.

Q. Now, depending on the size of the merchant, on your case, if this were a smaller merchant -- and this is only a thought experiment, it is not -- I am not asking you to dig into the underlying contractual arrangements, but as a thought experiment, on your case, 25% of that MIF -- sorry, 25% of the MIF component of the total MSC charged to Visa -- sorry, charged to Mastercard -- for Mastercard transactions is not actually passed on by the acquirer, even though 100% of the MIF fee is indeed passed on for Visa transactions. So within one contract, you end up with a bifurcated approach to pass-on depending on the acquirer -- sorry, the network in question.

A. I think the -- the idea that whatever the rate of pass-on I've -- I've identified can then be literally translated to an individual merchant situation is -- is entirely wrong. My approach is to look at what the evidence is overall at the market level, but using evidence at merchant levels, and then identifying across the full set of merchants in the dataset what the average rate of pass-on might be.

Now, let's just take the proposition that -- of the 25%. So that's a -- for example, a 75% rate of pass-on for the smaller merchants. That, of course, could be some combination of 100% for some merchants and

50% for some other merchants, or any other distribution across merchants that would -- would average out to 75%. It simply does not mean that, on any individual set of negotiations, you must have a delineation of 75:25.

Q. That is not going to be much comfort, is it, to this particular merchant who is going to see its claim reduced for Mastercard transactions by 25% throughout the period on the basis of your analysis?

A. Well, I'm not -- I'm not trying to -- sorry, I think what I'm trying to do is assess what is the best available evidence in relation to the degree of pass-on and then form views as to, under what circumstance is it appropriate to identify differences in the potential rate of pass-on across circumstances. The main one I've identified is by merchant size. Obviously, then, you know, you can have a view as to which -- which claimants fit within what size and so on, but my approach is not to sort of think, well, a small merchant would rather have 100% of a reduction and no per cent of an increase and therefore that must be the answer to the question. I'm looking at overall, in the round, what is the actual evidence telling you.

Q. Could we look, please, at {RC-I4/58/1}. This is a further communication from the same acquirer to the same merchant. You will see that they have

explained changes to the pricing structure, that includes an ad valorem component and a per unit component, does it not, under "Changes explained"?
A. Yes.
Q. Under the existing pricing. Then from September 2016, that is going to change to a purely ad valorem rate for those transactions; correct?
A. Yes.
Q. If we then please look at {RC-I4/58/3}, you will see that then there is the characteristic breakdown of the different components and what that means for the interchange fee; can you see that?
A. Yes.
Q. If we then please look at --
A. Can I make one brief comment on that?
Q. Of course.
A. The fact that the interchange fee is set out as the 0.2% in the overall structure of what the total MSC is of 0.27% does not mean that you should treat this as if it's an IC++ contract or that the degree of pass-on is necessarily 100%. The reason for that is the analysis should be: what's the impact of the overall MSC as a result of the change in the interchange fee? Now, that could -- that could be a complete level of pass-on, or it could be a different level of pass-on depending on

what the -- in this case, the [acquirer] fee variance is. So in other words, if you pass on all of it, you'd sort of retain the same [acquirer] fee. If you had whatever economic factors to take into account that would lead to a less than complete pass-on, then there might be some variation in the [acquirer] fee, even if you break out the three components in this way.
Q. I think you have mentioned the name of the acquirer.
A. Oh, I'm sorry.
Q. Try and avoid that if we can, please. Spare my blushes.
A. Yeah.
THE CHAIRMAN: Can I just ask, is the interchange fees chargeable at any one time, is that public information, because there is reference at the bottom here to a web page?
A. Yeah. My understanding is that interchange fees are in published rates from the schemes. Obviously, this link goes to the acquirer in question. That might sort of import the information from the schemes. Obviously, there are a large number of individual rates, and one of the issues is often, in contracts, you see blending, again, not speaking for the IC++ ones, which -- which means that there might not be a direct correlation between what the fees are across the individual transactions and what the MSC is for that.

MR BEAL: Could we then please look at {RC-I4/60/1}. Again, same acquirer B, same merchant.
A. Yeah.
Q. Here, what is changing is the business prepaid rate and the business immediate debit rate, and you will see though both of those rates include both an ad valorem component, a per unit component and a cap; do you see that?
A. Yeah, I can see -- yes, I see that, yeah.
Q. Under the heading saying, "What does this mean for you?", it says:
"Based on the nature of your business and your individual card transaction profile, we have calculated your new pricing to take account of the latest interchange and scheme fee changes as well as the operating costs of our service to you.
"Your new Fees are contained [in the] schedule overleaf ..."
We then have the standard schedule given --
A. Yeah.
Q. -- I think it is the next page. It may not be included in this one, but anyway, it is the standard schedule that we have seen.
We then see, please, {RC-I4/60/2}, "Changes to the inter-regional interchange fees ..." being notified

with an inception date for those changes; can you see that?
A. Yes.
Q. Then it refers to "Potential scheme fee changes in 2020". So what I am putting to you is this is an example of an acquirer deliberately notifying its client of anticipated changes to both interchange fees and scheme fees, that is the first point?
A. I think I agree with that. That's what the letter is doing.
Q. Whether or not it is strictly an IC+ contract or a blended contract is difficult to discern from this individual material; correct?
A. Correct.
Q. But that the acquirer is seeking to derive the impact of the latest interchange fee changes on the basis of the individual business and its individual card transaction profile?
A. I think -- I think there's a paragraph suggesting that the acquirer has analysed the impact, so I think that is fair to some extent, yes.
Q. If we then please look at {RC-I4/60/3}, where we end up with is an identified change to the Merchant Service Charge which is cumulatively put at a Visa debit rate of a figure of something?

A. Yeah.
Q. So what that shows, is it not, is that the acquirer is expressly taking into account the changes in interchange fees, amongst other things, in order to derive a revised pricing schedule for the client?
A. Yes, I guess my -- my point is not that acquirers would not take into account changes in interchange fees, it's rather that in the -- in setting prices, they would take into account that information, but also factors such as the existing margin that they make on that merchant and their assessment as to, you know, what the merchants' bargaining position may be, and they would weigh up these factors in terms of, well, what -- what -- what degree of change in the rates would be most optimal. Now, that might be 100% in some circumstances, but it might be less than 100% in other circumstances, particularly depending on factors that I outlined in the hot tub the other day, such as if you have a higher degree of bargaining position and a higher starting point therefore for MIF margins, then you'd be inclined to not necessarily go for complete pass-on, because you'd be concerned about losing some of the profitability of your -- of your contract.
Q. Could I then please invite you to look at {RC-I4/33/3}. This is a contract between an acquirer and a merchant.

If we then please turn to {RC-I4/33/31}, this is dating from 2017, we then see that the relevant percentage transaction value fee, transaction fee is set out and this appears to be a blended contract; can you see that? But it is tiered?

A. Yeah, sorry, by "blended", do you mean you have some commonality in the MSCs across some different transaction rates? I agree, yeah.

Q. By "blended" I mean it is not broken out into a separate charge for either interchange fees or scheme fees --

A. Yeah.

Q. -- therefore you are treating it as a standard contract?

A. Yeah, I think there's a potential terminology issue. There's the extent to which the MSC is broken out into the three components and there's a separate question, often termed also "blending", where a same MSC is applied to different transactions, sometimes even if the MIF is different. I agree that in these cases, the first definition of blending, i.e. it's just an MSC without the three individual components being presented.

Q. Have you ever treated this sort of contract as an IC+ contract?

A. No, I haven't -- I haven't -- I don't know whether --

Q. Could we please look at --

A. -- this contract is IC+, it doesn't seem to be.

Q. -- {RC-I4/56/1}. This is an invoice, a different acquirer, a different merchant. Can you see that what is shown there on the invoice is a series of transactions taking place?
A. It's very small. Sorry, can it be increased in size a little bit?
Q. I am sure we can magnify it.
A. Thank you.
Q. We see different types of card transactions with transaction charges valued by reference to those different transactions and there is a straightforward percentage given --
A. Yes.
Q. -- which leads to some quite small figures for some of the transactions.
A. Yeah.
Q. You would accept, I think, that that is a standard -- we have referred to it as "blended", but as long as the terminology is common I do not mind what we say --
A. Yeah.
Q. -- so it is a standard contract?
A. Yeah.
Q. But it is broken down and therefore tiered for different types of cards; can you see that?
A. Yes, I agree.

Q. Now, can I just summarise where we are at a very high level during Trial 2A so that I understand what your position was there. My understanding was that your position in Trial 2A was that the treatment of a cost by a firm was not relevant to the analysis?
A. In Trial 2A, given the signal to noise issue, we had to look at proxies, and in my view, one needed to look at the long-term rate of pass-on and I identified that there's a range of mechanisms that could apply, recognising that the MSC was a small component of the overall merchant charge.
Q. I do not think you thought that the relative size of the cost was particularly relevant for Trial 2A, did you?
A. No, I -- I identified actually that the theory is consistent with that statement, i.e. that the size of the cost, depending on -- assuming that it's a variable industry-wide cost, which I consider it is, then the rate of pass-on would depend on a number of factors but not the size of it.
Q. I have a distinct recollection that a number of the questions I put to you were answered by you with a response that that would not necessarily hold true over the long run; do you recall that?
A. Yes, I did emphasise that the pass-on rate in the long

run was, my understanding, what we needed to identify and that there could be reasons why a short-run approach might fail to capture the full amount of the long-run assessment. One of the reasons for that is that there are a range of mechanisms by which pass-on can occur and those might take different amounts of time.

Q. The overall thrust of your opinion, consciously or otherwise, was that the long-run view would lead to a higher rate of merchant pass-on than otherwise; correct?

A. Well, I think -- I think all the experts would agree that a long-run rate will generally be higher than a short-run rate, except if the short-run is sufficiently long to already capture the long run effect. It can't really go --

Q. Now we are dealing with acquirer pass-on --

A. It's unlikely to go down.

Q. -- and your opinion seems, consciously or otherwise, to have changed, does it not, because you are saying that the long run is not as important as you thought it was for Trial 2A?

A. I don't think that's quite correct. I think, as a matter of principle, I -- I agree, as I did in Trial 2A, that the long-run rate of pass-on is what we're looking at, so that puts equality as to the focus on the long-run in Trial 2A and Trial 2B. I think the evidence in relation to Trial 2B as to how long a dataset you need in order to capture the long-run effects indicates that you may not need a very long dataset in order to get to the long-run rate. So I think that might be -- sorry, even that's not that different to my view in Trial 2A, because for the proxy, which I identified as Cost of Goods Sold, I also indicated that it seems likely that the long-run rate of pass-on would be identified fairly quickly, in other words changes in COGS would likely translate to changes in merchant prices within one or two years, so fairly quickly. So, again, my view in that respect is -- is similar.

Q. Let us look at the acquiring market, if we may, the focus of Trial 2B. You would accept, would you not, that the MIF is a substantial variable cost for all acquirers operating in this market?

A. Yes.

Q. You would accept that all acquirers therefore inevitably know that other acquirers will be paying the MIF and so it is a common cost?

A. Yes, that's essentially the industry-wide aspect that I consider is applicable here, yes.

Q. As a point of principle, it seems highly unlikely, does it not, that competitors will price below that cost?

A. Well, they might -- yes, I think that's fair, that in the long run, you wouldn't be able to sustain a business if you're continuously pricing below cost --

Q. Well, it is more important than that, is it not, the profit-maximising price that has to be set will be set by reference to the main cost components of the acquiring service, just on a marginal cost basis -- a marginal cost pricing basis?

A. Yes, I think that you've outlined the pure economic theory which is that price will only be set by reference to -- to marginal costs. Obviously, as the experts discussed in both Trial 2A and I think to some extent in Trial 2B hot tubs, we're not talking about perfect competition as being the relevant benchmark here. So I'm not suggesting that only changes in marginal costs or rather that the price level must be linked only to marginal costs, you would expect that overall prices would need to recoup in the long run some of the fixed costs as well.

Q. You have accepted that acquirers explicitly take the MIF into account when setting their prices on an IC+ basis?

A. Yes.

Q. I have taken you to evidence that shows that acquirers expressly factor in the MIF when setting their prices for standard contracts?

A. Yes, my -- my -- I agree with that, but that's consistent with my findings that there is material pass-on, which I do find, but it does not imply complete pass-on, which I find may well apply to larger merchants but may well not apply to smaller merchants, and I think I already explained the reason why, the fact that you take something into account doesn't necessarily imply 100% pass-on because you also need to take into account other factors, such as the margin that you'd be exposed to losing if you did pass on the full increase in a MIF, or if -- or if you failed to pass on the full increase in a sort of a decrease --

Q. In Trial 2A, for a cost that could be as low as 0.2% of revenue rather than 60 to 80% of revenue, as the MIF is for an acquirer, you thought it would be substantially passed on by a merchant even when it was bundled into a cost stack of overhead costs; correct?

A. Yes, I think it's correct to take into account the sum of the relevant variable costs when thinking about the degree of pass-on and consistent as between my view in Trial 2A and 2B, the factors that are important are, one, is it variable, two, is it an industry-wide cost? Those clearly apply. Then, three, a number of other factors, some of which are not easily measured but can be qualitatively discussed, such as the degree of competition, and that's really the key issue that affects the degree of pass-on even if -- even if you agree, as I do, that there's likely material pass-on for a variable industry-wide cost change.

Q. So are you suggesting that alone of all the markets you have considered, the acquiring service market is the one that is somehow quasi monopolistic in nature?

A. No, I'm not -- I'm not suggesting that at all. In fact, I think for Trial 2A I identified a range of empirical outcomes, some incomplete, some more complete, in terms of pass-on. That was driven by the evidence base that I had for the different sectors that we were looking at. In this case, it could well have been that I would have found complete pass-on for both large and small. Again, that depended on the empirical evidence. The theory takes you so far, i.e. material likelihood of pass-on, but it doesn't take you so far as to what is the degree. That's -- that's where I identify the empirical evidence.

Q. So dealing from Trial 2A with a very small cost for a merchant, something approaching 0.2/0.3% of the overall revenue, you suggested an appropriate pass-on level in the round of 88%?

A. Yes.

Q. Turning to a very substantial variable marginal cost of an acquirer, somewhere of the order of 60 to 70% on average perhaps over the period, you are only suggesting a pass-on rate for smaller merchants -- for smaller acquirers -- sorry, acquirers to smaller merchants of 75%, and what I am going to suggest to you is that inconsistency is simply not plausible, is it?

A. I don't think there's any inconsistency there at all. I'm not relying on the share of cost as the driver of the empirical analysis, instead I am relying on the empirical analysis. It's the other direction, I am relying on the empirical analysis to determine the appropriate rate of pass-on. That may vary due to things, amongst other including the nature of competitive -- how competition is working, and I think there are some reasons to suppose that in the case of smaller merchants, competition wasn't particularly working all that well and that can be consistent with somewhat lower than full pass-on.

Q. Your results violate Marshall's third law of economics, of which I have had a crash course in the last 24 hours, do they not?

PROFESSOR WATERSON: I wondered when that was going to come up.

MR BEAL: Thank you very much. Thank you for the useful tip.
A. Again, I don't think that my approach is inconsistent with that, in the sense that --
Q. I am not asking about your approach, I'm asking about your results?
A. My results I don't think are inconsistent with the idea that a large cost could be passed on to a significant extent. It doesn't necessarily, in my view, particularly where the interchange fee is a smaller percentage of the price, which it is for smaller merchants, imply 100% pass-on.
Q. You are aware, are you not, that the acquirers have been simply prepared to say to merchants that the MIF component is non-negotiable?
A. That may be what they're telling merchants.
Q. Well, it is what the evidence was in Trial 1.
A. Yes -- well, I think it's probably fair to say that, because -- well, we had a lot of debate about could you have a bilateral bargaining counterfactual for MIFs, and -- and in the first instance trial I found that that was unlikely.
Q. Now, merchants on standard contracts, you would accept, are typically -- will typically have lower bargaining power than larger merchants on IC+ contracts?

A. I think that is likely.
Q. So the smaller merchants are going to be less able to resist the imposition of price increases, are they not?
A. I think the -- I don't agree with that, and the reason -- I can see the intuitive proposition that if a small merchant and a large merchant rocks up to the acquirer's door and you've said, "There's a MIF increase, you know, am I -- am I going to put the MIF increase onto the small one, over which I have market power, or the large one, over which I don't", and intuitively I can see you might say, well, it's easier to push through price increases on the small one, whereas the big one's going to fight back and say, "No, I've got -- I've got bargaining power". The flaw in that reasoning is that it fails to take into account the starting point prior to the MIF change, and the starting point prior to the MIF change of course already captures the difference in the bargaining power of the merchant, or conversely the market power that the acquirer has over the merchant.
So if you do take that into account, which is consistent with figure 2, as I mentioned, with much higher MSCs for smaller merchants, and although the figure didn't precisely set out what the profitability of those higher MSCs for smaller

merchants was, supposing that they have at least higher gross margins, i.e. MSCs above MIFs are higher for small merchants than they are for large, then that is a critical factor, because it means that if you do try and pass on the increase to the small merchant and you do lose some of those merchants as a result, because maybe they can get a better deal elsewhere, then you lose a lot of profitability, whereas for the large merchants, because of their bargaining power, you've already got much thinner margins.

So the point is not that their bargaining power prevents the increase, it's that their bargaining power has already led to a situation where they have low margins that they're paying on those acquiring contracts, and that leaves the acquirer, in a sense, much less incentive to avoid 100% pass-on, because it's losing much less profitability if the merchant moves to a different acquirer.

Q. I am going to come back to your margins response a bit later on. The practical point which I am trying to deal with at this introductory section is simply this. The practical implication of your results is that a typical acquirer is willing to swallow or absorb 25% of the costs of an increase in the MIF for the benefit of smaller merchants, notwithstanding that those smaller merchants are, on any view, much less commercially important to that acquirer than larger merchants. So what I am suggesting to you is that outcome is counterintuitive from a commercial perspective and indeed from the perspective of common sense.

A. I think my previous answer explained why counsel's proposition is incorrect. The smaller merchants are paying higher MSCs, therefore with higher margins, at least gross margins MSCs compared to MIFs, therefore if you do try and pass it all on and you lose the customer, that's a lot of profit gone out the window. Conversely, for larger merchants, the margins are thin, so the trade off to try and avoid complete pass-on in order to protect the profits works a completely different way. You don't have as much profit to protect, therefore the incentive is indeed to pass on more of the price.

Q. Can I move on to the role of economic theory. You were, it is fair to say, more vocal about this as a concept, were you not, in Trial 2A than you are now, as steering results?

A. Sorry, what was that bit? Steering results?

Q. As in --

A. Oh.

Q. -- you placed greater emphasis on the role of economic

theory in Trial 2A than you do now?
A. I think I agree the same economic theory principles in both Trial 2A and Trial 2B. So I think in that context I take the same starting point. I think one important difference is that for the signal to noise issue that we faced in Trial 2A, one needed to think about the proxy and I relied on economic theory as one of my inputs to thinking about the proxy. In Trial 2B, that simply isn't necessary, so we can sort of skip that debate and go straight to the qualitative evidence.
Q. As I understand it, you are now recognising more expressly than you did previously, and it may be simply a matter of degree, that the outcome as an empirical result, and one needs to look at it in the round on the evidence; correct?
A. Well, I'm not sure that's correct, because I think I was stating quite explicitly in Trial 2A also that the matter of degree is an empirical question, that the theory takes you so far, it gives you some a priori expectations about what might be likely, but you still need the empirical evidence base in order to think about what's the degree. I think that point applied equally in 2A and 2B.
Q. Now, in terms of, if we look, please, in your 13th report at paragraph 21, which is {RC-F1.4/6/22}, which

is the amended one. Paragraph 21, it should be.

A. Yeah.

Q. You have gone to tab 5, I am sorry, it is tab 6 that we are dealing with. All of my references will be to tab 6 because I am referring to your amended --

A. Okay.

Q. -- your track change version. It is {RC-F1.4/6/22}.

A. Yeah.

Q. Thank you.

If we look at 21, you cite essentially two reasons, do you not, for saying economic theory holds less sway on this occasion than you would have given it last time. The first reason you give is that you claim that merchants have bargaining power against acquirers compared with merchants' customers against merchants. Where is your evidence in support of that?

A. Is your question do businesses --

Q. My question, you are saying there:

"Since the customers purchasing card acquiring services are businesses rather than individuals ... those businesses' relative buyer power could affect the degree of pass-on."

So you are implying, are you not, that one of the reasons that the predicted outcome from economic theory alone cannot hold here is because you say, well, merchants have higher bargaining power vis-à-vis acquirers than individual consumers have vis-à-vis merchants?

A. Yes, I think I -- I am -- sorry, I am just trying to understand the precise question. I am saying -- just to be clear, I am saying that merchant bargaining power or the degree of market power with respect to merchants could be a factor relevant to acquiring pass-on.

Q. Can I just break that down then.

A. Yes.

Q. If you are simply saying it is a possible factor, you are not actually relying upon any empirical analysis of whether or not it is a factor; is that fair? You are simply speculating that it might be?

A. I think I am considering that it is likely to be on the basis of a number of aspects. One is the economic theory as to how market power affects the likelihood of pass-on, and that is consistent with, I think, what I was describing earlier. There's other evidence as well, such as the differential MSCs that different merchants pay. That's a further indication that relative buyer power may vary across merchants.

Q. Did you take into account the actual evidence from merchants saying that the MIF was non-negotiable?

A. I don't think that's relevant, because what I'm thinking

about is not whether the MIF is negotiable, it's not that --
Q. Well, you may have --
A. -- they could try and negotiate a different MIF, it's the counterfactual difference in MSCs with respect to the change in MIFs that I'm looking at. So I'm not talking about --
Q. You are relying on -- on bargaining power --
A. -- negotiability of the MIF.
Q. -- bargaining power implies that you can change the price you are receiving. If the evidence from merchants is, "I cannot change that component of the price and there is nothing I can do about it", surely that means bargaining power is not worth anything?
A. No, I disagree, because the issue is not -- not, as I think counsel is suggesting, whether the merchant is coming along and saying, "I see you've set out the MIF and the other components of the charges, I don't like that level of MIF, can we negotiate about that", and that's pertinent to the degree of pass-on. I'm agreeing that that type of negotiation isn't happening, but I disagree that that's relevant, because what's relevant is the overall impact on MSCs when there's a change in MIFs, and that can either be complete or incomplete

depending on a range of empirical factors and indeed theoretical factors, and those are the factors that I take into account.

Q. Could we look, please, at the PSR 2024 report, that is {RC-J9/3/4}, paragraph 1.11. You will see, in the first white bullet down there, it says:

"Merchants and acquirers are unable to respond to increased [Interchange Fees] in such a way as to exert competitive constraints on Mastercard and Visa."

Could we then go please to {RC-J9/3/26}, paragraph 3.39, four lines down it says:

"As explained above, the setting of a minimum MIF within the four-party schemes ... amounts to a restriction of competition ... which has the effect of immunising one part of the MSC from competition; the merchant being unable to negotiate with the acquirer the level of that part of the MSC. Accordingly, this prevents an element of the MSC being negotiated down, with the consequent effect of artificially increasing the MSC."

So you did not take into account this report in your 13th report, did you?

A. I may have made some reference to the PSR 2024 report in some regards, but not on this point. This point, I think, is not relevant to the degree of pass-on of changes in the MIF, because, as I just explained, the degree of pass-on being either full or less than full does not depend on whether the acquirer is able to negotiate with the schemes as to the level of the MIF, which I understand it's reasonable to say perhaps it cannot do, or, as a result, whether the merchant can negotiate with the acquirer as to the level of MIF. Again, I'm not suggesting that is the case, it's simply irrelevant because, at least for standard contracts, the acquirer's taking an in-the-round assessment as to what MSCs to offer, what degree of blending and tiering to offer, what levels, and amongst the factors they'll take into account are the competitive conditions and the margins that they make, and so that can be consistent with less than complete pass-on. I then move to the empirical evidence and that's what I find.

Q. Now, coming back to your margins point when faced with a price increase. So imagine a MIF increase comes through, the relevant MIF increases from 0.5% to 1%. Your opinion, as I understand it, is that in those circumstances that acquirer will pass on 100% of that increase to a larger merchant, but only 75% of that increase to a smaller merchant. Is that a fair summary of your position?

A. Yes, I think the only point to add is that these are in-the-round assessments at an average level so it is not intended to suggest that it applies literally necessarily in each and every negotiation, but that in the round, the evidence suggests that 75 is a reasonable amount of pass-on to -- to view for smaller merchants and complete is potentially reasonable for large.

Q. If that acquirer was operating on a marginal cost pricing basis, then surely the marginal costs would have increased and therefore the marginal cost increase will have to be factored into the reflected pricing?

A. I think I agree with all of those statements, but they're not inconsistent with my assessment, because even if it is the case that -- even assuming that the acquirer is pricing on a marginal cost basis and therefore that they're taking into account the change in the marginal cost, again, that does not imply complete pass-on, it simply implies taking into account the change in the marginal cost in the pricing. Where you end up in terms of the degree of pass-on depends on some other factors, including, as I mentioned --

Q. Well, you are implying, are you not, that there is headroom within the acquirer's margin to be able to absorb that particular price increase, but only in respect of smaller merchants?

A. I think that's pretty fair as a -- as a broad brush assessment, that the margins as indicated by the gap between the MSC and the MIFs, in my view, are higher for smaller merchants, and to the extent that is the case, then that would be a factor that would be taken into account in the degree of pass-on. So I think that is a fair broad-brush statement as to the -- you know, one of the economic drivers as to my differential pass-on rate, yes.

Q. But you are only going to find a business that is able to -- a business is only going to be scared about increasing its prices, even with a higher margin, if it is essentially in a monopolistic position, is it not? So it is only if it rubs up against a non-monopolistically optimal pricing cost that you would find that the firm would fight shy of passing on any particular cost increase to a customer, i.e. your margins point only works if effectively the firm is already pricing at the maximum level it can extract from the market, which implies essentially a monopolistic position?

A. I disagree that it requires a monopolistic position. I do agree to sort of a less strong version of that statement, which is that the likelihood of pass-on would be -- and the degree of pass-on would be greater if you had an industry-wide variable cost that -- in a situation of perfect or near perfect competition, because in that case, the margins would be low and the implications of trying to avoid pass-on would be detrimental from the profitability of -- of that company. In contrast, since we're not in a situation of perfect competition, and indeed acquiring margins can be potentially substantial and vary across merchants, that is a factor that they would expect to take into account, and therefore if they are trying to, you know, operate in a profitable way, an optimising way, that would be a reason to -- to not necessarily pass on the full amount of the cost increase, again, for the reason of protecting the existing profits that they have from the market power that they have over at least one element of the merchant base.

Q. So, firstly, a very straightforward proposition: you cannot have five or six monopolists in the market, can you?

A. Five or six monopolists? Well, if it's a single market, then five or six would not be -- six monopolists --

Q. So when we have got five or six big players in the acquiring market in this country, you would not naturally describe any of them as a monopolist, would you?

A. I'm not -- I'm not suggesting that any of the acquirers

are monopolists --
Q. As a matter of economic theory, even with a monopolist, the predicted pass-on would be 50%, all else equal; correct?
A. In the -- in the sort of particular circumstances of a monopoly facing a linear demand curve and facing a marginal cost increase, yes, 50%.
Q. You are essentially, are you not, suggesting that these five or six big players are at the upper reaches of the margin they can obtain from the market which would explain why they are not in a position but to swallow the 25% additional acquirer pass-on that you anticipate for them?
A. I'm not saying that they're monopolists, I'm not saying that they are pricing at a monopoly level, I think all I'm saying is that they would be expected to price with respect to the market conditions that they face and the market conditions that they face might vary according to merchant size.
Q. In terms of spare margin in the market, your evidence is that there has been significant entry recently from payment facilitators; is that right?
A. Well, I -- so my evidence is -- and I think it's consistent with the PSR evidence -- that payment facilitators have taken on an increasing share of

the market.

Q. They do not work for free, do they, so they are taking their own margin on top of everything else?

A. Yes, but of course it's also important to recognise that one of the means of entry is to identify merchants that hadn't been accepting cards, and I think payment facilitators are often targeting that expansion of the card acceptance market as opposed to the same merchants necessarily that acquirers are targeting.

MR BEAL: Sir, that is probably a convenient moment.

THE CHAIRMAN: All right, we will have a ten-minute break.

(11.45 am)

(A short break)

(11.58 am)

MR BEAL: You will recall that we were looking at the two reasons you gave as to why economic theory would not necessarily hold for the acquiring market.

The second difference, as I understand it, was that you said the direction of the cost change may cause the pass-on rate to vary; that is right, is it not?

A. Yes, that -- that was one further factor that I cited.

Q. That, as I understand it, is essentially the "rockets and feathers" argument as it has been described; is that right?

A. I think the "rockets and feathers" argument is a different argument, which is that for even the same amount of long-run pass-on, it might happen more quickly for an increase and more slowly for a decrease.

Q. Is that not what a direction of a cost change is in this context?

A. Yes, but I think what I was talking about is not necessarily the speed, but even the possibility at least that the end point, the long-run level could vary according to the direction, so it's a different issue.

Q. We have got quite a long long-run period here, have we not, which is the claim period?

A. Yes.

Q. We know, for example, that consumer debit MIFs have been consistently at or around the level of 0.2% for that claim period?

A. Yes.

Q. Your argument is that on a range up to 50% but on a guided estimate at least 25% of that cost would have been absorbed by acquirers to the benefit of smaller merchants over that period?

A. Well, in relation to a reduction, obviously partial pass-on would be to the benefit in relation to -- sorry, in relation to a reduction, it would be potentially to the disbenefit, I should correct myself, whereas in relation to an increase of MIFs, a partial pass-on would

be to the benefit.
Q. I am asking you to confront the practical consequences of what you are inviting this Tribunal to do, which is you are inviting this Tribunal to knock off somewhere between 25% and 50% of the claim value attributable to consumer debit MIFs over the entire claim period.
A. Well, firstly, I'm not doing that, because there are two further factors that need to be taken into account. One, the share of IC++ that applies, and that obviously I'm taking into account at 100%. Then, secondly, the split as between small and large, and to the extent that there are some large merchants with complete pass-on, I think the overall impact on claim value would be less, and materially less, than the 25% reduction that is being cited.
Q. You would have expected, would you not, that sort of cost of a business to be reflected in the statutory accounts for the acquirers at some point?
A. The cost of interchange fees, you mean?
Q. If they have absorbed somewhere between 25% and 50% of the --
A. Yeah.
Q. -- very substantial cost of the MIF paid on debit consumer MIFs over that period, you would expect to see it reflected in the statutory account?

A. Sorry, I should just clarify, I am not saying that as to the level of MIF, they are absorbing 25% of it as a loss. I'm merely saying that for any change in the MIF, the rate of pass-on may be less than complete. That's not the same thing.
Q. But we are working on a counterfactual analysis in which the MIF is zero.
A. Okay, so -- yes, okay, so to the extent that there would have been a reduction in the MIF, then partial pass-on, I agree, would obviously lead to some reduction in the profitability of acquirers, at least in respect of the part of the market that the pass-on is incomplete.
Q. Well, I do not understand it to be Visa's case that as part of the assessment of what the recoverable loss is, you would need to identify a specific reduction in the MIF and then only knock off a particular percentage of the reduction of the MIF. I understood Visa's case to be that applying your results into the claim value, you reduce the overall claim value for smaller merchants by somewhere between 25 and 50%. I think you have alighted on 25%.
A. I think that's fair, because the claim value, to the extent that it is driven by the change in the MIF compared to the counterfactual, would then, if you assumed for smaller merchants 75% pass-on, would mean

that the claim value would be somewhat lower for smaller merchants compared to the full pass-on. That -- that I accept.
Q. But, de facto, that leads to a position where, over the claim period, acquirers have suffered 25%, on your best estimate, cost attributable to the total costs of the debit MIFs over that period?
A. The reason I'm sort of hesitating to agree with that is that although I would indicate that there would be less than complete pass-on, the starting point would be likely a material level of profitability in relation to the market power that the acquirers have in the small segment, and so it is possible that the profitability would be maintained at a relatively high level, but just somewhat less as a result of partial pass-on.
Q. Did you look at any of the statutory accounts from the acquirers before you prepared Holt 13 or Holt 14?
A. No, I don't think I did. The evidence that I think is most relevant to the assessment of pass-on is really looking at the -- you know, the much more detailed datasets that we have for Trial 2B and I think that's really where I was focusing my attention.
Q. Could we look, please, at {RC-I4/47/4}. This is an extract from a set of accounts. Because the accounts are statutory accounts and available online, I am going

to refer to the acquirer. This is Worldpay, and you will see that it provides a "Financial highlights", "Net revenue", "Gross profit", "Operating profit", etc. Then, under note 1, it says:

"Net revenue is defined as revenue less interchange and scheme fees."

Can you see that? Note 1?

A. Yes, I see note 1, net revenue, yes, I see that, yeah.

Q. It is from net revenue, not gross revenue, that costs are deducted.

Could we then, please, look at {RC-I4/47/51}. We see here a breakdown of the "Income statement". So you have gross revenue at the top. From the gross revenue figure is deducted "Interchange and scheme fees" and that produces a figure for net revenue that you can see there. So in other words, Worldpay are treating interchange fees as being a reduction in revenue rather than a cost; correct?

A. Yeah, they're saying -- seeing it sort of akin, I guess, to a Cost Of Goods Sold, I think.

Q. Then at {RC-I4/47/68}, please, we see an explanation that has been given in the third row down by the relevant committee, the audit committee that was looking at this issue, and we see, on the right-hand side, that the reason for the change was:

"The Committee considered management's proposals ..."

To show -- to strip out net revenue as a separate item was better because it enabled:

"... a simpler discussion of the relationship between revenue and profitability following recent changes in regulation around interchange and scheme fees."

So they have taken a conscious decision to present the accounts in this way; correct?

A. Yes.

Q. If we then, please, go to {RC-I4/47/100}, if we look at the impact that would have on the results. If one is viewing interchange as a pure cost imposed on the business rather than a deduction of revenue because it has been passed on elsewhere, i.e. to the issuing banks, then, on your analysis, 25% of that 2.9 billion figure that we see there would have been treated as a cost that was absorbed by the business; correct?

A. Not -- not -- I don't think that is correct, because this is the total --

Q. Yes, I am sorry, let's knock off scheme fees --

A. Yeah.

Q. -- so assume scheme fees represent 10% of that figure.

A. I see.

Q. Let us call it 2.5 billion rather than 2.9 billion. 25% of 2.5 billion would have been knocked off as a cost for the business because it was absorbed?
A. Well, again, that -- that sort of fails to account for the distinction between different contract types, IC++, standard, and the distinction between small and large. So the 25%, as I mentioned, doesn't apply to two of those three contractual situations.
Q. So if you were to give your economy-wide figure to this, you would still be knocking off 5% of 2.5 billion as a cost absorbed by the business over that period?
A. Yeah, I think it might be 6 or something. I think I might have ended up with 94 as an economy-wide pass-on rate.
Q. Could we look, please, in your 14th report at paragraph 121. That is {RC-G1.3/2/45}. At paragraph 121, you say that:
"... the acquiring market is ... not perfectly competitive."
You examine various points.
As I understand it, you do not accept that the acquirers are price takers; is that right?
A. Yes, in the sense that I don't accept that the output price that they set is -- is something over which they have no control or variation with respect to their

customers.
Q. Of course, they do not have any control over the MIF portion of the MSC, do they?
A. No, but that's an input. So my point is about the output price, not the input price.
Q. We have seen that because the way that output pricing is dealt with, the only control they have is essentially over the acquiring margin element of the MSC; correct?
A. Yes, to the extent that -- yes, I think I agree with that. To the extent that they cannot negotiate on the MIFs or scheme fees, if that's the case, then I agree with you that the main variation, in terms of the price that they set, would be the extent to which they set a margin above those two elements.
Q. You have suggested an acquiring service is differentiated. What evidence are you relying upon for that?
A. Well, I described the PSR's conclusions in the credit card acquiring market study set out in 2021, which describes quite a lot of evidence in relation to how the market works, the structure of the market, the nature of the services offered by different acquirers, the nature of engagement by different types of merchants with acquiring, amongst other things.
Q. Could we look, please, at {RC-J4.4/21.8/31}. This is

part of a slide pack dealing with merchant switching. I think you have seen this. It is the 2021 slide pack dealing with how merchants behave and switching behaviour.
A. Yes.
Q. We see that the reason for making merchants switch was predominantly due to price increases and price issues; can you see that?
A. Yes.
Q. "Poor customer service" reflected 11%, or --
A. Yeah.
Q. -- and "Service outages", 10%, and "Ability to have ... settlement times", 9%. So what I am suggesting to you is that it is price factors that are predominantly prompting merchants to think about switching between acquirers.
A. I think -- I think that is a fair picture of this slide, which is answering the question as to what are the factors that would make them consider switching. Obviously, there's other issues, such as the extent to which they consider switching, which is one, and the extent to which they engage in procurement exercises and how often they change contracts, and issues of that nature.
Q. Non-price factors are going to feature much more

heavily, are they not, with larger merchants on IC++ pricing, because for 80/90% of the MSC that is being charged, there is nothing they can do about it?
A. Are you discussing from the perspective of an acquirer, or from a merchant?
Q. Well, both, because -- assume that amongst large merchants on IC++ pricing that they are all competing in the same market.
A. Yeah.
Q. They are all going to face the same interchange fees and the same scheme fees, are they not?
A. Yes.
Q. So they can compete on acquirer margin, that is one thing they can compete on?
A. Yes, I agree.
Q. But I would invite you to infer and confirm that non-price factors are therefore more important for that sector of the market -- segment of the market than they are for smaller merchants, who are predominantly competing on headline rates of standard contracts?
A. I'm not sure I would go that far. I mean, I think, for larger merchants, the amount of cost at stake is obviously larger and that might cause them to focus a lot on the -- you know, the value for money. I think there could be factors going either way in terms of

the nature of the non-price factors that might be important. For large merchants, it might be lots of issues around, you know, dealing with, you know, global functionality, for instance, for an international firm, whereas for a small merchant, there might be, you know, a lot of expectation for the acquirer to provide a lot of the customer service and -- and to sort of ensure that there's a bit of a one-stop shop. So I don't think I would agree that there's a much greater focus on non-price issues by large merchants.

PROFESSOR WATERSON: Before we move off this slide, I am curious about the one that says "Nothing". So does that mean that these customers are saying, surprisingly, "Nothing would make me switch away from you"?

MR BEAL: There is a slide I am coming to where precisely that is said. These merchants are very happy with the existing service, they do not want to move.

PROFESSOR WATERSON: You know, I am surprised that someone would say, "I am never going to move".

MR BEAL: It shows a degree of confidence in their procurement team, which perhaps may be unwarranted, but that is what they are saying on this slide.

A. I think it could also potentially mean that, you know, they've got other things that they want to focus on and procurement of their card acquiring services might not be top of their list.

Q. Taking it back, if I may, to the price taking/price setting point. In Trial 2A, you assumed Cournot pricing as part of the model of imperfect competition; correct? Or non-perfect competition?

A. I don't -- I think I may have discussed the economic theory of a range of different models. I think it's not necessarily the case that all sectors would -- would be necessarily Cournot, in fact, you know, it might be that some would focus more on choosing prices rather than output levels.

Q. That would be Bertrand pricing, would it not?

A. Yes.

Q. So it is Bertrand pricing, regardless of what happens in 2A and 2B. Obviously, I am tweaking your tail slightly on the level of consistency between your two approaches in those trials. But, I mean, focusing here on Trial 2B, it is Bertrand pricing that you are essentially putting forward as the model of non-perfect competition when you refer to acquirers being price setters, not price takers?

A. It certainly wouldn't be pure Bertrand competition that I would be talking about here because there are a range of non-price issues and there's non-homogeneity between the services offered to different merchants by different acquirers. So there's a lot of -- I think it would be an oversimplification to just say that, you know, a pure price decision is made without --

Q. The acquiring service is pretty homogeneous, is it not, amongst the main acquirers for the main merchants?

A. Well, I think the PSR study indicates that there's a lot of variation in the types of non-price factors that are taken into account, so that would suggest it's not homogeneous.

Q. You have suggested, have you not, that there are non-negligible search costs in this industry?

A. I -- I can't remember where I've made that specific statement but I think it seems reasonable to say that merchants might face some costs if they want to engage in the procurement of different services, yes.

Q. Could we look, please, at bundle {RC-J4.4/21.8/25}. It is in this particular document moving on to page 25. This is another slide, and we say it is looking at the reasons why merchants have not considered switching.

A. Yeah.

Q. We see that only ten merchants in the box have not considered switching because they think it would cost too much:

"These costs were typically related to the time it would take to arrange and implement a switch."

A. Yeah.
Q. We see from footnote E1 that total number of merchants that have not switched and not considered switching is 448, so it is ten out of 448 that viewed the cost of switching as being an impediment to switching.
A. Yeah, I think -- I think obviously that's -- that's their direct response to that issue. It may also be that the cost-benefit assessment, even if they would consider it, is still insufficient to get them to engage, and as is seen here in this slide, there are a number of other factors that lead them to potentially not consider switching, such as the degree of satisfaction with the current provider. Of course, satisfaction with the current provider could indicate a very general, you know, satisfaction that the services provided are sufficient and that they're not aware that, you know, the pricing is dramatically out of line or anything like that. What it doesn't suggest is that it's a detailed assessment of the market conditions and the alternative offers that they could get and then a comparison of what they're currently getting compared to that, and that they're getting a better deal. So it could well be that had they engaged more, they might well have had a lower price.
Q. Could we look, please, at page {RC-J4.4/21.8/85}.

This suggests, does it not, that the majority of the merchants who responded to the survey considered it was easy to shop around, only between 21 and 24% found that it was difficult to do so, that is the red boxes?
A. Yeah.
Q. We see that that proportion in fact is highest, the proportion who found it easiest were smaller merchants?
A. Yeah, so it's -- yes. I think you need to understand what's the base of the merchants who are answering this question. Those are the merchants who actually did shop around, as opposed to the large proportion that the other slide indicated had not shopped around for a whole variety of reasons. So I agree that --
Q. Well, footnote F4/G4 gives us the figures. It is merchants that shopped around, 410?
A. Yeah.
Q. So it is not significantly different from the figure that we just looked at, the 448, is it?
A. Well, I think if you go back to the prior slide, I think there is a lot of people saying that --
Q. {RC-J4.4/21.8/25}.
A. Yeah.
Q. The total sample from this was 448, that was the footnote --

A. Okay.
Q. I am comparing 4-4 -- 410 with 448.
A. Yeah --
Q. Let us move on --
A. -- but that's why it's not -- this says, "Merchants that have not switched and not considered switching" and there's 448. The other one is those who did switch, 411.
Q. But I am saying -- you said, well, you are not comparing the right base. What I am saying is the base is roughly split between the two camps that we have looked at in these slides?
A. Yeah, so presumably the total base is something like 850/1,000, yeah. So -- sorry, I think that was my point, is that just because on the subset of people who did switch, a majority found it relatively easy, and obviously there's still a material group that found it difficult, that doesn't mean that that necessarily suggests that switching is prevalent; there's a lot of other merchants who, whether or not they know how easy it is, have got other reasons not to engage.
Q. You have said that you do not think cards are must-take cards for merchants. Do you recall that?
A. I think there's a -- obviously a good debate to be had about that issue. I think it may depend on

the circumstances of the merchant.

Q. Could we look, please, at bundle {RC-J9/3/22}. This is part of the 2024 report, paragraph 3.26, and in the fourth to last line, it says:

"The European Commission observed that 'Mastercard and Visa debit and credit cards are still 'must-take' for EEA merchants [and that] in the absence of caps, merchants would face the risk of excessive [Interchange Fees] passed on to them through their Merchant Service Charges."

A. Sorry, I don't think I'm on the same page. The fourth to last line --

Q. Paragraph 3.26.

A. Oh, I'm sorry, 3.26. Yeah, I'm ...

Q. Four lines up from the bottom:

"The European Commission observed ..."

Then I have just read it out. You can read it.

So that is recognising, is it not, that at least for EEA merchants these are indeed "must-take", and you cannot think of a reason why the UK merchants would be dramatically different simply because they have crossed the channel?

A. No, I don't think I'm making that statement at all, no.

Q. In your 8th report you may remember as well that the "must-take" nature of the cards was one of

the factors you considered to be necessary to establish liability under Article 101. Do you remember that?
A. Yes, it's some time ago now, but yes.
Q. Of course, we are assuming here, are we not, liability for the purposes of Trial 2?
A. Yes, I understand that.
Q. Please could we look at {RC-I4/41/5}.
We see in the first bullet:
"Given the widespread use of Mastercard and Visa in the UK, their cards are must-take for merchants in the UK. As a consequence, Mastercard and Visa must be offered by all acquirers, which would otherwise face, as one acquirer put it, 'critical and existential losses'."
So the most recent 2025 report for the PSR is still recognising the "must-take" nature of the cards in question?
A. Well, that's making a somewhat different point than the usual discussion of "must-take". The usual discussion of "must-take" relates to merchants accepting cards in order to attract customers, and then there's debates to be had about which cards do they accept and might they engage in steering if there are differential prices and so on. So there's a lot of debate about all those issues, quite a lot of which the experts engaged on in Trial 1. This is a different point about

acquirers, not merchants, and I can very well see that acquirers would typically want to, if they're offering acquiring services to merchants, would want to offer a comprehensive service that would cover, you know, a number of schemes.
Q. So the first sentence says:
"Given the widespread use of Mastercard and Visa in the UK, their cards are must-take for merchants in the UK."
A. Yeah, okay, so I see that that's the point about merchants --
Q. It is about merchants and acquirers, is it not?
A. Yes --
Q. Acquirers have the honour all cards rule, so they have to cover all the cards?
A. Acquirers, I think, generally do offer Mastercard and Visa, yes.
Q. Can we move on, please, to the role of previous studies. In your 14th report {RC-G1.3/2/114}, you referred to the Commission decision in *Mastercard I* as a study. Did you mean that? I mean, it is a regulatory finding that has been upheld by the Court of Justice in Luxembourg.
A. I'm not suggesting that one should quibble as to the status of the decision. I think I was just taking into account a range of evidence that primarily I think

Ms Webster had investigated in order to inform her perspective on acquiring pass-on and I used the broad label "existing studies", i.e. existing estimates of pass-on from a range of historical studies. I think some of them included decisions.

Q. We have all read the Commission decision in *Mastercard* more than is healthy for one. You will recall that they found that the MIF set a floor to the MSC; correct?

A. Yes.

Q. Can I suggest that a finding that acquirer pass-on is restricted to a range from 50% would be inconsistent with a finding that the MIF was a floor?

A. I don't think that holds.

Q. It would be a floor with a 50% hole in it, would it not?

A. No, because the question is whether the MSC on average would still exceed the MIF. If the -- if the size of the acquiring margin is sufficient, then you could have imperfect pass-on and yet still have MSCs above the MIF, and therefore still argue that there's a floor.

Q. Let us just do a very short worked example. So let us imagine that the MIF is 0.75% and the MSC is 1%. Let us say that the MIF doubles to 1.5%. That represents a 0.75 percentage point increase; correct?

A. Yes.

Q. Your bottom line figure of 50% pass-on of that MIF increase to smaller merchants on blended contracts would mean that the MSC would increase by as little as 0.375 percentage points, that would be half of the 0.75 percentage point increase?
A. Yes.
Q. That would make the new MSC 1.375%; correct?
A. Yes, on that example.
Q. The new level of the MIF would be 1.5%?
A. Agreed.
Q. Now, we do not ever see that, do we, in the real world outcomes?
A. No, I agree with that. We're looking at on average rates of MSCs that exceed MIFs, and again, that's not inconsistent with my finding. The example that I identify relates to a situation where, for small merchants, the gap between MSCs and MIFs is far greater than the 0.25 percentage points that is indicated here. That's shown, I think, in the figure 2 analysis, which showed that the MSCs for smaller merchants I think ranged anywhere from 0.8 to much higher for some of the smaller merchant sets, whereas MIFs -- well, MSCs for large merchants were more around 0.4%. So if there's a margin already for small -- sorry, if there's a margin already for the large merchants, average MIFs

obviously must be below the 0.4% consistent with that figure. So that means that you've got actually a much more material gap between MSCs and MIFs for some of the smaller merchant segments.

Q. But in each example that you have just given, the MIF does as a matter of fact set the floor for the MSC because the MSC does not go beneath that floor?

A. Well, I agree that in each of the cases I've described the MSC is higher than the -- than the MIF, that's right.

Q. Could you look, please, in your 14th report, paragraph 395, that is {RC-G1.3/2/122}.

In the first sentence there, you say:

"... the [European Commission] has noted that certain merchants (some of the larger merchants of the 200 merchants surveyed in 2004, all of which were likely to have been on IC++ contracts) ..."

So just pausing there, and indeed that is the only sentence I want to ask you about at this stage, where do you get your evidence that all of the larger merchants back in 2004 are likely to have been on IC++ contracts?

A. I think that's a fair challenge. I can't recall whether they all would have been on -- what the basis of the statement that they were likely to have been on IC++ contracts. I think perhaps a fairer perspective, and

absent sort of going back to look at the detail, would be that in general the largest merchants are the most likely to be on IC++. But I think it's fair to say that back in 2004, I don't have any current view as to exactly how many of them would have been on IC++ at the time.
Q. Now, in terms of --
A. I think I need to -- sorry, I -- yeah, I think I need to go back to review the decision, but I think really the point is that there's a relationship between merchant size and tendency to be on IC++.
Q. Your overall position is the further back in time you go, the lower the proportion of IC+ contracts is; correct?
A. Yes, I think that is also the case --
Q. You did not --
A. -- certainly in terms of value and therefore to some extent the number of merchants. Obviously, the value can change quite quickly if you turn a small percentage of merchants with big transaction value into IC++.
Q. You did not look back, for example, at the evidence of Paul Ryan of Bet365 from Trial 1, where he looks at for -- that particular company moved from a blended contract to an IC+ contract as at 2011?
A. I don't recall looking at that particular evidence, no.

Q. You also did not look at the PSR 2024 report for the purposes of anything other than referring to it in section 7.1 of your 14th report, which is {RC-G1.3/2/115}. My understanding is that you do not think that the findings from the 2024 report are reliable; is that right? That is paragraph 368(a).
A. 368.
Q. You give the high-level view.
A. 368(a) -- oh, yes. Well, as I say there, the evidence there was primarily qualitative survey evidence and therefore is difficult to translate into a meaningful quantitative estimate. I mean, it so happens that while there's some uncertainty about precisely what they meant and how best to use that qualitative evidence, it may be that it's actually consistent with my range anyway, but it's not something that I rely on as an estimate.
Q. Well, let us have a look whether that second proposition is true. So {RC-J9/3/35}, please, paragraph 4.12.
The PSR found that:
"... because most of [the] fees were passed on to UK merchants ..." --
This is dealing with the financial impact of the outbound interchange fee increases -- they found:
"Approximately 95% of all the outbound [Interchange Fee] increases were passed on to UK merchants either

immediately (80%) or at some point (15%). Only around 5% of these increases were 'absorbed' by a small number of UK acquirers and never passed on to merchants.

The schemes challenged the provisional finding, but the PSR was confident that pass through from the acquirers was significant.

We then see, at 4.14 to 4.17, the reasons why the PSR concluded that there was near complete and rapid pass-through and that the universal application of the MIF to all acquirers meant the scope for a competitive response was very limited. You see that?

A. No, which paragraph are you talking about?

Q. 4.14 down to 4.17.

A. Yeah, I think -- I think they're making some suppositions there, that if there is full pass-on then that would be consistent with merchants having little choice. Equally, I think it could be consistent with, at least for some cases, that merchants do have quite a lot of choice, but the degree of competitiveness, at least for those merchants, would be sufficiently high that you would have high pass-on because of the thin margin point I described earlier. So there are different reasons why you might have a view that, at least for some merchants, pass-on could be complete. But then, of course, for other merchants, it might not be the same.

Q. The 5% figure was based, was it not, on conservative assumptions about responses from certain merchants who simply had not answered the question properly at all that was put to them. Do you recall that from this report?

A. Yeah, they did not supply adequate information.

Q. So on a conservative basis, anyone who had not given a proper answer was assumed to have zero per cent pass-on?

A. Yes, that's what the PSR's approach was.

Q. If we then please turn to page {RC-J9/3/123}, paragraph 9.142, the conclusion from the PSR is that:

"... the benefits of a price cap remedy would not be passed on to merchants on blended contracts as quickly as they would for those on ... IC+ ... However, we consider that the price cap remedy is still likely to significantly benefit UK merchants on blended contracts, by reducing the level ... they pay ..."

Then they give their reasons for that and explain why then at 9.143 {RC-J9/3/124} on the next page:

"... the evidence indicates that, compared to ... IC+ ... contracts, the benefits of a price cap remedy will ... take longer to be passed through. In particular, we note that the repricing exercise can take around two months to complete ... and some acquirers did not envisage making pricing changes outside of their normal annual cycle ..."

That is recognising, is it not, that pass-on, even to those on standard or blended contracts, is going to be substantially complete, it just may take a bit longer?

A. I think -- I think it's really just making the comment about the speed. I don't think it's necessarily making a statement about the completeness of pass-on for standard contracts. As -- as I understand it, the PSR did not find that the evidence was that there would necessarily be complete pass-on on standard contracts. In any event, it didn't have, in this study, an empirical basis to really test that proposition, it had these, you know, fairly qualitative statements. I've -- I've chosen to focus more on the very rich datasets to try and form an empirical assessment.

Q. You will recall from the PSR 2021 report -- I am not going to take you there, but tell me if you cannot recall this -- they did in fact find that pass-on of scheme fee increases would be complete across all merchant groups, regardless of size?

A. I -- I recall they made that statement, but then immediately, I think, in -- qualified the statement by saying that there was uncertainty with respect to the scheme fee data that they had recouped from the acquirers and that they put less weight, or found that the -- the strength of that finding was -- was less robust compared to the IFR pass-on debate that they looked at.

Q. This 2024 report is looking at whether or not it is worth putting a cap in place; correct? That is the purpose behind the report?

A. Yeah, I -- I understand that to be the case.

Q. Therefore, they are necessarily saying is the benefit of this simply going to be swallowed by acquirers or is it actually going to reach the merchants; correct? That is the purpose behind this report?

A. That might be one -- one -- I haven't sort of examined the purpose to which they've applied it in great detail, again, because there's not a lot of empirical evidence within this study that I can really use and -- and --

Q. But of course, the empirical evidence behind the study would have to look at the Brexit event, would it not, because that is what it is dealing with?

A. Yes.

Q. You did not look at, empirically, the Brexit event to an extent that you relied on any of your empirical analysis for the Brexit event either, did you?

A. Well, I did look at it. In -- in my first acquiring pass-on report I -- I provided estimates based on the Brexit event for two -- I won't name them, I guess -- two of the acquirers, but I identified that there were reasons why I didn't put any weight on the Brexit event in relation to either of them, and I'm happy --
Q. So if the empirical data --
A. -- to sort of go into the reasons for that.
Q. Sorry. Forgive me for talking over you.
A. Yeah.
Q. If the empirical data for those two acquirers does not enable you to come up with an empirical analysis, one would expect you to pay greater attention to the qualitative analysis that the PSR has done, no?
A. Well, I think the more relevant question is: is there sufficient empirical evidence elsewhere with which to make an empirical assessment? And my answer to that is, yes, there are multiple datasets and MIF change events which I think are a much more rigorous and econometrically valid, or economically valid way to reach a view on the degree of pass-on than the translation of these high-level survey results.
Q. Could we look, please, in your 14th report at paragraph 374. That is {RC-G1.3/2/116}. You say there

you did not reference or comment on the Brexit study. Then under paragraph (b), you say:

"At least some acquirers appear to have passed on the increase by reclassifying such transactions as inter-regional, which meant that higher rates automatically applied without a price change."

You are referring interest to the actions, I think, of acquirer B; is that right?

A. I'm not sure I'm able to sort of say acquirer B necessarily did that. I think all I'm able to say is that acquirer B, in the responses to expert questions, simply confirmed that UK intra-regional EEA transactions, which were what you might have expected would be the subject, were not --

Q. It's a fair point -- they have kept the label "intra-regional" rather than "inter-regional". But you then say:

"Such an option would not have been available to acquirers in response to a reduction in MIFs."

Can I just test that. Why do you say that you could not reclassify if there were a change in the underlying classification of a particular transaction if, for example, per impossibile, the UK rejoined the EEA, why could you not reclassify an inter-regional transaction as an intra-regional one?

A. Yes, I suppose that -- that might be possible. It's -- it's unclear. Obviously, I think, again, not saying that this was consistent with the acquirer B data in Trial 2B, but if an acquirer wanted to take account of the changes in MIFs that the schemes applied due to Brexit, there are a couple of ways in which, in theory, they might do that. They might create a new classification, they might change the classification of those transactions. My understanding is they could have done so, and perhaps, to some extent, did do that.

Q. So imagine you have got a set -- as we know, you have got a set schedule of prices, we know that the way acquirers bill is by reference to a particular transaction. If the classification of a particular transaction leads to a higher MIF rate being charged, that is a form of acquirer pass-on, is it not?

A. Yes, I think that would be fair, that if a -- if a particular transaction type had -- had a change in MIF and you -- you essentially achieved a higher MSC on those transactions by -- by reclassifying them, then I think that could be a version of a pass-on.
The question is, again, not are there some options that acquirers can adopt for pass-on, because I think that is entirely agreed, presumably, by all the experts, but rather what does the evidence say about the degree of

pass-on, and I think that's really where the differences between the experts lie, not -- not that there are some mechanisms by which acquirers could achieve a pass-on if they -- if they, you know, had the economic incentives to do so.

Q. Now, sticking, albeit very briefly now, with final points on existing studies, which is the nominal topic I am under at the moment, you recall in Trial 2A I put the Chang et al study to you, it is the Australian one, sponsored by Visa, that deals with the effect of price caps being imposed in Australia. In your 14th report -- you do not need to turn it up, just so you know -- your table 7.1, at page 120 of that report {RC-G1.3/2/120}, dismisses that report as unreliable. So you have taken it into account, but you do not think it is reliable; is that right? In fairness to you, let us go to your table.

A. Yeah, I'm happy to accept that. I -- overall, I didn't find the references to the evidence on the degree of pass-on from a number of the studies that had been identified by the experts -- and I think Ms Webster was the one who looked at this in greatest detail -- met my criteria that I adopted for Trial 2A as to: would these be reliable. And my criteria were based on what was the process, what was the data, what sort of controls were used, is it an econometrically valid approach, a whole range of criteria, and so I think what I've said here is that I didn't identify that some of these existing studies met those criteria and hence I haven't put weight on them.

Q. Please could we look at {RC-I4/7.1/1}. This is a report from 2008 prepared by Charles Russell Associates [sic]. Scrolling down that page, please, you will see that it has been prepared by Messrs Stillman, Bishop, Malcolm -- or Mesdames Malcolm and Hildebrandt. I think William Bishop is now a panel member of the Tribunal.

Now, CRA have assisted you with the preparation of your report, have they not?

A. Yes.

Q. Could we look, please, at figure 1 on page 6 -- sorry, footnote 1 {RC-I4/7.1/6}. If we could concentrate on footnote 1:

"Our research has been funded by MasterCard Worldwide ..."

Can you see that?

A. I can see that.

Q. "... but the views expressed in this paper are ... [the personal views of the authors], reflecting our independent analysis of the evidence."

A. Yes.

Q. At page 6, the overall conclusion that is reached in the second paragraph up from the bottom beginning:

"Further ..."

It says:

"Further, the RBA's regulations have clearly harmed consumers by causing higher cardholder fees and less valuable reward programmes and by reducing the incentives of issuers ... to invest and innovate. At the same time, there is no evidence that these losses to consumers have been offset by reductions in retail prices or improvements in the quality of retailer service. The empirical evidence thus provides no support for the view that consumers have derived any net benefits from the intervention."

The intervention being lower interchange fees imposed by the Australian regime; correct?

A. That's what that finding says there, yes.

Q. Can we then see at {RC-I4/9.1/8}, please, halfway down the page there is a section that begins:

"One of the RBA's key expectations ..."

Could you please then read the next -- that paragraph and the next two.

A. Okay.

Q. Ending with:

"... improved quality of service."

(Pause)

A. Sorry, read until which paragraph?

Q. Well, the end of:

"... and/or improved quality of service."

A. Yeah, okay. Yes, I've read that.

Q. Page {RC-I4/7.1/17}, please.

A. Yeah.

Q. At page 17, one sees here in the third bullet point down after paragraph -- the section 4, it says:

"On the acquiring side, merchant service charges for four-party schemes have declined in line with the reduction in interchange fees. The decline in ... merchant service charges has been in the order of ..."

Then gives a figure.

A. Yeah.

Q. Finally, at page {RC-I4/7.1/28}, we see a comparison of the basis points decline. Under section 4.3, it says:

"As expected, merchant service charges for Visa and MasterCard have declined considerably since the introduction of the interchange standard. Interchange fees fell by an average of approximately 40 basis points ... from approximately 0.95% to 0.55% ... merchant service charges for four-party credit cards fell by approximately the same amount. The average merchant service charge for four-party credit cards [schemes] declined over this period by 44 basis points ..."

A. Yeah.

Q. So in fact the Merchant Service Charge had declined by more than the reduction in the MIF; can you see that?

A. Yes.

Q. Now, you did not cite this study in your report at any stage?

A. No. Again, I don't think these high-level indications from a report in 2008 relating to Australia are that pertinent to the question as to the degree of pass-on that I'm looking at based on the empirical, much more disaggregated evidence --

Q. When you have got Charles Russell --

A. I'm sorry, River.

Q. -- Charles River Associates' input into your workings, did they draw this article to your attention?

A. I don't recall them drawing it to my attention. Obviously, I think this was the individual author's perspective, not necessarily of the organisation, and I'm not sure there is any overlap, given this is a 2008 report, with the team.

Q. I am going to move on now to look at some factors, thematic factors that have emerged from the difference between the parties in this case. The first is the competitive intensity of the acquiring market.

A. Yes.

Q. Please could we look at bundle {RC-R/7/3}. At paragraph 1.3, the PSR here in its annex to the 2021 report observes:

"... that there has been entry and expansion in both the small and medium-sized merchant segment and large merchants segment since 2014."

They refer to the entry of Stripe in particular, and it says:

"This evidence indicates their expansion is predominantly driven by their success in onboarding merchants new to card payments ..."

So what we do not see there, do we, is any indication that there are barriers to market entry for acquirers in this market?

A. I think that's a fair statement. That -- that has indicated there has been some entry by some of the payment facilitators. I don't think the extent of barriers to entry has been the -- a key plank on which the PSR's findings about competition in the acquiring market, at least for the small business segment, has -- has been found. So there's --

Q. They have not found any material barriers to entry, have they?

A. I agree that they have said that there has been some entry. I think it is interesting to note that the entry, as I understand it, has -- has often been in -- in terms of onboarding new merchants, so payment facilitators have sort of expanded the -- the use of card payments to, you know, the sort of more informal and smaller shops using some IF and some of these other types of flexible tools, and --
Q. You have relied on a concentration of the market, have you not, as one of the reasons why you say there is a lack of competitive intensity?
A. I think when I said -- so I have cited that the five largest acquirers account for 90% of the market, and obviously what that indicates is that we're not in a situation of perfect competition here, there is a degree of concentration. But I have also accepted that, if you look at the PSR study in the round, it has identified that, despite that concentration, that the market is working reasonably well in certain dimensions, including with respect to particularly the comparators in the market for larger merchants.
Q. Concentration by itself is not going to be a guide, is it, because otherwise you would not have been able to reach your conclusions that there was a competitive market for mobile phone services in Trial 2A when you

were looking at the company in question there that was a mobile phone company?
A. I agree that concentration of the market is not the sole basis on which you would form a view as to a competitive assessment, and it's certainly not my view that the findings in relation to smaller merchants, and the competitiveness of the acquiring market for them, is contingent on the concentration point. I think it's rather more affected by the evidence that the PSR cited in relation to a whole slew of other dimensions, including extent of engagement and transparency of the pricing structures.
Q. Can I suggest to you that the evidence produced in this case by the merchants and by the acquirers is indicative of a sufficient, or indeed a high degree of competitive intensity between the acquirers.
A. Well, it's a very high-level statement --
Q. I do not have time to go into the detail, so it is simply going to be a: do you agree with that as a proposition or not?
A. Well, I focused on the evidence largely based on the PSR's review of the market for card-acquiring services, and I think there's quite a lot of evidence there that distinguishes the degree of competitive intensity as between the smaller merchants and

the larger.

Q. I am going to move on to payment facilitators. Please could we look at page 6 of the document that is presently up. That is {RC-R/7/6}.

A. Yeah.

Q. This describes payment facilitators, does it not, and we see that, in paragraph 1.12:

"... under scheme rules acquirers can permit payment facilitators to recruit merchants on their behalf ... The acquirer supports payment facilitators with authentication ... [etc] ... clearing ..."

And so on. So we see there, do we not, that essentially there is a scheme rule requiring an acquirer to be linked with a payment facilitator in certain circumstances?

A. Yes, I think that's fair. That's what it says.

Q. Are you aware that the CICC claim expressly does not cover merchants who use a payment facilitator?

A. I am aware of that now. I think it's fair to say that it wasn't entirely clear to me from the outset, but I'm happy to take that as their view, or that that is the case for their claim, yes.

Q. You have recognised, have you not, that payment facilitators themselves are likely to be on IC+ or IC++ contracts?

A. That I would be surprised at, if I have stated that.
I'm happy if you bring me to remind me where I made
that --
Q. Could we look, please, at {RC-F1.4/6/45}. It is your
13th report at paragraph 104. The last three sentences
-- the last three lines:
"Based on the information available to me, it is not
clear what the precise contractual relationship between
payment facilitators and their acquirers is, although
I expect payment facilitators to have an IC++ or
a similar type of contract with their acquirers."
A. Yes, that -- that -- sorry, that might be the case in
terms of the relationship between acquirers and --
sorry, payment facilitators and the acquirers, who they
are using, essentially, to --
Q. Yes.
A. -- support the service, because otherwise the acquirer
would be exposed to risk. But that does not mean,
I don't think, that the payment facilitators themselves
will use an IC++ contract --
Q. I was not suggesting that you were --
A. -- for their merchants, which is really the more
important, in my view, question, which is
the arrangement between the merchant and the provider.
Q. So -- but that goes to show, does it not, that there is

effectively two stages of 100% pass-on, but the ultimate question then is do the payment facilitators treat merchants on standard contracts any differently from acquirers on standard contracts, to which the answer is, there is no evidence whatsoever that they do not apply in the same way, save that payment facilitators are more likely to deal with smaller merchants, therefore are more likely to have standard contracts?

A. Yes, and I think they may be typically having simpler structures of contracts which likely include more blending than would be the case for acquirers often.

Q. Now moving on to smaller versus larger merchants. Let me just frame this question and we will see how much distance I can run in two minutes.

You have essentially said that you expect pass-on rates to increase with merchant size, albeit not monotonically; correct?

A. I have really just drawn a -- sort of more of a binary sort of distinction between large -- larger and smaller, where I expect the larger ones to have a higher rate of pass-on than the smaller.

Q. What I am proposing to do after the short adjournment is to look at some of your results on this which indicate that, contrary to that suggestion, there is no fixed indication as to whether or not APO, on your estimates, increases or decreases with merchant size. So that is a task for after the short adjournment.

We have, however, prepared a table, which is intended to make this easier going than it otherwise will be. It is a mathematical calculation of your estimates by reference to particular groups and whether or not you can see a sequence -- a trending sequence going upwards in terms of APO based on your estimates. Could I ask that be made available to the witness over the short adjournment for two reasons. Firstly, it will make my cross-examination on the detail quicker, and secondly, he can then study it over the short adjournment to just confirm whether or not he is content to take the mathematical exercise as read. It is not a new expert report, it is simply pulling together figures that he has.

MR JOWELL: I am afraid --

THE CHAIRMAN: I assume there is an objection to that.

MR JOWELL: -- we do object, because, you know, this is, it may be mathematical, but it is a manipulation of data that the witness is being, obviously, ambushed with, and to provide it to him on the day of the cross-examination --

THE CHAIRMAN: When did you get it?

MR JOWELL: We got it one minute before Mr Holt started giving -- I called Mr Holt, literally one minute, and really it is not the way to conduct this sort of litigation, to suddenly spring it on us. I mean, when we had an equivalent document, I seem to recall we provided it at least a week in advance in Trial 2.

THE CHAIRMAN: It is not unusual to prepare a document for the purposes of cross-examination if it is just a gathering of information that is available elsewhere.

MR JOWELL: No, I see that, but this is a -- one can see from it that it is a manipulation of the data, effectively, and the data can be sliced and diced in all sorts of ways --

THE CHAIRMAN: Right.

MR JOWELL: -- and it is only fair --

THE CHAIRMAN: Well, you could have made that point.

MR JOWELL: -- that Mr Holt should have an opportunity to consider the underlying, for example, what is the code that has gone into this, how has the data ...

To expect him to deal with it over the short adjournment without the assistance of any team, or the data packs, or anything like that is not --

THE CHAIRMAN: You have given him some assistance anyway as to what to look for.

MR JOWELL: Well, I am not intending to do that. I mean, you know, it is not possible even to interpret this.

THE CHAIRMAN: Well, I understand the difficulty, that he cannot talk to anyone over the lunch adjournment and he has just got to look at it himself, but it seems to me that if it is something that Mr Beal could put -- properly put to a witness, it makes sense for him to at least have a look at it and then --

MR JOWELL: Yes, but I think the way that it was dealt with in 2A when a similar point came up was that the witness was able to then put in effectively a responsive document themselves.

THE CHAIRMAN: Right.

MR JOWELL: I think fairness dictates that, if Mr Holt considers that is necessary, he should have an opportunity to consider this, be provided with the pages that are underlying it and --

MR BEAL: We face responsive documents with every set of submissions that comes in from the schemes. Look, now is not the time to air our dirty linen in public.

THE CHAIRMAN: Well, your side put in some responsive documents to the --

MR BEAL: We have -- (overspeaking) --

THE CHAIRMAN: -- addenda graphs --

MR BEAL: -- yes.

THE CHAIRMAN: -- surely before.

MR BEAL: Nobody is claiming the moral high ground.

THE CHAIRMAN: We can talk about whether there needs to be a responsive document, I think, after lunch when everyone has had an opportunity to look at it, but I think --

MR BEAL: Could I pass that document up, in the light of your indication, sir, and give one to Mr Holt.

(Handed)

THE CHAIRMAN: Right.

MR BEAL: Thank you very much.

A. Thank you.

THE CHAIRMAN: So Mr Holt, I did not want to ruin your lunch, but at least you have something to look at, since you cannot speak to anyone else.

A. I understand. Thank you.

THE CHAIRMAN: All right. We will resume at 2 o'clock.

(1.02 pm)

(The short adjournment)

(2.00 pm)

THE CHAIRMAN: Good afternoon.

MR BEAL: Good afternoon.

Please may we turn to {RC-F1.4/6/126}, and what we have here, I hope, is table 6.4.

A. Is this the 13th amended?

Q. Yes.

A. Yeah.

Q. The 13th amended report. We have pass-on rates here given by group; can you see that?
A. Yes.
Q. We have two different acquirers' data being considered?
A. Yes.
Q. We can see, just going through from the left-hand column for the first acquirer, acquirer B, you have a total figure given for everyone at 92%-odd; can you see that?
A. The total figure -- yes, I see that, yeah.
Q. Then in the next column, group 1 through to group 5, we have results that go, initially, down, then down again, then down again, then up again, and then group 6 is higher and then group 7 is even higher still; can you see that?
A. Yes.
Q. That produces an overall figure that we looked at right at the start?
A. Yeah.
THE CHAIRMAN: Which figure with you looking at? The top row?
PROFESSOR WATERSON: The implied pass-on rate.
THE CHAIRMAN: Implied pass-on rate, okay. Thank you.
MR BEAL: Implied pass-on rate, immediately behind -- immediately above the acquirer details for acquirer C.
THE CHAIRMAN: Yes.

MR BEAL: Then the same exercise with acquirer C implied pass-on rate. The overall figure is 114%, and then we have figures that start off over 100% decrease, decrease, increase, increase, decrease, increase; can you see that?

A. I see that.

Q. If you had not split out those groups, you would have got the total pass-on rate of 114%; correct?

A. Yeah, that's right.

Q. Now, we could do that exercise with every other dataset that is in there, but we have tried, in this note that was the bone of contention before the short adjournment, to try and break out what the consequences are in terms of the step changes in the figures. Just so you know, the first table, on the left-hand side of the note, represents all of your findings; the second table, in the middle, is reflected in your table 7.1 in Holt 13.

A. Yeah.

Q. Then the third column is breaking out table 7.1 into increases and decreases.

I should say, for the avoidance of doubt, we are relying on your description of these as being reliable estimates. Obviously, that is the subject of discussion between the parties as to which estimates, if any, are reliable.

Then, finally, the graph that we see -- the chart, sorry, that we see, bottom left-hand corner, is a pictorial representation of the table on the top left-hand corner. What I am going to suggest to you, cutting to the chase, is that looking at all of your observations in pictorial form, one ends up with -- how can I put this -- roughly equal numbers, being higher or lower, depending on the observation that comes next. So if we were playing, for example, a game on TV, "Higher or Lower", you could do a coin toss for any particular observation and say is it going to be higher or lower in the next observation group, and the answer would be you would be right roughly 50% of the time as to whether it is higher or lower; can you see that?

A. Yes.

Q. What I am going to suggest to you is that that does not show an upwards only trend for acquirer pass-on, on the basis of your estimates, for merchants?

A. Shall I comment on -- on this analysis?

THE CHAIRMAN: I think you are being invited to.

A. I think I am, thanks. And thank for letting me have a look at it over the lunch hour.

So I think I'm agreeing with the point that, if you look group by group -- and recall there are seven groups of merchants with different size dimensions, which is based on the PSR analysis -- that if you then look at a range of pass-on estimates using different datasets for different acquirers, and indeed for the PSR as well, that there is not a monotonic relationship. In other words, had there been a monotonic relationship, I think, as counsel was indicating, what he might have expected to see in these charts, you'd have a had a lot more next group up and fewer next group down, if indeed there was a monotonic relationship such that the degree of pass-on was higher as the merchant size got ever bigger, and I accept that that is not the pattern that these tables are indicating.

I think then it's important to make clear observations: one is, what's the relevance of the implicit assumption that this needs to be tested at the group-by-group level to demonstrate a monotonic relationship; secondly, what are the reasons and evidence in relation to the broader relationship of pass-on in relation to smaller versus larger, as I have indicated; and third, what are the implications were I to, in a sense, step back from thinking about merchant size and instead just think about pass-on estimates in the round. So I think those are the three points.

So taking the first one. I think I already accepted in the hot tub that there isn't a non-monotonic relationship, so in a sense this additional summarisation of the evidence doesn't really take us any forward; I'd already accepted in the hot tub this very proposition. The question then is what do you expect to see? Do you expect a fully monotonic relationship or not, and I think there are some reasons to suppose that, no, you wouldn't expect that.

The first is that we're basically dealing with a very small number of datasets and events, so there's a very small number of actual estimates. Of course, these numbers are quite high, because every single estimate is being multiplied by seven, but basically each model, of which there are seven estimates by group size, there's only a relatively small number of reliable models. There are the PSR ones and a small number of the Trial 2B datasets which I consider to be reliable, and there's really only one increase and one decrease in the Trial 2B datasets that I consider to be worthy of investigation. No doubt we'll come to the Brexit event, which I don't, later.

So that entails that you have to recognise that there's a degree of noise and there might be some uncertainty. Some of that uncertainty might reflect within merchant size group variation, other aspects might simply reflect a degree of imperfection in the model.

MR BEAL: I am sorry to interrupt, but can I just, in a sense, cut to the chase. If you are accepting all these difficulties, why did you not just band all of groups 1 to 6 together and provide a single estimate of APO for the entire bunch?

A. Well, I -- that might have been an alternative approach that I could have adopted. I was actually taking a cue, in a sense, from the structure that the PSR had originally adopted and I followed that for the purpose of reviewing the PSR dataset. Firstly, that helped with comparability of the overall results to the PSR, and then I adopted for consistency a similar approach to Trial 2B. But I take the point that you could potentially have done that.

Q. Can we see how you did deal with the individual --

A. Sorry, can I -- I had --

Q. Of course.

A. -- three points and I've made part of the first.

The first part, therefore, is that there might be some noise and I wouldn't expect there to be a monotonic relationship, and indeed, while I accept that and maintain that market power is an important factor and that market power tends to be higher in relation to acquirers vis-à-vis the smaller group of merchants compared to the larger, I also accept that there might be other factors besides size alone that might affect that, and I think chart 2 of the hot tub discussion sort of makes that point, that basically, you know, there are groupings of merchants, but the evidence isn't quite so clear-cut that it applies, in terms of massively different --

Q. Mr Holt, I think you are straying off topic now. Can we have your second and third points perhaps in a sentence?

A. Sorry. This point is that you can look at the MSCs and there's three broader categories: large; and then a significant increase for a group of different merchant sizes, three lines -- this is figure 2 of the hot tub chart; and then there's a higher one for a conglomeration of -- of the smallest groups up to, I think, 380,000, or whatever that threshold is. So, again, that's sort of indicative that you don't really need to look at this in quite such a precise way.

So moving on to the second and third points -- and I'll try and be quick. Firstly, my view on the size -- the merchant size issue is an in-the-round assessment based not only on this evidence but also the PSR evidence, the economic theory and the MSC differentiation.

I think, secondly, if, as I think is sensible, you can take a step back and look at the overall weighted effects of the smaller and larger distinguished by the 50 million threshold, the evidence is very clear. So table 7.1 of Holt 13 amended does show that the average is 55 to 66 across all the estimates for below 50 million, and about complete, i.e. about 100, for above. So I think it is a clear impression that comes, and indeed table 8.1 in Holt 14, I think, reinforces that. So my view is already that after Holt 13, and it's reinforced having also looked at the evidence of some of the other experts.

The second point on looking at this evidence is that if anything that evidence understates it, because the analysis which suggests that maybe it doesn't hold quite as strongly as I might be putting it is actually the evidence on which I put less weight. So if you go to table 7.1 -- and I think it is worth calling it up, just so that the Tribunal can see what I'm talking about here -- there are three pieces of evidence that -- that sort of suggest that perhaps the merchant size effect isn't so strong, but on each of those three I've identified reasons in my reports as to why I put relatively less weight on those. Now, they have made it into the table, I accept that I have put some weight on them, but I have already called out reasons why I put somewhat less weight. The three in question are the two [redacted] ones -- oh, sorry --

THE CHAIRMAN: I think you should not -- yes.

A. I'll switch to using "A, B, C"; is that all right?

THE CHAIRMAN: Yes.

A. Okay.

THE CHAIRMAN: Although I am thinking, I mean, I did invite you to give your thoughts on these tables, but I think --

A. I am giving --

THE CHAIRMAN: -- it is more appropriate for you to answer specific questions about the --

A. Okay. Well, what I was trying to answer is why I don't agree with the relevance of the tables that have been put to me and what the evidence of size actually says. In short, it says, yes, there is a clear distinction when you take a step back and look at the 50 million threshold, and secondly, without going into the detail, although I would be happy to do it, three of the estimates across acquirers B and C actually I had put less weight on, or there's unusual features, one example being that an overall assessment for the below 50 million of complete pass-on in one of those cases is actually wholly affected by one estimate for the 10 to 50 category where that estimate was 200%, i.e.

implausibly high.

So once you accept, as I consider it reasonable, that you can have different amount of weights for some of these estimates, I think the relationship that I've identified is actually stronger even than these tables indicate.

MR BEAL: I think you would accept, would you not, that group 6, for example, which is 10 to 50 million turnover, exhibits generally higher APO than groups 1 to 5, but you chose not to --

A. It does -- yes, it did in -- in that case, yes.

Q. But you have chosen not to draw the bright line distinction at that level, you have chosen to hive off group 7 for 100% treatment and then give groups 1 to 6 individualised treatment that you then pass-through the 2018 optic of working out what the respective shares are; correct?

A. Yes, I used shares based on the PSR 2018 data for comparability. It's also worth noting that the PSR evidence that I used is part of my assessment as to the degree of pass-on for the up to 50 million category 6 --

Q. I am going to move on now to contract switching.

PROFESSOR WATERSON: Can I just raise a question --

A. Yeah.

PROFESSOR WATERSON: -- on this table, which is table 6.4 in the amended version.

A. Yes.

PROFESSOR WATERSON: So in looking at these groups and in looking at the group as the set of cases as a whole, is it the case that you can accept the hypothesis that there is no distinction between the groups 1 to 6, or 1 to 5, or whatever? In other words, did you do Chow tests?

A. No, I didn't sort of statistically test for whether the individual estimates are -- are different. Again, I'm accepting that there is a degree of noise and I'm therefore looking at all of this in the round. I'm looking at the average for the 1 to 6 from one estimate, but then weighing that alongside similar estimates from a range of other studies, or other acquirers, and then forming a view in the round based on all of that.

MR BEAL: Could we look, please, at {RC-G1.3/2/36}. This is your paragraph 91 in Holt 14, and in the last sentence you say:

"... there appears to be a material share of merchants on Standard Contracts who may not benefit from MIF reductions even though over the longer term ..."

You attribute that to difficulties in switching; can you see that?

A. Yes -- sorry, which -- which paragraph exactly?
Q. 91.
A. 91.
Q. Last sentence.
A. Yeah.
Q. You have not actually relied on any evidence adduced by Visa or Mastercard for that proposition, have you?
A. So this -- so I have to check. I think this section of the report, 4.3, is where I'm looking at the evidence -- actually, before I answer, let me just check what section 4.3 is. I think I'll give a more helpful answer. So it's called, "Evidence on contract duration, renegotiation and switching". So this is part of my industry background commentary. It's the second report, i.e. it's the responsive report to what the other experts have said, and I'm essentially using evidence, including from the PSR, to make some observations about the nature of the acquiring market. In my view, it's not actually something that the Visa evidence would be that helpful for, because it's actually more about the acquiring market with respect to merchants.
Q. Could we look, please, at page 71 of your 14th report {RC-G1.3/2/71}, and at paragraphs 213 to 214 you consider that the high switching rate found by Dr Trento, the figure there shown in 213 in blue, which

I am not going to read out, you suggest that could be attributable to what you describe as the "business death rate"; is that right?
A. In part, it could be, yes.
Q. Could we look at {RC-J9/12/4}, and what we see here in this figure, is it not, is the birth and death rates of businesses from 2012 to 2017?
A. Yes.
Q. Unsurprisingly, well, fortunately for a growing economy, you have more businesses coming into existence than are going -- coming at all.
A. Yes.
Q. Could we then turn to page 5, and there is a section that says:
"Which industries have highest business birth and deaths?"
Three paragraphs down, there is a paragraph that begins:
"The highest rate of business deaths was observed ..."
Can you see that?
A. Yeah.
Q. It:
"... was observed in the education sector ... [and] the industry showed a spike in the number of single

employee limited companies. In 2012, these made up 56% of the overall births in education, which grew to 83% in 2016 and decreased to 63% in 2017. Another notable increase in business deaths was in the health industry and this again showed a similar pattern in relation to single employee limited companies."

There is then a reference to the IR35 initiative that HMRC introduced; can you see that in the next paragraph?

A. Yeah, I see that.

Q. IR35, are you aware of what that involved?

A. To some extent, yes. It has to do with the treatment -- I think the tax treatment of independent contractors; is that right?

Q. Independent contractors as single member companies.

A. Yeah.

Q. Suddenly you got hit with a less preferential tax regime, and so they all switched back to being self-employed contractors rather than contractors through a limited company; are you aware of that?

A. A little bit. We have some ICs in our company, so, yes.

Q. So a large proportion of the merchants in this claim are not likely to be self-employed or formerly self-employed contractors, are they?

A. I think that's probably fair, yeah.

Q. Could we then, please, in this report, look at page {RC-J9/12/37}, paragraph 96. This is moving on to the question of the structure of the MSCs.
A. Sorry, are we moving away from switching now?
Q. Yes.
A. I think there is one or two very important points to make on switching. Firstly --
Q. I am assuming you have made them in your report, and this is cross-examination.
THE CHAIRMAN: If you could try and just --
A. Okay.
THE CHAIRMAN: -- stick to answering the question.
MR BEAL: So --
A. Should I make an observation or not?
THE CHAIRMAN: He has not asked a question.
MR BEAL: That was not the question --
A. Sorry. Okay.
Q. -- and it is not your platform for --
A. Fine.
Q. -- simply repeating your written evidence.
A. Okay. I thought it would be helpful to interpret the evidence, but --
Q. Well, no, helpful or not, that is not the way it works.
Page 37, please.
A. Okay.

Q. In paragraph 96 of your 14th report you are suggesting here that most MSCs are ad valorem in nature; can you see that?
A. Yes.
Q. How did you test for that?
A. That was looking at the [acquirer] data, as is indicated there, I think.
Q. What number of observations did you make in order to derive that proportion?
A. What number of observations?
Q. Yes.
A. Well, I think what I was looking at is the overall [acquirer] data -- sorry, acquirer -- sorry, I think -- I think I've mentioned the name of --
Q. Acquirer C. Let us call acquirer C acquirer C.
A. Yeah, okay, acquirer C. What I was looking at here is the proportion of transactions which is identified by Dr Trento as having a component that has a per unit component and I was just looking at what is the overall value by -- of transactions.
Q. So when you say:
"... it appears in the MSCs in the PSR Data and [Trial 2B] Acquirer Data most are ad valorem."
You are saying that you simply looked at the acquirer C data; is that right?

A. That was my main focus. That was my response to Dr Trento, who had claimed, on the basis of the acquirer C data, that it may be appropriate to normalise by volume, i.e. per unit.
Q. Could we look, please, at {RC-J8/49/1}. This is a document, a publicly available document from acquirer C, and halfway down the page it talks about a headline rate; can you see that?
A. Yeah.
Q. That headline rate is then split out into an ad valorem component and a price per unit component; correct?
A. Yes, I can see on the left-hand side, yes.
Q. On page 2 {RC-J8/49/1}, it has a reference to something called an "Additional Transaction Fee"; can you see that?
A. Yes.
Q. The additional transaction fee is described as being an additional fee paid on behalf of the merchant by the acquirer to Mastercard and Visa; can you see that?
A. Yes.
Q. Could we then, please, look at {RC-J7/10/3} and towards the bottom of that page ... (Pause)
Sorry, I have given myself the wrong reference. Let us move on.
Please can we look at {RC-I6/4.3/1}, and there is

a paragraph in highlighted yellow, the second of the two highlighted paragraphs in yellow, where acquirer C describes how their pricing is split, can you see that, between headline rates and additional transaction fees?

A. Yes.

Q. We see that the headline rates are set so that they recover?

A. Yes.

Q. The things that are identified there. I am not going to go into any detail. Then we see that there is a separate categorisation of what are called "ATF charges"; can you see that?

A. Yes, I see that.

Q. So it is clear from that, is it not, that that particular acquirer is seeking to recover, I will put it in that neutral terminology, the costs that it has to pay to the schemes when it is setting its prices?

A. I agree with that, and I -- I think the interesting aspect here is that -- can I refer to the contract type, the three letter? ATF contracts. So there has been quite a lot of discussion as between the experts and even between the experts and acquirer C as to the nature of these contracts. My take in the round, based on all of that, is that these contracts for acquirer C do, as counsel just suggested, have a somewhat closer relationship between the setting of MSCs and the -- and the MIFs. They're much more specifically called out as to the basis of which they're -- as to under what circumstances increases in MSCs are levied that is targeted to -- to MIFs. Some of the experts considered that that was perhaps the case for saying that these might be IC++ contracts. I think, in the end, at least for my part and I think the other experts, we agreed that they're not actually IC++ contracts, but my point is that they do not seem to be representative of standard contracts, because the degree of linking is much greater than you see in some of the other contracts.

Q. On your analysis, you are either one or the other, are you not? It is a binary decision, you are either IC+ or you are standard, that lies behind your entire analysis?

A. Yes, and I think what I'm saying here is that this may be an exception whereby I wouldn't treat the results based on acquirer C as representative.

Q. Well, you say they are not representative; they are either in one bucket or the other?

A. I think what I'm saying is that it's not quite so binary, in this particular instance there's an element to which they have a greater linkage and I wouldn't --

Q. Can I --
A. -- carry much weight from these results to other -- to my broader standard contract findings.
Q. I am going to move on to the counterfactual now.
Now, the way you have pitched the counterfactual analysis, as I understand it, is you say that the crucial issue is the degree to which acquirers would have passed on MIF reductions; is that right?
A. I think -- I think that's probably fair. That was my understanding as to the counterfactual that in the counterfactual there would have been no MIFs, or at least for the relevant MIFs, and therefore from the actual to the counterfactual there would be a reduction. But I have I think also identified on some occasions that it's really a matter for the Tribunal to determine the appropriate counterfactual.
Q. You have also proceeded on the assumption that there would be a one-off reduction at the start of the claim period; is that right?
A. It's possible that I -- I may have made an observation of that nature, but I think, even if I have, it's subject to the same caveat that, that may be an interpretation, but really I recognise that it's a matter for the Tribunal and that there might be a -- some differences between the parties as to what

the counterfactual should be.

Q. If that assumption is not correct, then the counterfactual would have to be one in which the MIF was never imposed on acquirers in the first place; is that right?

A. I don't think that's correct. I think it doesn't follow that if the counterfactual is not a day one of the claim period reduction, then there are a number of alternatives as to what it could be. It could be a day minus two, year minus two, or never imposed. There's a range of outcomes, in other words.

Q. That is a question of degree. What I am suggesting --

A. Yeah.

Q. -- to you is you would get to a counterfactual in which there was no discernible impact of a previously imposed MIF, regardless of whether that is four/five years or never.

A. I don't think that's for me to determine as to what the counterfactual entails as to the prior point in time at which it's appropriate to treat the MIFs as having not been imposed.

Q. But your analysis would necessarily change, would it not, if one is looking at what happens if a 0.5% MIF is suddenly imposed on an acquiring transaction?

A. No, and the -- I accept that if your proposition is that the alternative, the counterfactual should be that it was never imposed and then you could see what happened when it was imposed or you could look at the counterfactual in that way, you might try and characterise that as an increase rather than a decrease. Again, I'm not making that observation and I think it's for Tribunal to determine.

What I've actually done in my analysis is to use the evidence in the round. Given that there are a limited number of events, I've used both the increases and the decreases for the -- for the interchange fee changes in order to inform my estimate of pass-on, and indeed I've also relied on one case of a general model, where I've determined that the criteria for that being appropriate were met, and of course that's both increases and decreases within the same model.

Q. Could we look, please, in your 13th report, this is page {RC-F1.4/6/32}, and we will see how you have dealt with your amended position in paragraph 63 and 64. So it is true that you have looked at both price increases and price decreases?

A. Yeah.

Q. Prior to this amendment, you essentially thought that the same observations could be made about each of them; correct? So prior to the amendment, what you said, at paragraph 63, was:

"... there is a wide range of estimates, the results ..."

You have deleted "clearly" and then said:

"... pass-on ... for Standard Contracts is incomplete ..."

So you are making that assumption across both price increases and price decreases. The way you have amended this is to concentrate on price decreases and the evidence for those, and you have let increases fall into a different cap, where you say:

"On the other hand, the evidence from [an acquirer] suggests that pass-on of MIF increases may have been complete for merchants of all sizes."

A. Yes, I think I'm just commenting on the results as I identified. My in-the-round assessment is that the merchant size issue is the perhaps more important distinction to be drawn, rather than whether you focus on increases and decreases, given that I used both increases and decreases. And, again, I note that three of the results that are in this table, I have identified specific issues to do with the data of one of the acquirers, acquirer C, the fact that the IC++ results for that acquirer, in the case of one of the events, is materially different than 100, and the issue I mentioned before about the 200% rate for group 6 for one of the estimates as being important factors that, you know, somewhat cloud the assessment, but if --

Q. How does the 0% figure cloud the assessment if you are looking at 200%, which is implausible, surely 0% is implausible as well, paragraph 64 {RC-F1.4/6/33}?

A. In the end, I -- I -- in a sense, I have put somewhat less weight on -- on -- on that 0%. Again, the 200% is based on one of the seven group sizes and it stands out as being very different than all the others. So that's -- and yet I carry it forward into my analysis nonetheless, I think conservatively.

As to the zero you just mentioned, that's the case of the commercial contactless difference-in-difference assessment, and that's -- that's an increase. I recognise it's a relatively small and targeted increase. My evidence suggested no evidence of pass-on, but in the end, because of my weighing up in-the-round evidence, I haven't directly put weight on it in terms of saying, well, zero is part of my range, or even zero is part of an average which I'm then assuming. I've sort of recognised that perhaps that's a little bit outside my a priori expectations.

Q. At paragraph 65, you recognise that switching is one way

in which pass-on could be taking effect, but your estimations are not capable of dealing with that, are they?
A. Yes, I think that's fair. I did make a number of observations on that regarding the fact that switching to IC++ is already captured in my analysis because it's assumed to be 100% and therefore full pass-on, and I made some observations about whether there's actually any evidence that switching does lead to an increase in pass-on rate compared to the already material amount of pass-on I observe in my -- in my report, and I don't find that there is any evidence to suggest that the pass-on associated with the switching is materially higher --
Q. The range -- we have been through switching so I am going to move on.
The range you produce is really very wide, is it not, 50% or 100%?
A. I think that's fair to say that it's a wide range and I have -- and this is, again, the range in relation to the small merchants, just to be clear, as opposed to increases or decreases. I think that range reflects that you've got some noise coming from the fact that you've got a relatively small number of estimates from different datasets from different acquirers, and I've

tried to identify what I consider to be the reliable estimates within the wider set and then take account of all of those in the round. 50 to 100, I thought, was a plausible range. I think there are some evidence points that I put somewhat more weight on which are in the 50 to 60 range, but again, to be somewhat conservative, I -- I felt a midpoint would be appropriate.

Q. Please could we look in your 14th report, paragraph 408. That is {RC-G1.3/2/127}.

The significance of increases versus decreases can be quite meaningful here on your -- in your expert opinion, can they not, because you conclude here that the evidence overall establishes that price increases are likely to be passed on, and that position has been further strengthened by the additional estimates you build into table 8.1 in Holt 14?

A. Yeah, I think that's a fair statement. I think, again, when you look into the detail, some of the evidence of increases relates to acquirer C, which I had in my report identified as being of less weight, and indeed highlighted a number of issues, which I could go into but they're set out in my report, as to why I say that some -- somewhat less weight should be put on that, and that if you would instead, you know, sort of filter by one of the filters that Dr Trento uses, which is the IC++ range, then one of those would fall out on that basis, because the IC++ rate I found for acquirer C was materially less than 90%.

So I think I have been quite conservative in how I've put that paragraph.

Q. Could we go to page {RC-G1.3/2/19} of this report, please.

A. Yeah.

Q. Paragraph 37.

You are now, as I understand it, accepting that evidence suggests acquirer pass-on happens relatively quickly, see the last sentence in that report; is that right?

A. Yes, I think, having looked at the evidence both from the PSR and the Trial 2B datasets, my view is that the pass-on, to the extent that it's happening, tends to happen relatively rapidly. I'd say often within a year and certainly not much more than that.

Q. Please can we then look at {RC-G1.3/2/34} in this report, paragraph 86. Here, you are talking about the potential tying impact of terminal equipment, POS terminals; can you see that?

A. Yes.

Q. Do you accept as a matter of fact that terminal contracts can be held with third-party suppliers, not just the acquirers?

A. I'm happy to accept that as a matter of fact, yeah.

Q. Do you accept as a matter of fact that leasing options for terminals are available on a monthly basis, monthly leasing?

A. That could be, yes.

Q. Have you looked at the terms and conditions offered by any of the acquirers for leasing equipment -- for terminal -- POS terminal equipment?

A. No.

Q. Right, I am going to move on to data issues. I am going to start, please, with the PSR data. Could we look at {RC-J4.4/21.2/15}. This is a section that starts "Data issues". Can you see this?

A. Yes.

Q. It identifies that:

"Acquirers told us they had difficulty providing data on scheme fees at the desired level of disaggregation."

So one of the potential issues is that scheme fees might not march in step with interchange fees; correct?

A. Yes.

Q. Page {RC-J4.4/21.2/17}, please.

There is then a section headed, "Consistency of acquirers' allocation of merchants to pricing options", and the PSR:

"... encountered ... discrepancies in how acquirers allocated merchants to the pricing options ..."

A. Yes.

Q. Including whether or not they are on -- which type of pricing they are on. Can you see that?

A. Yes.

Q. Page 18 {RC-J4.4/21.2/18} to 19 {RC-J4.4/21.2/19}, at the bottom of that page, we see there had been some outliers that had been stripped out?

A. Yes.

Q. Then they were re-included in the data at the request of one of the acquirers; correct?

A. Yes.

Q. Page {RC-J4.4/21.2/23}, paragraph 1.44, says:

"Figure 3 shows the evolution of average interchange fees incurred on capped credit card transactions by merchant groups."

Then, when we see the next figure {RC-J4.4/21.2/24}, what we see is that the average trend in MIF rates as a percentage of card turnover broadly followed the average rate; is that correct?

A. Do you mean, sorry, after the IFR cap was introduced, it falls to the cap?

Q. That, and also there is --
A. There's some --
Q. Within reason, there is a degree of homogeneity, between 0.9 and 1% before the rates -- before the cap was introduced?
A. Yes, so these are the interchange fees, yeah, sure.
Q. Then if we look, please, at figure 4, page {RC-J4.4/21.2/25}, and we see the "Monthly average interchange fees on capped debit cards, by merchant group[s]" broken out, we see, for example, that groups 4, 5, 6 and 7 all had average MIF rates that were substantially below the cap for debit card transactions; correct?
A. Yes. I would note that the scale is a bit different. So the range is about 0.2, whereas the range you mentioned before is about 0.1. So it is wider, but the scale is different, I would just observe.
Q. I think I am making a slightly more obvious point, if you do not mind me saying so, which is, for anyone on these transaction rates post the IFR, what is going to happen is an increase in MIF rates?
A. Yes. Yes, I'm -- yes, and indeed the PSR recognised that, in some of its evidence it put less weight on because for one of the groups, I think it was group 7, there was an average increase in the MIFs that that

group -- the merchants in that group faced, even though there was the IFR reduction. My understanding of the possible reason for that was that, for debit, consistent with this chart that counsel has just brought our attention to, that there may have been some differences across merchants depending on their average transaction value.

Q. So the whole event analysis for the IFR event is going to produce an increase in fees for group 7, probably group 6, and a decrease for groups 1 and 2, for example; correct?

A. Well, the IFR -- sorry, the PSR evidence does show that for group 7 there was an increase, but there was a decrease, I think, from memory, for everyone else. So, overall, it put less weight on the group 7 results for -- for that reason, but put weight on the other groups. I think it might have put less weight also on group 1, which is the -- the very smallest merchants.

Q. Page {RC-J4.4/21.2/33}, please, box 3. There is a section, three paragraphs down, that begins:

"The sample is therefore not representative of the transactions distributed across the sector as a whole."

Can you see that?

A. Yes.

Q. "The size distribution ... is skewed ..."
A. Yeah.
Q. We see that:
"The five largest merchants among the customers of the five largest acquirers accounted in 2018 for over £100 billion of transactions ... 14% of total transactions, and none of [those was] in [the] sample."
A. I see that. Again, this sort of points to a reason to put less weight on the group 7 results which already coincides with the reason given, that the IF-- sorry, MIF average for them increased.
Q. Page {RC-J4.4/21.2/38}, please. Bottom of the page, we see some adjustments giving rise to an estimate of 745 million for the amount of money extra that those larger merchants were having to -- that is the bill that they were facing, and it says:
"These sensitivity checks, together with the fact that we include no gains for debit card transactions, show that our main estimate may be conservative."
So it is clear, is it not, that the IFR did not include gains for debit card transactions when looking at the overall analysis.
A. Well, I think there are some comments here about IC++ and the PSR did carry out analysis of pass-on for IC++ and reached a view that there was complete pass-on.

Obviously, I have mainly focused on the standard contracts data, so I'm not sure what impact this has on that.

Q. Can we move on to the standard of the acquirer data in its various forms. I am going to take this very quickly. Acquirer A data, I think everyone recognises it is problematic; is that fair?

A. Yes.

Q. Acquirer B data, your annex 4 of Holt 13 obviously indicates that you could work with the acquirer B data because you have produced econometric analysis on the basis of it?

A. Yes, that's correct, I did put weight on it, but only two of the three events.

Q. Then for -- sorry, for another acquirer --

A. C. Sorry.

Q. I am not going to give the --

A. I have now done that. Sorry. Sorry.

Q. It is fair to say that another acquirer that we have looked at, you have been able to work satisfactorily with their data as well, although you have identified problems with it?

A. I think that's fair. I've -- I've identified particularly serious problems with the Brexit information for that acquirer. I have carried out analysis for the other two of the three events for that acquirer, but as counsel has suggested, I've raised a number of concerns about the data and also its representativeness.

Q. Now, can I move on to some issues of methodology. The first is data aggregation.

A. Yes.

Q. When we were discussing this issue in Trial 2A, I had understood that you thought generally, as a high level proposition, disaggregated data is better where it is available?

A. I think disaggregated data does have an important advantage in general, in that it allows potentially more focus on an over time variation. In the context of Trial 2A, that was my primary consideration. In Trial 2B, in contrast, too much disaggregation comes at a cost, which is essentially what I described in the hot tub as the consequences of the blending and the bundling of pricing by acquirers, and that's a further factor that needs to be taken into account.

Q. Can we look in your 13th report, please {RC-F1.4/6/121}, paragraph 319. You recognise here, do you not, that identifying and considering the affected groups of transactions is preferable, so far as possible, to avoid mix effects?

A. I think I refer back to my -- so, yes, I do identify that for a signal-to-noise ratio reason, particularly for events which might have a more targeted and smaller impact on a smaller subset of transactions, that would be a reason to focus the analysis on -- on those transactions. But, again, there's the trade off to consider in relation to the degree of blending and bundling. So I've tried to take into account all of those considerations in determining how I carry forward this analysis.
Q. If we look back, please, to paragraph 313 at {RC-F1.4/6/120}, you have nonetheless chosen to include aggregated and disaggregated models and place equal weight on each of them?
A. Yes, because I recognised that there were some trade-offs, there's a degree of uncertainty, and therefore, in my view, it was appropriate to test the sensitivity of the results to my specific approach to disaggregation, and, yes, I've put weight on both.
Q. Now, logs and levels. You would accept, would you not, that at Trial 2A, everyone conducted calculations using both logs and levels?
A. Yes.
Q. Normalisation?
A. I won't go into it, but I have dealt with that as to

why, in my view, logs have some issues in the Trial 2B context that don't apply in Trial 2A. I won't say any more than that.

Q. Normalisation.

A. Yes.

Q. You would accept that Dr Trento has carried out the same normalisation as everyone else for the acquirer data and it is only the general pass-on analysis where this becomes an issue?

A. It was a significant issue for the PSR data analysis that he carried out in Trento 3. My understanding is that he's essentially abandoned all of that now and relying on the acquirer disclosed data and I think you're right, he's then focused on --

Q. You do not like general pass-on analyses, do you, in this case, for this specific case?

A. I have identified a preference for event analysis over general analysis, that is fair. I have identified what are the trade-offs and the reasons for that, and within those trade-offs I have identified that there is a role for general analysis under essentially two conditions. One, there's enough disaggregated information to help control for the mix effects, and two, that there's a sufficient amount of focus on over time variation, such that the general approach will provide a materially useful estimate. Putting those two criteria together, it was actually Dr Trento's approach to the general model for acquirer B that I felt was a -- a useful contribution and I included an -- sorry, I included a variant of that in my Holt 14 findings.

Q. Ordinary least squares versus weighted least squares. You have chosen to proceed with weighted least squares; correct?

A. Yes, for the acquiring data, but I adopted the overall same approach as the PSR for the PSR data, which was ordinary least squares.

Q. In a nutshell, the difference between them is, on a weighted least square basis, you are assuming that some results are better than others?

A. I think I would put it slightly differently. The main -- the -- the weighted least squares approach puts more weight on transaction value as opposed to equal weight on all merchants, so that's specifically what it is doing. I've recognised that both OLS and weighted least squares can be appropriate, but there's one further condition, which is that you do need consistency in terms of the adoption of either of those two approaches with your assessment of the average MIF savings. If you have inconsistency, then I think that causes a bit of a problem. I have adopted the weighted MIF savings plus

WLS approach. Some other experts have adopted an OLS and a simple MIF savings approach. I haven't -- I haven't excluded any analysis on that -- on that basis.

Q. If Dr Trento had followed the weighted least squares method, his APO estimates would have been higher, would they not?

A. They may have been. I think you would need to ensure that you're also looking at, for consistency purposes, as I just said, updating the analysis to account for the weighting of the MIF savings. Again, I have adopted essentially a WLS approach and therefore I consider that, on that ground, my analysis is somewhat conservative and I don't think really a lot rides on that particular issue.

Q. Could we then move on to dealing with outliers. Can we look, please, in your 14th report, this is {RC-G1.3/2/102}. So paragraph 321 of your 14th report, and you say you:

"... do not object to the removal of transactions with MIF rates that are not in line with factual evidence ..."

Can you see that?

A. Sorry, which paragraph am I looking at?

Q. Paragraph 321, it is the first sentence.

A. Oh, I see, yes.
Q. Then you deal with Mr Coombs, who is not here to defend himself.
A. Yeah.
Q. Then Holt 13, please, 274, that is {RC-F1.4/6/108}. As I understand it, "due to limitations in the PSR Data", you focused on a period between 2014 and 2016; is that right?
A. Sorry, we've jumped back to the PSR analysis now. This is my --
Q. We have established that we do not need cleaning data, we are now looking at what you have done.
A. Right.
Q. So the PSR. With the PSR data, you restricted your analysis to 2014 to 2016, is that correct, and you dropped outliers?
A. Yeah, I think I adopted the approach that the PSR did there, yes.
Q. We see at footnote 253 on that page, which is all in blue so I am not going to read it out, what your approach was, which essentially followed the PSR's approach; is that right?
A. Yeah, so this is following the PSR's approach indeed in the PSR data, because this is my difference-in-difference analysis of the PSR data.

Q. You chose not to use datasets from sample 1 and sample 2 because there might be inconsistencies in the data collection or data approach to those two different samples?
A. I think that decision was in order to ensure that the difference-in-difference analysis was comparing things on a like-for-like basis.
Q. Have you, anywhere in your reports, explained the basis upon which you removed specific observations or what number of observations you removed?
A. I -- I don't think I included a detailed discussion of that in my report. I have identified that I followed the PSR approach. I have in my second report commented to some extent on the respective approaches to cleaning that I have adopted compared to Dr Trento. I've identified that some of the analysis, particularly of the Brexit event, seems to be particularly problematic for data-based reasons. So I think, you know, those are some of the comments I've made about the data cleaning.
Q. Mr Cook will no doubt take you to task on that shortly.
Can we then please look at time trends. Please could we look at your 13th report {RC-F1.4/6/91}, paragraph 231. What you say there is that:
"In circumstances where there is evidence that the variables of interest may be trending, incorporating

a control for a time ... can help mitigate this type of bias."

Do you see that?

A. Yes.

Q. If you do not have evidence that the variable of interest may be trending, you would not need to use one, would you?

A. I think -- I think that -- that is fair. Obviously, if there isn't any trending and you include a trend variable and it leads to a low estimate because there is no trend, it wouldn't necessarily have much impact at all in any event.

Q. Well, is it not at risk of capturing some of the variation from the variable of interest --

A. But that's a different issue. That would be that there is a trend, but then you need to investigate further what the precise source of the trend is.

PROFESSOR WATERSON: On time trend, and looking at your tables, I was puzzled, because there is a lot of coefficients which are 0.0000 and then they have asterisks which indicate that they are significantly different from zero.

A. Yes, yes, that is a very fair point. In fact, it's something I did raise myself when looking at those very same tables. The answer to the question is that because we're looking at a tractable table with two significant digits, you can still have a precise estimate of 0.004 and that can be material and have an impact, but still looks like 0.00 due to grounding.

PROFESSOR WATERSON: Yes, I assumed that was the case, yes, but I was just puzzled as to --

A. Yes, that's the answer.

MR BEAL: Can we look, please, in Dr Trento's fourth report, this is {RC-G1.1/2/50}, figure 10 -- I have given private a wrong reference here. Just give me one moment. (Pause).

A. I see figure 10 {RC-G1.1/2/47}.

Q. Thank you.

THE CHAIRMAN: Page 47.

MR BEAL: 47. Thank you very much.

Yes, the paper copy is three pages out and I have managed to add on the three pages.

We see there, do we not, some figures on the left-hand side for commercial debit Card Present transactions? Save for a peculiar blip, that does not, as such, show a time trend, does it?

A. I think the MSC does show a bit of a pre-event trend, yes.

Q. Then, similarly, on the right-hand side, I am going to suggest to you that that does not show a particular

trend, apart from a blip, either.
A. Yeah, I think -- I think the extent to which there is a trend in that context may -- might be -- might be somewhat limited. I would note that these are looking at based on Dr Trento's restriction of the analysis to the affected transaction that, in my analysis, I was looking at the impact of blending, so I was looking at the prospect of blending across CP and CNP together and indeed also across Mastercard and Visa. So because we're looking at different datasets, it's possible that I identify a trend even if in his approach he does not.
Q. On the right-hand side, post the event, one sees, does one not, essentially a two-step change in the MSCs?
A. It seems like there's a two-step change for the -- yes, it does seem like that, yeah.
Q. So adding a time trend in this case would reduce the pass-on estimate, would it not, because it would attribute the second step to the trend rather than to the delayed effect of the MIF increase?
A. I think that -- that could -- could be part of it, but, again, to the extent that there's a trend in the prior period, that I think is something that you would want to look at. Again, I also think it's important to look at the inclusion of other transactions that could be part of blending, and so you might get a different analysis,

and if you essentially restrict the analysis to these, you might overlook some important information.

Q. I am going to now turn to essentially your table 7.1 analysis. As a general point, you have given each of your estimates equal weighting to derive a simple average of estimates or an average of the events; is that right?

A. Not quite. It's true that I have presented a simple average and I've done two versions: one is by individual estimate and secondly by event. So, for example, the PSR/IFR would be one event, whereas there might be more than one estimate for it, so that's the distinction. So those averages are shown, but the rate I've adopted is not strictly based on those averages, those averages are actually lower than the midpoint of the range I've put forward.

Q. Could we look, for example, at table 8.1 in your 14th report. That is {RC-G1.3/2/126}.

A. Yeah.

Q. Now, the top half of this table essentially replicates table 7.1; is that right?

A. Yes.

Q. Then the bottom half gives some additional results?

A. Yes.

Q. Are you aware that presenting these estimates in this way with a simple average of estimates or a simple average of events in fact gives a misleading impression of your overall position?

A. Well, I don't think it does, because these are the events and studies, or estimates that I've put some weight on. There are two qualifiers to that. One, I don't actually put equal weight on all of them and I've already referred to the ones that I put less weight on.

Q. Well, where do we find your analysis of which ones cut the mustard and which ones do not?

A. It's my in-the-round conclusion that I draw from this table. So that's the --

Q. So you do not -- you do not apply some sort of weighting to the estimates in order to determine their reliability?

A. No, I've done that in a more qualitative way. So I've (a) identified a range, the 50 to 100, and implicitly that puts less weight on -- on observations outside of that, and (b) I have given a number of reasons why I put somewhat less weight on two or three of the estimates, mostly based on data --

Q. The impression --

A. -- reasons.

Q. -- one might draw from this table, bottom right-hand

corner, always look at the bottom line, is that you support an economy-wide pass-on rate of 66% and that is simply not right, is it?
A. Well, I think I've been very clear that I don't immediately adopt the average of these estimates or indeed the average of the events as my value. I think I've been pretty clear that I've said my view is that there is some range of estimates, I've applied my a priori perspectives on the nature of the MIF changes to provide some degree of weighting to that, and based on that I find 50 to 100 is plausible and reasonable for smaller merchants and complete pass-on is reasonable for larger merchants.
Q. So Mastercard was simply wrong, was it, at paragraph 56 of its skeleton {RC-A1/3/15}, to suggest that you had derived an economy-wide pass-on rate of 66% and to essentially back that as a proposition for what this Tribunal should find?
A. Well, I think they're not wrong to say that the simple average of events of the economy-wide estimates is the 66%, so I think that is factually accurate. I think I have then -- I think largely conservatively -- adopted a somewhat higher value reflecting --
Q. Well, are you standing by the 94% figure or not?
A. No, I'm not talking about the 94%, because that sort of

then conflates the issue with the IC++ share. It's in the --

Q. So the economy-wide figure you are giving here, does not include the IC++ result?

A. No.

Q. You did not make that clear here either, did you?

A. I'd have to --

Q. (Overspeaking - inaudible).

A. -- I think it's pretty clear that --

THE CHAIRMAN: Well, the heading --

A. Yes. No, the heading says "Standard Contracts" --

THE CHAIRMAN: -- says "Standard Contracts".

MR BEAL: Sorry, sorry. I will not take a bad point.

A. I was a second behind, but I did spot that as well.

Q. So it's economy-wide for standard contracts once one has stripped out the IC+ contracts, that is what you are saying?

A. Well, it's not stripping them out. The whole focus of this entire trial really has been the standard contracts.

Q. Could we then look at the -- go back to table 7.1 {RC-G1.3/2/120}, which, as I understand it, you say nothing with the additional estimates has caused you to change your perception of where your figures come out, is that right? So 7.1 still reflects what you say

the analysis should be?
A. Well, I've updated my results table in my -- in my second report, or Holt 14, to take into account some further relevant evidence, and then I've --
Q. But you say in terms that nothing in the additional estimates has caused you to change your opinion as to the estimates?
A. Yeah, in a sense actually it's almost the opposite. It's actually caused me to reinforce the reasonableness and conservativeness of my opinion compared to what I had already done in Holt 13.
Q. So if anyone wants to know where you stand on anything and the reasons why you have come to the conclusions you have, table 7.1 provides the -- an appropriate basis to do that?
A. I think it's the appropriate starting point. I think, as -- as is the case for all the experts, we engaged in a, I would hope, constructive analysis of what each other had done, in some cases putting weight on what each other had done and in other cases not. So what I have done is sought to do that in a pretty comprehensive way in relation to what other estimates and approaches have been and I've incorporated that in my analysis, and in the end, I think it's fair to say I have not actually then as a result had to change my

overall range, but, if anything, it sort of further reinforced that the range was reasonable and conservative.

Q. The first three entries we see on table 7.1 range from 17%, which I think you would accept is an implausibly low figure?

A. Well, it's lower than my expectation, I think that's fair. It's actually above what the PSR itself seemed to find in terms of its conclusion that the IFR did not seem to lead to any observable pass-on for small merchants. I've, in a sense, looked afresh and in more detail at what the PSR had done and provided my own view as to improvements as to how you could look at it and found some higher results. 17% is I think a reasonable estimate, which is why I've put it forward in the table based on the data, but I have not actually, you know, overly weighted it in terms of my actual range or average.

Q. 0%, you would accept, would you not, is not a plausible result?

A. I think that's, again, fair, and one of the reasons why I have applied my range is to recognise that I did have some a priori perspectives and that things that somewhat conflicted with that, whatever the -- you know, the merits of the individual analysis, there could be some noise in there and therefore I did ultimately put less weight on that.

Q. If we remove the 0% result, then the average of estimates increases from 64% to 73% and the average of events jumps from 59% to 78%?

A. Perhaps. Again, I wouldn't suggest that that would be the reasonable approach that I would take. If you're starting to make individual judgments, then you would want to do that in the round across all of them, not start selecting individual results one at a time.

PROFESSOR WATERSON: So just to understand this about the 0%. That is on a smaller basis.

A. Yes.

PROFESSOR WATERSON: Is that the reason why you get a difference between the simple average of the estimates or the simple average of events, or is it something else?

A. So I think you're -- yes, so I think the reason -- the reason is that some events have more than one estimate. I think it's fair to say that that is actually -- I think, Professor Waterson, you are correct to say that the fact that I only have one estimate of that event, whereas I have more than one estimate of one or two of the other events, means that the average of events, including the zero being weighted as one event, does bring it down somewhat. But again --

PROFESSOR WATERSON: My point was a rather different one --

A. Oh.

PROFESSOR WATERSON: -- that that event presumably has far fewer observations in it than the other events?

A. I think that's fair -- well, sorry, I'm not -- yes, because it -- so that event was a difference-in-difference analysis of a relatively -- a change that was material but for a small amount of transactions.

PROFESSOR WATERSON: Yes.

A. Obviously, the number of observations can still be high, because if all merchants are included, there's still one merchant per observation. There are somewhat fewer observations because in a difference-in-difference analysis, of course, you have a treatment and a control group.

PROFESSOR WATERSON: Yes.

A. So you're not using all the merchants, you're using sort of two extremes, so that's one reason why there's fewer observations. But I wouldn't say that a reason to put less weight on that evidence is because it has few observations. You might say that it's a -- it's a fairly -- it's an event that applies to a relatively small set of transactions and that might be something that you might comment on. Of course, that's also the case, maybe to a somewhat lesser extent, for some of the Trial 2B events as well. And then, secondly, of course, I did acknowledge that there was a bit of noisiness in that particular estimate. It was consistent with no pass-on. Indeed, you know -- but there was a potentially wide range of uncertainty around it.

PROFESSOR WATERSON: Thank you.

MR BEAL: Could we then please look at page 136 in this report {RC-F1.4/6/136}, this 13th report, paragraph 346. At the top of the page there, about seven lines down, you recognise that:

"The averages shown in the last rows of the table are calculated as simple averages across all available estimates or events. As these are not weighted based on representativeness ... and do not account for potential differences in the level of precision ... I do not propose to use these as my central estimates."

You see that?

A. Yeah.

Q. So the weighting exercise that you have conducted is opaque, is it not? We do not know on what basis you have conducted the weighting evidence based on representativeness?

A. I don't think it's opaque. I think what I've said is that I've got some estimates I've carried forward, I have identified some limitations to some of them and therefore they don't all merit equal weight, arguably that applies to the ones that are below 50% and the ones that apply above 50% -- sorry, above 100% rather. There are some very specific points that I've acknowledged that coincide with some of the high estimates, which I've called out, and as a result of all that in the round, that's where I derive my 50 to 100%. It's not like I've said here's estimate 1, I apply a 62-point whatever percent weighting to that. I've not gone down that route. I've just said look at all the evidence in the round, recognise what a priori expectations might indicate, and then that provides some boundaries to the overall approach.

Q. You did not include -- I mean, assume, for the sake of argument, that you are with me that the 0% figure is implausible. You have not included in this table the results for increases which you do not think are reliably estimated either, as in, you have included a 0% figure, but you have not included the ones that go the other way, have you?

A. I'm not sure I understand that. I have included in the table some results that I put less weight on and which are filtered out of my range. So there's a couple of estimates above 100% that I filter out of my range, but they are in the simple average of estimates and the simple average of events. So I haven't done an estimate where I say, let's look at the average of averages, now let's strip out ones I put less weight on on the upper end and get a new value, or alternatively do that for removing the low value. I don't really see any purpose in doing that. The -- I've already in the round done that by looking at what is a reasonable range based on all of this evidence.

Q. Now, in terms of price increases, just looking back at the bottom of table 7.1, if you strip out the 0% figure, you end up with figures of -- I had better not say those. You end up with figures that are above 100%; correct? {RC-F1.4/6/135}. Bottom of --

A. Yes, so -- yes, and I've already explained that the two that are above 100 each have a specific issue -- yes, each have a specific issue. In one case, it's that the result for 0 to 50 is entirely driven by a value of 200%, and in the other case, there's a number of data issues as well as an IC++ result that is materially below 90, and so I've already identified that I've put somewhat less weight on those.

Q. At the bottom of that page, you say:

"... the evidence suggests that pass-on of MIF increases may have been complete for merchants of all sizes with the exception of ..."

You then identify essentially the 0% figure as --

A. Yeah.

Q. -- the first one; correct?

A. I think that's just a literal commentary on the results individually. So, yes, that sort of line simply takes the two cases that you just referred to and which I commented on as, if those are the estimates, then, you know, this is just a factual statement of the table.

Q. Last question before the break for the transcriber. When we come to look at MIF decreases in this table, you've got a range of figures; correct? But if one -- I am limited to what I can say. But if one sums up the various different figures for decreases, you end up, in a sense, within the 50 to 100% range, but you do not end up with 75%, so there must be a sense in which you have given less weight to the percentages at the lower end of that range; correct?

A. I think that is fair. That's consistent with what I've described, that the range and the point estimate within that range I've adopted are actually higher than the result of taking the average of all these estimates, so I think that's consistent with that point.

MR BEAL: That is probably a convenient moment.

THE CHAIRMAN: All right.

Ten-minute break.

A. Sure.

(3.16 pm)

(A short break)

(3.27 pm)

THE CHAIRMAN: How are we doing for time? We are okay?

MR BEAL: Yes. Please could we go into closed, because I think that will make life easier for me and the witness.

THE CHAIRMAN: Okay. Yes, can we do that.

(In private)

(4.48 pm)

(The hearing adjourned until 10.30 am on Thursday, 27 March 2025)