COMPETITION APPEAL TRIBUNAL

NOTICE OF APPEAL UNDER SECTION 46 OF THE COMPETITION ACT 1998
CASE NO 1054/1/1/05

Pursuant to rule 15 of the Competition Appeal Tribunal Rules 2003 ("the Rules"), the Registrar gives notice of the receipt of an appeal, lodged on 2 November 2005, under section 46 of the Competition Act 1998 ("the Act") by MasterCard UK Members Forum Limited ("MMF"; "the appellant") of 47-53 Cannon Street, London, EC4M 5SH, against a decision (CA98/5/05)[1] taken by the Office of Fair Trading ("the OFT") on 6 September 2005 ("the decision").

The decision relates to the arrangements for setting the multilateral interchange fees ("MIF") which are payable between acquiring and issuing banks on UK domestic MasterCard credit and charge card transactions in the absence of any bilateral agreements between the banks. The arrangements are referred to as the "MMF MIF" and were set out in the UK Domestic Rules of the MMF. The relevant rules together comprised the "MMF MIF Agreement". The MMF MIF Agreement is no longer in force. The decision concerns the MMF MIF Agreement that was in force from 1 March 2000 until 18 November 2004, when new arrangements for setting the MMF MIF were introduced.

In the decision the OFT concluded that the MMF MIF Agreement restricted competition within the meaning of Article 81(1) of the EC Treaty and section 2 of the Act (referred to collectively as "Article 81(1)"), and did not meet the exemption conditions set out in Article 81(3) of the EC Treaty and section 9 of the Act (referred to collectively as "Article 81(3)").

MMF appeals against that decision on grounds that are set out in the following terms:

1. the decision is based upon an incorrect application of Article 81(1). The test laid down by the Court of Justice is that the existence of a restriction, distortion or prevention of competition is to be determined by reference to the actual context in which it would occur in the absence of the agreement in dispute. To determine whether the MMF MIF Agreement has a restrictive effect, the OFT is required to determine how the market would operate in the absence of that Agreement. It failed to carry out such an inquiry properly or at all.

2. the OFT acknowledges that the application of Article 81(1) rests upon an assessment of the counterfactual but errs in determining what the counterfactual is and in its assessment of that counterfactual. According to well established case law, a counterfactual which is either "difficult" or "impossible" must be discounted in any analysis; yet the counterfactual the OFT defines is impossible in any real sense or, at the very least, difficult. The OFT relies heavily on the assumption that Australian and Swedish comparators establish, in relation to the MasterCard scheme, both the viability of bilateral negotiations and their efficacy in terms of improved competition. However, the decision does not contain a proper analysis of those systems.

3. the OFT's conclusions that absent a fallback MIF, bilateral negotiations with arbitration as the only fallback would lead to a different, more competitive result, and that the interpolation of a fallback MIF severely restricts the incentive to engage in bilateral

[1] The text of the decision can be found at: http://www.oft.gov.uk/NR/rdonlyres/E0CDB5F8-3ECC-462A-9D73-FDEC47ACEDA2/0/mastercard.pdf.

negotiation, are based on assumptions. Nowhere in the decision has the OFT sought to examine how the situation might differ in practice if arbitration were used, or whether the use of arbitration as a fallback would be practical. The OFT relies simply on a theoretical counterfactual that would be difficult or impossible to achieve. In practice, arbitration as the exclusive fallback would be significantly more costly, slower and more uncertain than a fallback MIF. The OFT has therefore misapplied the relevant law.

4. whilst the OFT acknowledges that the MMF MIF and the "honour all cards" ("HAC") rule are integrally connected, it has failed to conduct any detailed analysis of the HAC rule. This is a material error in the assessment of the MMF MIF under Article 81(1), since when viewed in the context of a counterfactual which includes the HAC rule, the OFT is bound to conclude that the MMF MIF is in fact pro-competitive.

5. the OFT has erred in finding that there are three relevant markets – a "wholesale market", and "acquiring market" and an "issuing market". There is a broader product market which encompasses all card-based payment systems and, in addition, other payment mechanisms.

6. the OFT failed to establish that in the counterfactual any difference in the level of the interchange fee would exert any material impact on competition. Article 81 is engaged only if, when a properly defined counterfactual is examined, the OFT is able to establish with cogent evidence that any difference in the fee level would be manifest in terms of conduct and behaviour which the OFT describes as relevant to competition. This requires an assessment of the actual difference between the fees charged under the MMF MIF and those in the counterfactual. Once that difference has been assessed, it is further necessary then to link that difference to activity in the relevant market which is said to characterise competition. The OFT failed to conduct either of those two steps and thereby erred in the application of Article 81(1).

7. an alleged restriction engages Article 81(1) only if it exerts an appreciable effect on competition. The OFT applied the wrong test in law to establish appreciability. Had it applied the correct test it would have concluded that the alleged restriction exerted no or no material impact on competition at any relevant point in the four-party card scheme.

8. the OFT distinguishes between services it considers to be "integral" to the scheme's operation as a viable payment transmission mechanism and other, additional, services which it considers are not integral. According to the OFT, only the costs of providing payment transmission services should be recovered through a MIF. The OFT has erred in finding that the recovery of "extraneous" costs through the MIF represents a restriction of competition under Article 81(1):

   (a) the analysis of the effect of the extraneous costs restriction turns upon an assumption made by the OFT that the actual difference between the MMF MIF and a MIF stripped of extraneous costs is substantial. The decision does not set out the basis for this assumption;

   (b) the distinction between payment and transmission services (which are integral) and other services such as the provision of interest-free credit and the guarantee against cardholder default (said to be extraneous) is central to the decision. However, the distinction is a false one: there is no precedent or principle of law which permits an agreement such as that in issue to be prohibited upon the basis that an interchange fee is charged by issuer to acquirer which is predicated, even in part, upon the so-called extraneous costs;

(c) the OFT fails to provide a proper definition of what is meant by an "integral" service and fails to apply any sensible notion of the term to the facts in issue;

(d) in relation to both the acquiring and issuing markets, the OFT's finding of a restriction of competition arising out of the alleged extraneous costs is flawed because the OFT's basic case rests upon alleged restrictions in an "inter-system" market which it says does not exist;

(e) the OFT wrongly asserts that whether a merchant benefits from extraneous costs services is irrelevant. Whether a merchant and hence an acquirer benefits is manifestly a relevant consideration to take into account. There are two relevant benefits to consider: that of interest-free credit; and that of the payment guarantee against cardholder default. Merchants benefit from both.

(f) The decision fails to meet the burden of proof in showing any impact in the issuing or acquiring market.

9. without prejudice to the appellant's case with regard to Article 81(1), the OFT misapplied Article 81(3). Costs over and above payment transmission costs are in fact beneficial to merchants. Indeed, the decision acknowledges that merchants individually benefit from the alleged "extraneous" costs. The reasoning in the decision is false: the OFT refers to no evidence of its own on merchant disbenefit; and it misconstrues Article 81(3) by requiring the parties to demonstrate an unequivocal and quantifiable benefit to the UK economy as a whole before exemption can be granted.

10. as to the first condition of Article 81(3), the OFT has erred in concluding that certain qualities of the product and associated costs are indeed extraneous. It has also erred in concluding that a MIF including such costs does not meet the first exemption condition.

11. as to the third condition of Article 81(3), the OFT relies on an almost exclusively theoretical basis for rejecting the contention that a MIF can include so-called extraneous costs. This is an error because the test is not theoretical but, rather, based on reasonableness. Applying a test of reasonableness, the so-called extraneous costs satisfy the third exemption condition.

12. as to the second condition of Article 81(3), the OFT, having accepted that it has to weigh up the negative and positive effects on consumers, errs by:

    (a) considering not only users of the MasterCard scheme (i.e. cardholders and merchants), but <u>all</u> consumers who make purchases from merchants who accept cards. There is no requirement that every consumer must benefit;

    (b) by failing to examine under Article 81(1) whether bilateral negotiation would lead to better or worse results than multilaterally set interchange fees;

    (c) by failing to recognise that, consistent with its own logic, any effect of the MMF MIF Agreement upon consumers would be so marginal, or *de minimis*, as to be irrelevant;

    (d) by failing to quantify the benefits that merchants individually derive from credit cards and wrongly assuming that aggregate benefit has to be established.

The appellant seeks an order:

(a) setting aside the decision;

(b) for such further or other relief as is appropriate;

(c) for costs.

Any person who considers that he has sufficient interest in the outcome of the proceedings may make a request for permission to intervene in the proceedings, in accordance with rule 16 of the Rules.

A request for permission to intervene should be sent to the Registrar, The Competition Appeal Tribunal, Victoria House, Bloomsbury Place, London WC1A 2EB, so that it is received within **three weeks** of the publication of this notice.

Further details concerning the procedures of the Competition Appeal Tribunal can be found on its website at www.catribunal.org.uk. Alternatively, the Tribunal Registry can be contacted by post at the above address or by telephone (020 7979 7979) or fax (020 7979 7978). Please quote the case number mentioned above in all communications.

Charles Dhanowa
Registrar
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