[2006] CAT 10

IN THE COMPETITION APPEAL TRIBUNAL

Case: 1054/1/1/05
1055/1/1/05
1056/1/1/05

Before:
Sir Christopher Bellamy (President)
Dr Arthur Prior CB
Mr David Summers

MASTERCARD UK MEMBERS FORUM LIMITED

-and-

MASTERCARD INTERNATIONAL INCORPORATED AND MASTERCARD EUROPE SPRL

-and-

ROYAL BANK OF SCOTLAND GROUP

Appellants

-supported by-

VISA (EUROPE) LIMITED AND VISA (UK) LIMITED

Interveners

-and-

OFFICE OF FAIR TRADING

Respondent

-supported by-

THE BRITISH RETAIL CONSORTIUM

Intervener

ORDER

1. On 6 September 2005 the OFT adopted Decision No. CA98/05/05 *Investigation of the multilateral interchange fees provided for in the UK Domestic Rules of MasterCard UK Members Forum Ltd* ("the Decision"). In the Decision the OFT found that the arrangements contained in the UK Domestic Rules of the MasterCard UK Members Forum Limited ("MMF") for setting the fallback multilateral interchange fee ("the MMF MIF") which applied to UK domestic MasterCard transactions between 1 March 2000 and 18 November 2004 restricted competition within the meaning of both Article 81 (1) of the EC Treaty and the Chapter I prohibition imposed by Section 2 of the Competition Act 1998 (the Act), and furthermore did not meet the exemption conditions set out in Article 81(3) of the Treaty or section 9 of the Act.

2. The UK Domestic Rules of the MMF which are subject to the Decision were notified to the OFT on 1 March 2000. The Decision was adopted following an administrative procedure lasting some 5 ½ years including the issue by the OFT of what were, in effect, three statements of objections in September 2001, February 2003 and November 2004.

3. According to the introductory paragraphs of the Decision, MasterCard and Visa are the principal credit and charge card schemes operating in the UK. MasterCard and Visa are member associations made up of banks that are licensed to issue and/or acquire their respective branded cards, and have a significant number of members in common. The Decision states that MasterCard and Visa operate "four party payment card systems". The four parties referred to are the cardholder purchasing the goods or services in question; the bank that issues the card (the "issuer"); the merchant who provides the goods or services to the cardholders; and the bank that deals with the merchant (the "acquirer"). Issuers are responsible notably for recruiting cardholders and making payment to acquirers in respect of goods or services purchased by the cardholder. Acquirers are responsible notably for recruiting merchants, for forwarding transaction details to issuers, and for making payment to the merchant for the goods or services in question. A number of banks are both issuers and acquirers.

4. Merchants pay acquirers a merchant service charge (MSC) on each MasterCard transaction with a cardholder. When the transaction details are presented to the acquirer by the merchant, the acquirer reimburses the merchant for the value of the transaction less the MSC. The acquirer then forwards the transaction details to the issuer. Under the UK Domestic Rules of the MMF, the issuer then reimburses the acquirer for the value of the transaction less an "interchange" fee, the MMF MIF. The MMF MIF is thus an interchange fee paid by acquirers to issuers. Having reimbursed the acquirer less the MMF MIF, the issuer then debits the retail price to the cardholder's account, and seeks payment from the cardholder. Under the UK Domestic Rules the MMF MIF was at the material time collectively agreed by the members of the MMF, who include all the principal United Kingdom banks.

5. The Decision finds, at paragraphs 137 to 345, that there are three relevant markets to be considered for the purpose of applying Article 81 or the Chapter I prohibition:

> "• the market for the provision of card transaction services between issuers and acquirers for purchases made by way of MasterCard branded consumer credit and charge cards in the UK;
>
> • the market for the provision of merchant acquiring services by acquirers to merchants for purchases made by way of MasterCard branded consumer credit and charge cards in the UK; and
>
> • the market for the provision of branded credit and charge card issuing services by issuers to cardholders in the UK."

6. The Decision further finds that the UK Domestic Rules give rise to two restrictions of competition, namely "the collective price restriction" (paragraphs 388 to 674) and "the extraneous costs restriction" (paragraphs 675 to 742). The OFT's analysis is summarised at pages 10 and 11 of the Decision in these terms:

> "<u>Collective price restriction (Paragraphs 388-674)</u>
>
> x. The collective price restriction arises because the MMF MIF agreement involves collective agreement on the amount of the MMF MIF which applied to almost all domestic transactions until 18 November 2004.
>
> xi. The MMF MIF reduces incentives for the Parties to seek benefit from efficiencies and determine pricing policy individually by entering bilateral agreements in which the amount of the applicable interchange fee differs from the MMF MIF.

xii. In addition, the MMF MIF operates as a significant and common price floor for Merchant Service Charges ('MSCs') charged by acquirers to merchants, and has a direct effect on MSCs paid by merchants to acquirers. Therefore, the existence of the MMF MIF restricts the scope for intra-scheme competition between acquirers on the amount of MSCs paid by merchants.

xiii. The OFT considers that there are benefits flowing from the existence of the MMF MIF which satisfy the first exemption condition and which would not be available if issuers and acquirers were required to enter into bilateral agreements setting interchange fees (see paragraphs 520-532). However, the recovery of extraneous costs (i .e. costs of services which are not necessary for the operation of the MasterCard scheme as a payment transmission mechanism – see paragraph 526) through the MMF MIF means that the collective price restriction is not indispensable to the attainment of the benefits created by the MMF MIF agreement (see paragraphs 533-587) . Accordingly, the MMF MIF agreement does not meet the criteria for exemption in Article 81(3) or section 9 of the CA98.

<u>Extraneous costs restriction (Paragraphs 675-742)</u>

xiv. The extraneous costs restriction arises because extraneous costs are recovered through the MMF MIF, which as a result exceeds payment transmission costs incurred by issuers.

xv. The recovery of extraneous costs through the MMF MIF results in acquirers paying an unduly high interchange fee. This higher interchange fee is reflected in higher MSCs through which the cost of the MMF MIF is passed on and recovered from merchants directly, and from consumers indirectly where merchants increase retail prices to recover the costs of MSCs.

xvi. As an increase in costs faced by all acquirers, a higher MMF MIF influences both the ability and willingness of acquirers to compete on the amount of MSCs charged to merchants.

xvii. Competition between issuers is distorted by the passing on of extraneous costs because, when these costs are recovered via the MMF MIF, they provide a large flow of revenue to issuers, and incentives for issuers to induce consumers to hold and use cards (e.g. through loyalty schemes, advertising and funding the provision of an interest-free period). The resulting cardholder inducements make the MasterCard scheme more attractive as a payment method (for cardholders and

prospective cardholders) relative to alternatives such as debit cards, cheques or cash.

xvii. As well as distorting competition between payment schemes, the recovery of extraneous costs through the MMF MIF also distorts competition between issuers within the MasterCard scheme.

xix. It has not been demonstrated that there are benefits from the recovery of extraneous costs through the MMF MIF that represent appreciable objective advantages of such a character as to outweigh the disadvantages to competition. Accordingly, the MMF MIF agreement does not meet the criteria for exemption in Article 81(3) or section 9 of the CA98."

7. The Tribunal received three appeals against the Decision lodged by the MMF on 2 November 2005, by MasterCard International Incorporated ("MCI") and MasterCard Europe SPRL ("MCE") on 4 November 2005, and by the Royal Bank of Scotland Limited ("RSBG") on 7 November 2005. MCI is a Delaware corporation and the main operating subsidiary of the MasterCard group of companies. MCI owns the MasterCard trademarks and licenses them to financial institutions worldwide in accordance with rules, standards, and procedures established and administered by MCI. MCE is a subsidiary of MCI and apparently processes UK domestic transactions. RSBG is one of the principal issuers of MasterCard credit cards in the United Kingdom and a member of the MMF.

8. On 31 January 2006 a statement of intervention was lodged by Visa Europe Limited and Visa UK Limited, pursuant to the Tribunal's Order of 9 December 2005.

9. By letter of 9 February 2006 the European Commission informed the Tribunal, in reply to the Tribunal's letter of 24 January 2006, that it did not wish at this stage to submit observations pursuant to Article 15 of Regulation (EC) 1/2003. The European Commission has previously taken a decision granting exemption under Article 81(3) in respect of the multilateral interchange fee in respect of international (as distinct from domestic) transactions under the Visa system: see *Visa International – Multilateral Interchange Fee* OJ 2002 L318/17.

10. The OFT's Defence was lodged on 28 February 2006. On 7 March 2006 a statement of intervention was lodged by the British Retail Consortium, also pursuant to the Tribunal's Order of 9 December 2005.

11. The Tribunal subsequently invited the parties to agree a list of issues for consideration at a case management conference (CMC) to be held on 31 March 2006. Agreement having proved impossible, the OFT served its list of issues on 26 March 2006, and the appellants and Visa served a separate list of issues on 27 March 2006.

12. At the CMC on 31 March 2006 the appellants and Visa submitted that there were material divergences between the OFT's Defence and the Decision. It was submitted, notably, that the OFT had (i) advanced a wholly new "counterfactual" against which the existence or otherwise of a "restriction of competition" was to be judged, namely that the MasterCard scheme could viably operate without an interchange fee, with issuers and acquirers honouring transactions "at par", this counterfactual being apparently based on the OFT's new expert report submitted by Professor Carlton of the University of Chicago, and Dr. Alan Frankel, both of whom are employed by the international consultancy firm Lexecon; (ii) effectively abandoned the "counterfactual" in the Decision, namely that in the absence of the collective price restriction, issuers and acquirers would enter into bilateral agreements, with arbitration as a fallback; (iii) effectively abandoned the contention that the transactions between acquirers and issuers constituted a wholesale "market", and, by implication, was a restriction of competition in that "market" as set out in the Decision; (iv) advanced a changed analysis of the nature and effect of the extraneous costs restriction, including allegedly distorting effects on "inter-system" competition; (v) resiled from the position taken in the Decision that a MIF at a reduced level would be capable of satisfying the provisions of Article 81(3) or section 9 of the 1998 Act, in effect taking no position at all on the application of Article 81(3) or section 9; and (vi) indicated that the benchmark for any assessment of the reasonableness of costs imposed on merchants would be the transaction costs payable under the Maestro debit card.

13. It was accepted by the OFT during the CMC conference of 31 March 2006 that, in the Defence, the conclusion that the arrangements for setting the MMF MIF infringed Article 81(1)/section 2, and did not satisfy Article 81(3)/section 9, had been reached by

a different route from that in the Decision, and that the route taken in the Defence was in substitution for the route taken in the Decision. However, when pressed further, leading counsel for the OFT stated "for various reasons I am not a position to say to you absolutely unqualified – and this can be another complication – that what is said in the Defence is wholly in substitution for what is in the new Decision" (transcript, pp. 29-30).

14. During the CMC of 31 March 2006 the parties also made submissions as to what procedural course the Tribunal should now follow, in the light of the above developments, having regard notably to the Tribunal's case law on the circumstances in which it is or is not open to the OFT to advance a new case or introduce new evidence in support of a Decision already adopted: see e.g. *Argos and Littlewoods v. Director General of Fair Trading* [2003] CAT 16. The position of the parties, in broad terms, was that MMF and RSBG did not wish the matter to be remitted to the OFT but considered that the appeal could proceed on the basis of "more a judicial review type of appeal", although no point would be taken on the basis that those appellants had not had a proper opportunity to address the Defence. MCI/MCE wished the appeal to continue, without qualification. The OFT expressed the view that it would favour proceeding with the appeal provided that the basis of any appeal "can be sufficiently clearly defined", but reserved its position until the parties' Replies to the Defence were available. Visa considered that given the changes in the Defence as compared with the Decision, the matter should be remitted to the OFT for the administrative procedure to resume. According to Visa, a statement of objections was also pending against Visa and that, if the matter went ahead, Visa might find that its case had been pre-empted without Visa having had the benefit of any administrative procedure at all.

15. In the course of the CMC of 31 March, counsel for the appellants MCI/MCE and Visa requested the Tribunal to require the OFT to indicate, paragraph by paragraph, those elements of the Decision upon which reliance was no longer placed (MCE/MCI) or what in the Decision was still pursued and was not (Visa).

16. The Tribunal stated that its understanding was that the OFT would, within 14 days, indicate to the appellants and the interveners any paragraphs of the Decision that are either no longer relied on, or relied on in only a qualified way, indicating what the

qualification is. The OFT having intimated possible difficulties, the Tribunal refrained from making an order on the basis that the OFT would use its best endeavours to produce within 14 days the clarification that the appellants and Visa sought (transcript, pp. 52-53).

17. Following that CMC, the Tribunal ordered that Replies by the parties to the Defence should be served by 26 May 2006, and that a further case management conference should be fixed for 19 and 20 June 2006. The Tribunal anticipates that on that latter occasion it will need to determine whether, in the events that have happened, the Decision should be remitted to the OFT, or that these proceedings should continue, and if so, to what extent or on what issues.

18. Further to the parties' request that the OFT clarify the paragraphs in the Decision that by virtue of the Defence are no longer relied on or qualified, further correspondence took place between the parties, notably the OFT's letter of 19 April 2006, MCI/MCE's letters of 19 and 20 April 2006 expressing reservations about the OFT's letter of 19 April, and OFT's response of 20 April 2006.

19. That correspondence was then followed by a further request for clarification by Visa dated 27 April 2006, by which Visa seeks an order of the Tribunal in the following terms:

> "(1) the OFT provide to the appellants, the Interveners and the Tribunal by 3 May 2006 by way of schedule an ordered list identifying:
>
> (a) each paragraph of the Decision upon which the OFT no longer places any reliance;
>
> (b) each paragraph of the Decision upon which the OFT continues to place qualified reliance, and in respect of each such paragraph stating precisely the manner in which the statements in the paragraph are now qualified;
>
> (c) express confirmation that, apart from the paragraphs identified in (a) and (b) above, the OFT places reliance upon the contents and conclusions contained in all remaining paragraphs of the Decision;
>
> (2) the OFT provide to the Appellants the Interveners and the Tribunal by 3 May 2006 a response to the following

request for clarification and/or further and better particulars of its Defence:

1. *In relation to the OFT's case as regards the collective price restrictions and the alleged "counterfactual" to that restriction, now set out at paragraphs 14, 15 and 108 of the Defence:*

   (a) *Please confirm that the OFT accepts (or does not contest) the Appellants' case, made in the Notices of Appeal, that bilateral agreements are impracticable?*

   (b) *Please confirm that the OFT itself is not advancing, and will not advance, any positive case in the Defence or otherwise in these proceedings that bilateral agreements are likely or viable or practical .*

   (c) *If the OFT does not give the confirmation sought in either (a) or (b) above, please identify precisely and by reference to enumerated paragraphs in the Defence, the positive case advanced by the OFT as regards the likelihood, viability or practicability of bilateral agreements occurring in the absence of the MMF MIF.*

2. *In relation to the OFT's case as regards market definition and a restriction of competition arising from the collective price restriction, now set out at paragraphs 96 to 98, 101, 104 to 106 of the Defence.*

(a) *Please state whether the OFT contends that the collective price restriction (i.e. the collective agreement on the MIF) gives rise to a restriction of competition in the wholesale market or a restriction of competition between issuers and acquirers in any other way .*

(b) *If the answer to (a) is yes, please identify clearly, and by reference to specific paragraphs in the Defence and/or the Decision, the relevant restrictive effects and how it is said that such effects constitute such a restriction of competition as described in (a).*

(c) *If the answer to (a) is no, please clarify the basis, if any, upon which the OFT relies upon the existence of the wholesale market, identifying which, if any, paragraphs of the Decision finding the existence of such a wholesale market, upon which the OFT continues to place reliance in these proceedings.*"

20. The OFT replied to that request by letter dated 28 April 2006, to which Visa responded by letter of 2 May 2006. By letter dated 3 May 2006 MCI/MCE indicated its dissatisfaction with the OFT's responses. On 4 May 2006 the OFT made further submissions in response to Visa's letter of 2 May 2006. MMF and RBSG took the same position as MCI/MCE in a joint letter to the Tribunal of 5 May 2006.

21. As regards Visa's request for particulars under paragraph 8(2) of its letter of 28 April 2006, set out above, the OFT's reply of 4 May 2006 does not in the Tribunal's view state clearly whether the "restriction of competition" in the wholesale "market" relied on in paragraphs 396 to 410 of the Decision is maintained in those terms, particularly in the light of the fact that the OFT now makes no positive case as to the likelihood of the parties to the MMF UK Domestic Rules entering into bilateral agreements.

22. As regards the proposed schedule referred to in paragraph 8(1) of Visa's letter of 28 April 2006, set out above, the Tribunal notes that, in the Defence, the OFT describes the Decision as "'indicative' rather than 'dispositive'" (paragraph 2) and states, among other things, that the OFT's comments on whether a MIF could be justified under Article 81(3) were "obiter dicta".

23. The Tribunal's view is that those observations tend to understate the legal nature and effect of the Decision. A decision adopted by the OFT to the effect that Article 81 and the Chapter I prohibition have been infringed is a formal finding that the parties have engaged in illegal conduct. Such a finding has significant legal consequences. The agreement or decision in question is void: Article 81(2) and section 2(4) of the Act. Findings by the OFT that there has been an infringement of Article 81(1) or the Chapter I prohibition, or findings of the Tribunal to that effect if the matter is appealed, are binding on the court in proceedings for damages or any other sum of money: section 58A of the Act. Findings of fact are binding on the parties in the circumstances set out in Section 58 of the Act. Such findings are also material in any application under the Company Directors Disqualification Act 1986 for a competition disqualification order under section 9A of that Act, as amended by the Enterprise Act 2002. The legal character of an OFT decision of infringement is unaffected by whether, in a particular case, directions are given or penalties imposed under sections 32 and 36 of the Act.

24. In the Tribunal's view the present Decision is to all intents and purposes binding on the parties and exposes them to civil claims for the period 2000 to 2004 unless set aside by the Tribunal or withdrawn by the OFT. Although not, strictly speaking, binding on Visa, the Visa system as regards UK domestic transactions appears to operate in principle along the same lines as the MasterCard system in issue in these appeals.

25. In those circumstances in the Tribunal's view it is particularly important to be able to identify clearly what findings are made in the Decision by the OFT, upon what basis those findings are made, and whether those findings are maintained. Moreover, from the point of view of the parties it is important that, when appealing, they are in a position to identify precisely the findings that are in issue, and the basis for those findings. It is also important for the Tribunal to be able to identify clearly the findings in issue, bearing in mind that the Tribunal's jurisdiction under section 46 of the Act arises in respect of the Decision and not otherwise.

26. In the present case, it is apparent from the documents before the Tribunal that the case made in the Defence by the OFT against the UK Domestic Rules of the MMF is in several respects materially different from the case made in the Decision. A new case, largely based on the expert evidence of Professor Carlton and Dr. Frankel, is advanced in the Defence on a number of points.

27. In those circumstances, in the Tribunal's view, it is necessary in these proceedings to have the utmost clarity as to which findings, facts, matters, or reasons are no longer positively relied on in the Decision, or are withdrawn, or are otherwise qualified or modified.

28. At the close of the CMC of 31 March 2006 the Tribunal had anticipated that a schedule along the lines then requested by MCI/MCE and Visa, and now sought under paragraph 8(1) of Visa's application of 27 April 2006, would be a convenient means of providing the necessary clarity.

29. The OFT, however, now resists providing such a schedule, essentially on the basis that its case has been sufficiently clarified in correspondence, and that the production of

such a schedule would be "enormously time-consuming and costly, and involve a plainly disproportionate exercise".

30. As to those points, the Tribunal accepts that further clarifications have been progressively provided in the correspondence, upon which at this stage the Tribunal expresses no view. However, the extent to which the OFT has clarified the case as made in the Defence does not in itself wholly clarify which parts or paragraphs of the Decision are now no longer relied on, withdrawn or qualified. Although, particularly in the OFT's letter of 18 April 2006, a number of paragraph references are given in footnotes, it is not easy to follow from the correspondence which paragraphs in the Decision are, in fact, withdrawn or qualified, nor to draw together the various statements now made in the OFT's letters of 19 April, 20 April, 2 May and 4 May 2006, nor to be sure that the Tribunal now has a comprehensive picture of which paragraphs in the Decision are not pursued, or are withdrawn, or qualified as the case may be.

31. As set out above, the Decision is a formal, published, legal document, having serious legal consequences. It is the findings in the Decision which form the subject matter of this appeal. If, as is apparently the case, there are a significant number of paragraphs in the Decision in relation to which a positive case is no longer advanced, or which are withdrawn or qualified, in the Tribunal's view that fact should be properly set out in a formal schedule stating briefly in relation to each of the affected paragraphs what the position is. In the Tribunal's view such a schedule is necessary, first, so as formally to identify changes in the Decision; secondly in the interests of the parties, so that passages in the Decision no longer relied on or qualified are properly identified; and thirdly so that the Tribunal itself may have the matter clarified in one formal, readily accessible document. In that latter regard, such a document is likely to be necessary in any event if the Tribunal has to rule on how far the present appeals may proceed, or on what issues.

32. As to the OFT's submission that the preparation of such a schedule would be unduly onerous or time consuming, that submission tends to reinforce the contention of the appellants and Visa as to the significance of the changes to the Decision. However, the Tribunal does not envisage a complex document, but a relatively telegraphic schedule

indicating, paragraph by paragraph, the changes to the Decision as compared with the Defence, stating e.g. “no positive case now advanced”, “withdrawn”, “see now paragraph x of the Defence”, as the case may be, in whatever manner is most appropriate. It will also facilitate the Tribunal’s task if such a schedule is cross-referred to the relevant paragraphs of the Defence.

33. For those reasons, the Tribunal makes the following Order pursuant to Rule 19 (1) and Rule (2)(b) of the Tribunal’s Rules (SI 2003/1372):

1. That the OFT file with the Registry within 14 days of this Order a schedule stating in summary form, paragraph by paragraph, which paragraphs of Decision CA98/05/05 are not relied on before the Tribunal, or are withdrawn, or as to which no positive case is made, or are qualified (and what the qualification is) giving brief particulars and the appropriate cross-reference to the relevant paragraph(s) of the Defence.

2. Liberty to apply.

Sir Christopher Bellamy **9 May 2006**
President of the Competition Appeal Tribunal