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

Day 1

January 25, 2016

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(10.30 am)

MR JUSTICE BARLING: Good morning, Mr Brealey.

MR BREALEY: Good morning, my Lord.

MR JUSTICE BARLING: Good morning, everyone.

MR BREALEY: Here at last. My Lord, if I could just make the formal introductions.

MR JUSTICE BARLING: Yes.

MR BREALEY: I appear on behalf of Sainsbury’s Supermarkets Ltd. with Mr Derek Spitz and Ms Sarah Love. And Mark Hoskins QC appears on behalf of MasterCard Inc and the related MasterCard companies along with Mr Matthew Cook, and Mr Hugo Leith, who is behind Mr Cook.

I suppose we should just very quickly take a rain check on the bundles.

Mr Hoskins -- I can speak for him -- well, I can’t extract things and make a sort of mini F, then –­ I would probably have to provide it, or obviously if you... (Continued)

MR BREALEY: Okay. I have been truncated then.

MR HOSKINS: I'm looking at 14th March. It says “Claimant, Ltd. with Mr Derek Spitz and Ms Sarah Love. And...”

MR JUSTICE BARLING: March. You are probably looking at a... (Continued)

MR BREALEY: Of March, yes.

MR JUSTICE BARLING: Of March?

MR BREALEY: The most recent hymnsheet is Monday, 14th is... (Continued)

MR JUSTICE BARLING: Let’s see where we get to.

MR BREALEY: Shall I go with my Lord’s list?

MR JUSTICE BARLING: We will leave that with you then for the moment.

MR BREALEY: I can go E whatever it is.

MR HOSKINS: For our part, we have tried to make sure that... (Continued)

MR BREALEY: Our list might pick up quite a lot --

MR HOSKINS: No, we have done that. I might have further thoughts, but to be honest, then I would probably just add them into the E bundles. That is the basis on which we have prepared them.

MR BREALEY: I can go E whatever it is.

MR JUSTICE BARLING: We will leave that with you then for the moment.

MR BREALEY: Shall I go with my Lord’s list?

MR JUSTICE BARLING: Let’s see where we get to.

In no particular order, I think so far as the trial timetable is concerned, everyone is now assuming that we will be going into the week of 14th March. I think that is right, isn’t it? Because we are all assuming that the days of the 15th, 16th and 17th February might have been non-sitting days. I mention this just to make sure that people are singing from the same hymnsheet.

MR BREALEY: The most recent hymnsheet is Monday, 14th is Mr Hoskins’ oral closing.

MR JUSTICE BARLING: Of March?

MR BREALEY: Of March, yes.

MR JUSTICE BARLING: How much of that --

MR HOSKINS: Sir, I have not seen one to that effect. The most recent one I have is non-sitting days, sir, as you said.

MR JUSTICE BARLING: March. You are probably looking at February.

MR HOSKINS: I’m looking at 14th March. It says “Claimant, oral closing”. Sorry, I thought it said “Mr Hoskins, oral closing”. My mistake.

MR BREALEY: Okay, I have been truncated then.

I’m starting my closing on the Friday and continuing on the Monday, and then Mr Hoskins goes on the Tuesday.

MR JUSTICE BARLING: Yes. Okay. So it sounds as though we are all roughly on the same page on that point.

Then there are a few points in relation to confidentiality arrangements. I don’t know to what extent you have been alerted to this, but at the moment the confidentiality ring is purely one in the High Court. And, well, speaking for myself, it seemed to me... (Continued)
that there ought to be something in this Tribunal as well, to make the matter effective. Because presumably it would be this Tribunal who had to deal with any problems.

So Ms Boyle has prepared two draft CAT confidentiality ring orders for your consideration. The reason there are two is because it has been done like that I think to reflect what was already the case; one for the claimants and one for the defendant’s material.

What we would propose to do would be to let you have some hard copies some time today to take home, but also email you the drafts. But the feeling is, because the High Court orders are very wide indeed, there is over 100 people, I think, on -- and they cover virtually all the material and the undertakings are in very wide terms, that, therefore, the new orders in the CAT ought probably ideally to be culled and to reflect the people.

That’s one thing.

The other issue of course is to whether there should be further undertakings by those concerned. And the feeling at the moment is that’s probably inevitable. It is a bore, but it is inevitable. If they are culled it won’t mean chasing down people necessarily who have given some form of disclosure. They can remain covered by the High Court. But it is really to do with people who are going to be involved in these proceedings.

MR BREALEY: We will definitely have a look at that today. As soon as possible.

MR BREALEY: It does impact to a certain extent. I don’t know if my Lord and the Tribunal have had updated opening submissions that are coloured yellow and coloured blue?

MR BREALEY: They are the same skeletons, but Sainsbury’s are highlighted their confidential bits in yellow and MasterCard have marked it up in blue. So when one sees blue, that’s MasterCard’s, so rates of MIFs etc, and both skeletons have blue and yellow.

I will be referring to some of MasterCard’s --

MR BREALEY: Yes. Are they unchanged apart from that?

MR BREALEY: Word for word.

MR BREALEY: Right.

But it will mean that some of it I will not go into the detail in opening.

MR BREALEY: Sure.

MR BREALEY: Because it is just --

MR JUSTICE BARLING: Or you can refer us to a paragraph and we can read it again. Fine.

I think the draft orders that have been prepared by Ms Boyle also incorporate the request that has been received from Stewarts Law LLP, which you are aware of, to attend the private part of the hearing when the defendant’s confidential information is being dealt with.

I understand that that is not likely to be an issue.

Effectively there’s no objection from your side to that; is that right?

MR HOSKINS: That is correct, there is no objection.

MR JUSTICE BARLING: Good. So the order should incorporate it.

Again, just sticking with confidentiality for the moment, there’s a question about the broadcasting beyond the court of proceedings to counsel’s chambers, is it, or to solicitors’ offices? That has been mentioned to us this morning. The Opus system is intended to be relayed outside the court. You look a bit surprised at that.

MR BREALEY: I’m sorry.

MR JUSTICE BARLING: You weren’t aware of that?

MR BREALEY: No, I’m sorry.

MR JUSTICE BARLING: Can I just flag it up, if that’s the case, then we obviously have to deal with it in some way and find out who is at the other end.

MR BREALEY. Who are the recipients, yes.

MR JUSTICE BARLING: And make sure they are within the confidentiality ring, or that the thing is turned off at appropriate -- so it is just another thing we have to be aware of.

MR HOSKINS: I have just been told there is a feed to the Jones Day office. We will make sure when we see the draft confidentiality orders that the people who are -- if they are watching it -- I guess it is easiest for everyone who is just in the ring at Jones Day, then there is no having to send people out of the room at the Jones Day end, which we can’t police.

So we will propose all the names of the people at Jones Day --

MR JUSTICE BARLING: Who will be watching it. All right, that’s probably something just to discuss with your opposite numbers too, isn’t it?

Moving away from confidentiality onto evidence, we have got, as you are aware, a fourth expert report on behalf of Mr Greg Harman dated 20th January. There has been a request for it to be put into the core bundle, and we haven’t done that at this stage because we
MR JUSTICE BARLING: I think, Mr Brealey, those are the sort of initial points we have got and we needn’t delay you any longer now.

I don’t know whether you have any other housekeeping points or whether we have covered everything?

Opening submissions by MR BREALEY

MR BREALEY: No, I think we are in a good place.

I’m more or less going to go through the opening submissions. I mean, I’m obviously not going to read it out. I want to highlight the key documents, draw things together that might not otherwise seem crystal clear.

If I could just summarise, I’m going to go, that means, to the regulatory context first, but can I just

summarise where Sainsbury’s is coming from, just to formally open this case.

So, as the Tribunal will be aware, Sainsbury’s seek damages running into many tens of millions of pounds in relation to the amounts it paid in merchant service charges, called the MSCs. And these MSCs were paid for the processing of purchases made by MasterCard credit and debit cards from December 2006.

Those MSCs consisted mainly of interchange fees set by MasterCard which we say breached article 101 of the treaty.

We set out the issues; there are quite a lot of them. This is quite an exam question at the end of the day.

But if I could just summarise very quickly where we are coming from on the issues.

So first on the regulatory context, we shall see that both MasterCard and Visa have been investigated at length by the competition authorities. Neither payment card scheme has received an exemption for the UK MIF.

Both payment card schemes were informed, were told, in around 2006, and we shall see this a bit later on, that the Visa exemption for the Visa EEA MIF was unsound. That’s the quotes: “Was “unsound”. So they were told in 2006 that the Visa exemption was unsound and unlikely to be renewed, and that’s why it was not
renewed. It expired in 2007 and so that Visa 2002 exemption for five years was not renewed.

We know that MasterCard knew from 2007 that the basis upon which it set the EEA MIF was unlawful. So it knew that, if not before, certainly in 2007. As a result of which MasterCard offered the undertakings to reduce the EEA MIF to 0.3, those undertakings were in 2009, and Visa made similar commitments as regards the EEA MIF. So there was the infringement decision, undertakings and commitments.

But, and this is quite important, MasterCard did not follow the logic of the infringement decision and of MasterCard’s unsuccessful appeals to reduce the MIFs generally, let alone the UK MIF.

It is clear from the documents that both Visa and MasterCard were told that the level of MIFs generally were inefficient, and when we get to the EU regulation, the EU has told both card companies that as a result of their unwillingness and, I quote, “proactively to adjust their practices”, they would be regulated, and indeed they were so.

We have seen that the regulation EU wide was adopted because both payment card companies were unwilling to adjust their practices. I’m going to spend most of this morning on the regulatory context because there are some important documents.

After this regulatory context, I shall explain why the UK MIF set by MasterCard distorts competition. In short, the MIF, the UK MIF, affects price competition between competitor banks. It imposes an inflated minimum price on the MSC. One could not really think of a more classic case for article 101 to intervene to some sort of consensus collective price agreement that imposes a minimum price and which is, to boot, inflated.

And MasterCard does not, when one sees the skeleton, really dispute that the MIF sets a minimum price, which can go higher. We will come onto their skeleton in a moment, but one really doesn’t see this denied at all. Instead, in the section on infringement it relies on a few counterfactuals to suggest that this collective price cannot restrict competition. One such counterfactual has already been expressed, rejected by the Court of Justice, and the other appears new, but we say is totally and utterly unrealistic. And this is essentially the Visa counterfactual. And in any event is incorrect as a matter of legal analysis.

Just to recap, they don’t really deny that it sets a floor. They didn’t really deny that competition between competing banks is somehow restricted, but they rely on two counterfactuals to say actually this restriction is not a restriction of competition within article 101. We say that these two counterfactuals are wholly unrealistic.

After that, I shall move to exemption and what the lawful level of the UK MIF should have been. I shall explain how the merchant indifferent test works and how this was adopted by the EU, DG Comp, in its investigations, and in regulation 215751, the interchange fee regulation. This merchant indifferent test which the Tribunal has picked up is now adopted at EU level.

I note, and the Tribunal may have seen this, MasterCard it seems does not justify any calculation made by it at all. And I emphasise the word “calculation”. We do not see really any calculations that have been made by MasterCard, which then receive the level of MIF.

In all the disclosed documents we do not see a detailed account of how the UK MIF was arrived at. X, Y, Z, whatever. And certainly their expert, Dr Niels, does not purport to justify any MasterCard calculations. Instead, Dr Niels takes the levels that were actually set by MasterCard and then seeks to justify them ex post facto by reference to his own methodologies.

One of the methodologies is the same discredited methodology that we have seen in the Commission investigation. Essentially, we can call it the issue with cost methodology, whereby MasterCard imposes the cost of free funding onto the merchants.

The other methodology appears to be some sort of methodology by reference to the Amex card, but I shall take you no further than that. But I do emphasise the point that we do not see in the documents any real calculation made by MasterCard as to how it calculated the MIF, and in the economic evidence you don’t see the economist picking up the calculation and saying the process was actually spot on. We get the level and then Dr Niels tries to justify the level by reference to his own methodologies.

MR JUSTICE BARLING: So just pause for a second. Just for the sake of the transcript writers, as you are going to be using the phrase “MIF” for quite a lot of the hearing, it is M-I-F. It is a shorthand rather than, it might be a bit easier for you to type it.

MR BREALEY: I’m sorry. So MIF. It has been coming out slightly strangely.

So that is exemption. Obviously that’s quite a complicated area, but a big, big issue here. And I shall come onto this a bit later on, is this cost of

Sainsbury's Bank had to sign on MasterCard’s standard terms and conditions, a factor that the European Court of Justice in Courage v Crehan referred to. And it is quite clear, and MasterCard makes the key point time and time again, that it was MasterCard alone that set the interchange fee, and had it set an interchange fee at a correct level, there would have been no infringement of article 101. So that is essentially kind of in the nutshell where we are coming from and why we are here.

I just have to, before I go on to the regulatory context, the diagram above paragraph 5 of our open submission. One bright spark on our side at least saw that this was one of Mr Hoskins’ counterfactuals really because it looks as if -- anyway, it looks as if the interchange fee is going to the acquiring bank rather than the other way round. So those in the middle, where it says “interchange fee” and “settlement of funds”, the arrow should go --

MR JUSTICE BARLING: The arrow should go the other way.

MR BREALEY: I’m not sure why --

MR JUSTICE BARLING: It could be the charge goes the other --

PROFESSOR JOHN BEATH: The charge.

MR BREALEY: Certainly, if it is the flow of funds, it is the other way round. One day it might be the other way, but not ...

MR JUSTICE BARLING: The same could be said of the merchant service charge. It seems to be something being charged to the acquiring bank, if you look at it that way.

MR BREALEY: Yes. I was asked to point that out.

MR JUSTICE BARLING: Yes.

MR BREALEY: So that takes me to regulatory context. Should I kind of go on until, say, 11.45 am?

MR JUSTICE BARLING: You know, when it is convenient take a break and then --

MR BREALEY: Sure.

So regulatory context. What I would like to do is start with the Visa exemption decision and go through that. You have probably seen it, but I’m surprised every time I read these documents that one sees new points. I think because this is the start of the investigation we should look at it in some detail, so could we go to bundle E1, tab 2 because clearly when one sees the economic evidence and MasterCard’s submissions, they are still coming back to this exemption decision. They still rely on it.

It is important to see what it does. So in the opening submissions, I describe it to a certain extent, but I’m going to highlight various recitals in the
decision, and the first one is recital 9, to see what actually they were looking at. Bundle E1, tab 2, the Visa exemption decision.

Start with recital 9.

So:

"The present decision relates to the proposed modified Visa EU intraregional interchange reimbursement fee scheme for consumer cards to be implemented in the Visa rules in the course of 2002. The interchange fee scheme is applicable to cross-border Visa consumer transactions and merchant outlets in the EEA [15 in those days] and by default to domestic Visa card payments operations within a member state in cases where no distinct Visa interchange fee rate has been set by the national Visa member for that member state."

As far as Visa was concerned, if I can call it the EEA MIF applied by default to certain domestic MIFs. But then:

"However, the present decision relates only to the notified intraregional interchange fee of Visa as applied to cross-border Visa card payment operations between EU member states, not to any domestic interchange fees set by national Visa members, nor to the application of the intraregional interchange fee of Visa to domestic Visa card payment operations within a member state."

So although the EEA MIF did apply in certain circumstances to the domestic MIF -- I guess because, whatever, the costs were the same, I just don't know -- when it comes to what was exempted, it is only the EEA MIF. They were not exempting the EEA MIF insofar as it applied to domestic MIFs.

We shall see that in this Visa exemption decision the Commission is quite careful to distinguish at times between the EEA MIF and any domestic MIF. Then, if one goes to recital 13:

"As from its introduction, the MIF set by the Visa EU board has been set as a percentage of net sales. Despite the carrying out of a cost study for reference purposes, the Visa EU board has been free to set the MIF at any level it considers appropriate independently of any specific services provided by issuing banks to the benefit of acquiring banks."

Quite an important point for present purposes, and at some point we are going to have to sort out the confidentiality. Certainly that is the case in the 2007 infringement decision insofar as regards MasterCard.

That is exactly the same logic that MasterCard was applying, that MasterCard in the 2007 infringement decision said that the EEA MIF was not geared to a particular service or to certain costs. It had a free rein to set the MIF at the level it wants. One of the reasons, and I think this is common ground, that the card companies want to set the level of MIF to be competitive.

So they are always looking, and this is one of Mr Hoskins' counterfactuals, over their shoulder to see what the competitor is doing.

Why is this relevant? If one goes to paragraph 80 of this decision, to recital 80:

"Prior to the modifications described above ..."

Now, just pausing there, as you will have picked up what the Commission did was say "Well, you can't have a free rein, you just can't have an open-ended discretion, you have got to do it by reference to some criteria". And in this decision, they set it by reference to certain costs, one of which was the free funding, the payment guarantee and the transaction costs.

But insofar as -- I can call it the free rein:

"The Visa MIF was considered by the Commission in its supplementary statement of objections on 29th September 2000 as not satisfying in particular the second condition of article 81(3), notably because the Visa EU board was free to set the MIF at any level it wished, independently of the costs of the specific services provided by issuing banks to the benefit of merchants."

I just pause there.

I'm obviously not going to go through the whole -- so just to pick up this point of the free rein and when we see the evidence in this case. If it is seen that the payment card companies say they should have a free rein, Dr Niels says they should be determined by -- let the market decide. If they shall have a free rein, we see here even in 2002 the Commission is saying that sort of approach cannot be exempted. You cannot have a situation where the payment card company is, for any old reason, just setting a MIF which is ultimately going to be borne by the merchants. It has to be done by reference to certain criteria, which in this case it fixed on certain costs. And we will then see how those costs panned out later on in the investigation.

But the point I'm trying to emphasise here is even in these early stages the Commission was saying to the card companies you can't just have a free rein by reference to unlimited set of factors if you want an exemption.

Then recitals 21 and 22, we see what Visa was forced to do in this, to modify, in order to get this
exemption, it had to abandon this kind of free rein and use -- this is recital 21:

"Under the modified scheme, Visa will use these three categories of issuer’s costs involved in supplying Visa payment services as an objective criterion against which to assess the Visa intraregional MIFs currently paid by acquirers to issuers."

We see these costs time and time again in all the cases:

"These three cost categories are the cost of processing transactions, the cost of the free funding period for cardholders, the cost of providing the payment guarantee."

Then we see some footnotes.

We will come onto this in the evidence, we will go into this in far more detail.

In a nutshell, what is this cost of free funding?

It is essentially if you have got your credit card, you make a purchase, you have 28 days in order to pay it off.

If you don’t pay it off, for example, in 28 days you start paying interest. So what the credit card companies do, Visa and MasterCard -- well, certainly this is essentially what it is all about, the issuers incur costs of the 28-day period and those costs are then offloaded onto the merchant. So maybe the issuing bank has to borrow the money in order to -- we will come onto this in the evidence, but there is a cost to an issuer bank in giving the credit to the cardholder for 28 days.

What the schemes have done is offload these costs onto the merchant. The significance of this I’m going to refer to in a moment, but what doesn’t happen is that then obviously if the cardholder doesn’t pay it off, pays interest, the merchant takes no share of that. So the issuing bank retains the interest after, say, the 28-day period.

And the European Commission has objected in itself to this cost of free funding, saying this is not a cost a merchant should bear; the 28-day period is essentially between the issuing bank and the cardholder. It should not be offloaded onto the merchant. And the Commission said even if you were going to take it into consideration, you have to also take into consideration the substantial revenues that you have obtained from interest. That has been the case of the European Commission for almost ten years and it has been endorsed by the General Court.

If you are going to adopt the cost methodology you cannot just offload the 28-day period cost onto the merchant and then just ignore the vast sums that you earn in interest. We will come onto this in a moment. I’m trying to explain the fundamental reasons.

You see at paragraph 22 that the Commission is to a certain extent feeling its feet on these costs because it says that Visa will submit to the Commission within 12 to 18 months of the adoption of the decision the first cost study showing the calculations based on the three cost categories mentioned above.

It is quite clear, as I say, that the Commission was feeling its feet, didn’t actually have any detailed cost calculations on which it could make a definitive view. But since, obviously, it was a very important point in order to -- you can just see that the Commission almost took Visa at its word and said, “Right, I’m going to exempt you for five years, I’m actually going to sound the market out. You have got to give me some detailed cost studies. I’m going to listen more to third parties, what they are going to say, but you can have an exemption for five years.”

I will come onto this cost of free funding again in a moment. Objective necessity, if I could just pick this up at 58 and 59.

Now, 58 and 59 is about objective necessity. So Visa was arguing that, or to a certain extent, this MIF was important. And one has seen this from the MasterCard submissions. They say that article 101 doesn’t really apply because the MIF is essential for the operation of the scheme. One sees in Dr Niels’ report and Mr von Hinten-Reed’s report this reference to ex-post pricing.

The counterfactual, the hold-up issue, so that if you get rid of the MIF but you still have the honour all cards rule, issuing banks get into a position of power. We will come onto this again, but I’m trying to flag the point and then they will abuse the system and the whole system starts to collapse. This is what the payment card scheme operator was saying; that without the MIF, if you have got the honour all cards rule it is going to collapse.

I refer to this, particularly paragraph 59. There’s a lot in paragraph 59, but it is concerned in large part with this hold-up problem. If I can just take 58 or 59 more slowly:

"The Commission disagrees with the argument put forward by Visa that the MIF falls outside the scope of Article 101."

This is what Dr Niels is saying in this case:

"For a start, the Commission doubts whether it is
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MR SMITH: Mr Brealey, when in paragraph 59 the Commission

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transcript:

"Where the question is whether the clause is technically necessary for the operation of the Visa payment scheme, the only provisions necessary for the operation of the Visa four-party payment scheme, apart from technical arrangements on message formats and the like, are the obligation of the creditor bank to accept any payment validly entered into the system by the debtor bank."

"And the prohibition of ex-post pricing by one bank to the other. Accordingly, it is in theory technically feasible for the Visa scheme to function with alternative arrangements than a MIF not involving collective price agreements between undertakings, for example, the issuing bank could recover their costs in whole or in part from cardholders."

I rely on 59 for various reasons.

The first bit, as I have just said, one has to be very careful about if one is looking at 101(1) or 101(3), and also this is in the context of the ex-post pricing, where the card companies are saying: issuers will have substantial market power. They will be able to hold the acquirers to ransom. The acquirers will be, and we see this from the text,
MR BREALEY: So the way it goes, I think, is that the MIF is
MR JUSTICE BARLING: You have a bilateral payment on
MR SMITH: Or the Commission talking about any level of MIF,
MR BREALEY: I think --
MR SMITH: That one wouldn’t pertain if you had, for
instance, a MIF of zero?
MR BREALEY: Yes.
MR SMITH: That’s actually a greater restriction of competition.
We need this MIF in order to prevent that greater
restriction from happening, to which the European
Commission and the Court of Justice says: no, you won’t
allow that to happen, you will have a system of
a prohibition on ex-post pricing so you have to agree
bilaterally, but you can’t have a system where issuers
just hold the acquirer to ransom.
Again, we will come onto how the
European Court of Justice dealt with it. So both
the Commission and the courts have always said, well, we
understand what you are saying because a system of
bilaterals plus the honour all cards rule will put the
issuer in this position of market power. But you will
not allow -- you, MasterCard; you, Visa -- the issuers
to abuse that market power because it is likely, says
the European Court, you will adopt this rule which
prohibits that.
That’s essentially what our expert
Mr von Hinten-Reed says as well. But the important
point is that even back in 2002 the germ of this point
was being debated.
So that is the counterfactual and objective
necessity. Then how does the Commission in Visa deal
with restriction of competition?
We then go to recital 64. In our opening
submission, and again, we will come onto this a bit
later but I just flag it now, there are three vices in
the MIF, three anti-competitive vices in the MIF.
The first is that it prevents competing banks
competing individually. It is a multilateral
interchange fee. It is a common agreement on price.
That’s the first part, the banks are not competing. The
second is that this -- I can call it a price fixing
agreement -- this price fixing agreement imposes a floor
on the MSC because the interchange fee constitutes such
a substantial part of the MSC, it constitutes a floor.
So it is a collective pricing arrangement, it creates
a floor in the MSC which ultimately the merchants bear.
That is the second vice. It creates a floor. And the

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of argument. So that creates a floor. You do away with
it. Then MasterCard say and Visa say “If I can’t have
this collective price agreement, what’s going to
happen?” They then fall back into a system of
bilaterals.
So if I just go to -- I’m on the system of
bilaterals to MasterCard’s skeleton. It is right at the
end on page 131. Essentially, I think the parties are
all agreed on this, and so if one goes to page 131, so
you can’t have this multilateral interchange fee, this
collective price movement, so now what are you going to
do? You are going to have a system of bilateral rules.
At footnote 360, MasterCard say the following:
“It is obvious that an acquirer, and particularly
an acquirer under pressure from Sainsbury’s, one of the
largest merchants in the UK, would have been willing to
agree a reduction in interchange fees since this would
have reduced the payments which that acquirer had to
make, and in turn they were charging merchants putting
them in a commercially advantageous position.”
I’m just going to flag that point now because that’s
exactly what our expert says.
If we have this system of bilaterals, interchange
fees will go down. But then MasterCard and Visa say
that’s not correct because they will not go down,
third vice is that this floor actually gets higher and
higher because of this competition. This competition
between payment schemes, so the payment schemes are competing for issuer’s business and essentially throwing money at the issuers in order to get them to issue their cards. As opposed to the competing card scheme, that then raises the MIF because the more money they are throwing at the issuers, the more money they need to get from the merchants. Those are the three vices: the restriction on competition from the banks, the floor and the upward pressure.

One of the strange aspects of this case, when one looks at the witness evidence, is that MasterCard emphasise the competition between the issuers and how they need the interchange fees to compete. They say, well if I can see the commercial logic of that, but the European Commission upheld by the courts see that, but see it that it is a competition problem.

So whilst it is a commercial advantage for the payment card companies, and they extol the virtues of this, we need this money in order to compete, they slightly lose sight of, well, is this a restriction of competition? Which then allows the European Commission to say, actually, if you are going to have a MIF, you have got to have an efficient level.

That is the restriction of competition, so we see at recital 64: “The Commission considers that the MIF in the Visa system restricts competition within the meaning of article 81(1) by restricting the freedom of banks individually to decide their own pricing policies. MIF has a restricted effect on competition among Visa issuers and among Visa acquirers.”

I won’t go through the whole of this bit, but we see here again one reads the expert report of Dr Niels from MasterCard saying this is a joint service, two-sided markets etc. Exactly the same arguments were being made at paragraph 65, 66.

I want to emphasise paragraph 68. So 64 is what I call the first vice and paragraph 68 is the second vice: “The MIF, moreover, has its effect to distort the behaviour of the acquiring banks vis-a-vis their customers because it creates an important cost element. According to EuroCommerce on average approximately 80% of the merchant fee, which is likely to constitute a dead facto floor for the fees charged ...(Reading to the words)... would make a loss on its acquiring activity.”

We will see a bit later on, exactly the same analysis in the MasterCard infringement decision. Then I come to exemption. So, again, we have the Visa system, we know that the exemption is not applying to domestic MIFs, we know that the MIF is not necessary for the scheme to operate and we know that it is a restriction of competition, it creates a floor, it restricts banks from competing. But we also know that Visa got an exemption for a period of five years based essentially on this issue with cost methodology.

I want to just emphasise little bits about that. So if we go to paragraph 84. Again, we know that Visa is told that it could not get exemption if it just had a free rein criteria that was just within its gift. So it modified the scheme.

Recital 84: “To this end, Visa has in its proposal for a modified MIF identified three main cost categories which in its view constitute an objective benchmark for the level of costs of supplying Visa payment services and constitute an objective benchmark against which to assess the Visa intraregional MIFs paid by acquirers for issuers for POS transactions.”

These are the three categories of cost we see time and time again: “These cost categories are the cost of processing transaction, the cost of providing the payment guarantee and the cost of the free funding period.”

So I just want to focus on the cost of the free funding period because I think it is important to see. The pedigree of this in its relevance to domestic MIFs is, again, MasterCard rely to a certain extent on this as somehow endorsing this free funding period. It has been rejected time and time again, since the expiry of the decision of the EEA MIF, but I just want to emphasise its relevance to any domestic MIF.

If I can go back to recital 36. I just want to focus for the next few minutes on what the Commission said about the free funding period. Everything I’m going to say next on the free funding period.

Recital 36, this is all on the free funding period. At the beginning, I’m not sure if this is relating to the free funding, but I will go for it:

“One of the card payment systems [these are comments from third parties] commented that it failed to understand how in law a reduction in the level of a price could have any relevance for the granting of an exemption ... that is what one card system said.”

What I would like to do is focus on the line beginning: “The second card payment system to reply ...”
MR JUSTICE BARLING: Yes.

MR BREALEY: "While defending MIFs in a four-party card payment system, it is clear that the cost of any free funding period concerns only the relationship between a card issuer and a cardholder and not that the cost is excluded from the calculation of its own MIF."

So even there, we see -- I don't know who it is -- one card payment system saying actually this cost of free funding is not to be borne by the merchant, it is... (Technical crash; audio loss)

That's recital 36. Recital 37, this is national authorities.

One of the national authorities that replied:

"Consider that the changes to the Visa MIF did not justify ...(Reading to the words)... but did not state whether they merited an exemption. In its view, according to another national authority, a MIF in a four-party payment is a price fixing agreement within the...(Reading to the words)... In this context it held that the cost processing and some of the cost payment guarantee relating to fraud may be included in calculating the appropriate level of the MIF. However, it did not consider the free funding period and the cardholder default element in the payment guarantee as justified cost components in the MIF."

So that national authority was saying the cost of the free funding period should not be borne by the merchant.

Then if one goes almost to the right-hand side of the page. So recital 38 are the principles from retailers and specific points on consumer cards and the following.

Then (e), this again relating to the free funding period:

"Merchants should not pay for the free funding period, in particular since they consider it is not at all to be to their benefit, but only that of the cardholder. In particular, they denied that it led to any increase in aggregate consumer spending."

So the merchant was saying they should not pay for the free funding period, that is 28 days, for example, and they deny that (inaudible) aggregate consumer spending. That's what the retailers were saying to the Commission.

Then if one goes to over the page to 39.

MR JUSTICE BARLING: Sorry, Mr Brealey, there is a technical problem, so we might --

MR BREALEY: Might as well adjourn.

MR JUSTICE BARLING: We will take a 10-minute break.

Visa cardholders to make purchases at any merchant who accept Visa cards as if they all offered free credit. According to Visa, this benefits merchants because it encourages cardholders to increase their consumption by making additional purchases which otherwise they may not have made. While it is not proven that this facility increases total aggregate consumption...

That is quite an important point:

"While it is not proven that this facility increases total aggregate consumption, it is plausible that it may well stimulate cross-border purchases by cardholders travelling abroad who usually do not have the means to check their account balance and cannot delay their purchase to later. Without the free funding period, cardholders travelling abroad are likely to be more prudent with regard to their overall spending for fear of taking their account into the red. While this phenomenon may have a neutral overall effect on total consumption in Europe...(Reading to the words)... as opposed to domestic spending.

"In this light, the inclusion of the free funding period in a MIF for cross-border purchases can be discussed primarily as it benefits merchants with whom such purchases are made, but also as it promotes cross-border purchases within a single market.
MR BREALEY: My fault, I was going to quickly. Recital 109.

MR JUSTICE BARLING: Sorry?

MR BREALEY: So it is table 8.2 that I want to emphasise. It says: “This period of time will allow the Commission to re-examine the practical impact of the modified Visa scheme on the market and in particular its expected effect on merchant fees also in the light of the comments made by third parties to the 1993 notice.”

So as Mastercard, what would Mastercard get out of reading this exemption decision? I shall show the Tribunal in a moment how closely intertwined they are in their dealings with the authorities. So what would Mastercard get out of reading this exemption decision? Well, the first thing they would see is that the Commission regards the relevant market affected as the acquiring market. The acquiring market.

The Commission has rejected this notion of a joint service. The Commission rejects that in this decision and it rejects it in Mastercard’s own 2007 infringement decision. But even in 2002, Mastercard would have seen that you had got to focus on an acquiring market. The second thing they would have noticed is that a MIF in a four-party system is liable to be regarded as an inflated minimum price. It is looked at by the Authority as a collective price agreement, which sets a minimum price, so they would have been on notice of that.

Third, they would have been on notice that arguments about a zero MIF and the impact on competitiveness is a 101(3) criterion. And fourth and very important for this case, they would have been given a clear steer as to what could be exempted on a domestic level, a clear steer, recital 80, that the card payment systems cannot just set the MIF at any level by reference to unspecified criteria, recital 80. You can’t have a free rein. There’s got to be some objective criteria. And secondly, there was a clear doubt about the free funding period certainly as regards domestic MIFs.

If you were Mastercard, you would not have picked up this decision and said, “Hey, we have got a green light to offload tonnes of cost, free funding on merchants when it comes to us setting a domestic MIF”.

Now, why have I emphasised the cost of free funding in this decision? We are going to see again and again in the infringement decision, but I want to just show the Tribunal why I am emphasising this because there is a lot of things moving in this case, but actually trying to get some bright lines is not a bad idea.

Could I go please to Mr von Hinten-Reed’s second report, which is at D2.1, tab 3. It is page 551 of the bundle, internal 128. In my version, table 8.1 has blue, but table 8.2 does not.

MR HOSKINS: Correct.

MR BREALEY: So it is table 8.2 that I want to emphasise. Now, this is, as I understand it, all accepted figures. So this is Mr von Hinten-Reed taking Dr Niels’ figures and Dr Niels relies on figures prepared for or on behalf of Mastercard.

I’m pretty certain there is no doubt about these percentages that I’m going to show the Tribunal. Table 8.2, “Benefits according to Dr Niels’ corresponding costs and the cost base credit card MIF”. To take this slowly, so the benefit: reduction in transaction costs and risks, and then corresponding costs, processing costs and fraud costs, and we look at 2008, is 0.2%.

Now, just pausing there. That is not far off what Mr von Hinten-Reed calculates an exemptable MIF to be. He refers to 0.15. You can round that up to 0.2. The Commission has come out at 0.3. So even on an issuer’s cost methodology proposed by Dr Niels, who is in the room, you see that if you take the processing costs and some of the fraud costs you get to 0.2.

It is only when you offload the costs that the issuer incurs credit write-offs, collection from the
I do want to flag certain points relating to the court judgments and the Commission decision, but through the whole of this and really we need to go to Professor Christian von Weizsäcker.


If I look at how the European Commission does it paragraph 18, so we see at paragraph 18:

Following the Visa decision, the Commission opened an investigation into both Visa’s and Mastercard’s intra EA MIFs for commercial cards. On 24th September 2003, they sent a statement of objections to Mastercard in relation to its network rules and decisions. Mastercard responded to that statement of objections on 5th January 2004. Its response included 120 pages of written submissions, three annexed reports, including economic evidence from DotEcon ‘... and an expert analysis of the MIF by Professor Christian von Weizsäcker.’

I want to just, obviously given the time we can’t go through the whole of this and really we need to go to the court judgments and the Commission decision, but I do want to flag certain points relating to the investigation.

For that purpose can I go to bundle E2, tab 4, which is Mastercard’s response to the statement of objections on 5th January 2004. So the document at tab 4 is Mastercard’s response to the statement of objection.

So, I mean, one only has to look at the contents page, which is at page 167, to see the detailed submissions that they are making. This is just the start of it all, going over a lot of the ground that we are going to have to go over with Dr Niels in these proceedings.

That’s the point I will come onto in a moment. What I would also like to emphasise -- and if one can go to -- this is page 178 of the bundle, page 13, paragraphs 41. I’m not going to go through it all, but 41 to 63. I emphasise this is the procedural history.

We will just go through a few facts in a moment.

I emphasise these paragraphs because they are relevant to Mr Hoskins’ -- what I call the Visa counterfactual, his Visa counterfactual, saying what if Mastercard is at zero and Visa is still at 0.9%.

You quite clearly see here that Visa is intervening in Mastercard’s proceedings, Mastercard is intervening in Visa’s proceedings. They are completely at one when this comes to fighting off the European Commission.

The notion that a counterfactual is going to end up in a situation where Visa is at 0.9 and Mastercard is at zero is, in my respectful submission, fanciful. And I shall explain that a bit later on.

Table 8.2 I would ask the Tribunal to note because it is quite illuminating. That is the end of the Visa exemption.

If I can go back to the opening submissions. At paragraph 18, so we see at paragraph 18:

Following the Visa decision, the Commission opened an investigation into both Visa’s and Mastercard’s intra EA MIFs for commercial cards. On 24th September 2003, they sent a statement of objections to Mastercard in relation to its network rules and decisions. Mastercard responded to that statement of objections on 5th January 2004. Its response included 120 pages of written submissions, three annexed reports, including economic evidence from DotEcon ‘... and an expert analysis of the MIF by Professor Christian von Weizsäcker.’

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But we see the principal steps in the investigation.

Paragraph 41. EPI is the Europay International, so that is essentially Mastercard Europe. So Mastercard Europe responded to the first statement of objections.

The Commission also addressed an SO to Visa. Visa responded. This is Mastercard. So Mastercard knows all these facts about what Visa is up to. At 44, again we see statement of objections sent to Visa. Over the page we see at the top:

“The press release mentioned that the Commission had several pending cases relating to payment card systems which raised similar issues, and therefore, the envisaged Commission decision in the Visa case were important in setting the pace for the resolution of the other cases.”

Again, I’m referring to this because it is quite clear that Mastercard and Visa, maybe at slightly different times, are being treated in the same way.

We see at 46:

“Following the press release and publication in the OJ, Mastercard immediately applied for a meeting with the case handlers.”

The meeting was held on the 17th.

It goes on: “It requested a non-confidential version of the SO
Finally decided to initiate proceedings by the dispatch of the SO dated 21st September 2003."

Again, I emphasise that this notion that somehow this whole case collapses because Visa are going to be at 0.9 and Mastercard at zero is not -- and I will expand on this later on -- a realistic counterfactual.

Just very quickly, when one looks at the SO, just for the Tribunal's note, just briefly look at the headings. So if one goes to page 191 of the bundle, again we see Mastercard in 2004 "Optimal pricing strategies in two-sided markets".

Again, we see exactly the same in Dr Niels' first report. Page 194, at the top:

"The service by a four-party system is a joint service."

That had been rejected in the Visa exemption decision.

Mastercard are making the same point. It is ultimately rejected by the Commission and by the court.

Page 194:

"The service of the four-party system is a joint system."

Page 224, again, this is at the SO stage. I'm just referring to the heading:

"Restriction is no more than what is necessary."

Again, objective necessity.

I'm going to come onto the Professor von Weizsaecker in a moment, but at 236, we get again the exemption.

Then at 281, something I would like the Tribunal to note, this is the section 6, "Undesired consequences".

Essentially, what is being said here by Mastercard is -- I have already flagged the point, but they are going in some detail here and it is this ex-post pricing point, which is that if you prohibit the MIF, it will destroy Mastercard's four-party card payment system.

You need, it is said, some -- if you are going to have an honour all cards rule, you need some default mechanism in order to prevent the abuse of the system by the issuers.

So you can't have a multilateral interchange fee. You end up with bilaterals, but you have bilaterals plus the honour all cards rule, that gives the issuer a power they can abuse, and Mastercard is saying that cocktail is going to lead to the scheme shrinking and ultimately collapsing. That is why the European Commission and the European Court says, actually, that will not happen.

Again, we will see that. So that is what is being argued here: the issuers will have the power to abuse the system and that will lead to the collapse of the
MR BREALEY: Bundle 295, internal 6, paragraphs 27 to 43.

MR JUSTICE BARLING: Paragraphs 27 ...?

Consider now a four-party credit card system with an honour all cards rule but without any fallback way of setting interchange fees ...”

This is paragraph 30 on page 296.

For example, he is saying, paragraph 30:

"Consider now a four-party credit card system with an honour all cards rule, but without any fallback way of setting interchange fees. The only way to set interchange fees will therefore be to negotiate bilaterally between each issuer and each acquirer. However, if there is no final agreement in existence between an individual issuer and an individual acquirer on the interchange fee between them, the issuer is effectively free to decide which interchange fee to deduct from its payment to the acquirer while at the same time, owing to the honour all cards rule, the acquirer cannot refuse to accept that issuer’s cards. That acquirer will therefore be ‘at the mercy’ of the issuer, subject to the only extreme option of leaving the system altogether.

"As a result, the issuer would be in a very strong position in negotiations with the acquirer, since the alternative would be for the issuer to have a free rein to set the interchange fee.”

He goes on, and he basically says it will lead to the shrinkage of the system. And so we see “shrink” in, for example, paragraph 36.

MR JUSTICE BARLING: They rely upon a particular example, don’t they, which we see time and time again in the papers? I don’t know whether Professor von Weizsaecker was also relying upon that or not. Was it before?

MR BREALEY: This is --

MR JUSTICE BARLING: Maestro.

MR BREALEY: No, because this was -- I am not sure, actually.

MR JUSTICE BARLING: The timing may have been different.

MR BREALEY: I’m not sure whether Maestro was in here because of the timing.

MR HOSKINS: For the record, it is bundle A, tab 2, page 172.

MR BREALEY: I should say, I haven’t read any of the document that Miss Smith has handed up, but just, we do not accept the Maestro story.

MR JUSTICE BARLING: That’s when the shares start to plummet. So it is bundle A, tab 2, page 172.

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European Court has dealt with. So this is the --

MR JUSTICE BARLING: So my question was misconceived because

really, first of all, Professor von Weizsaecker isn’t

dealing with the Maestro situation.

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within the Mastercard system the issuers will abuse

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So that is -- it cannot be said that Mastercard
didn’t have the opportunity to put forward its arguments
in front of the Commission prior to the 2007 decision.

Could I then put E2 away and just go to E2.1, tab 9.

Again, I simply don’t think it is necessary to go
through this in great detail. This is tab 9. This is
the reply of Mastercard to the supplementary statement
of objections.

I just draw the Tribunal’s note to page 657. It is
the fourth bullet point down. I said earlier on that at
some point 2006 Mastercard would have known that the
Visa exemption was not going to be renewed.

So that fourth bullet point: "There is no mention of the fact that the Commission

later decided to inform Mastercard, if not Visa, that
its decision concerning Visa’s interchange fee is no
longer sound and the exemption decision will not be
replicated."

Just at that point Mastercard will know that those
three categories of cost that served to justify the EEA
MIF, even the cost of free funding for the EEA MIF, that
exemption is not going to be renewed.

MR BREALEY: Sorry.

MR JUSTICE BARLING: It may be there’s nothing we can do
about it because the acoustics are not that brilliant in
here, but we won’t take offence if you bawl at us a bit.


MR JUSTICE BARLING: So 657, that was bullet 4.

MR BREALEY: 657. While we are here, can we just go to
tab 10.

MR JUSTICE BARLING: Yes.

MR BREALEY: Some of this is, again, I don’t know how much
of this is confidential. This is tab 10 and this is a
letter of facts. We refer to this in paragraph 20 of
the opening submissions.

So, again, we have seen a response to the statement
of objections, we have seen a response to the
supplemental statement of objections and we were going
to see the letter of facts. So it is a response to the
letter of facts.

So we see that at 831, Mastercard’s response to
Again, just looking at the table of contents we see the
sort of arguments that are being advanced, although
I won’t go through these again.

But I would like to go to page 938 where, between
paragraphs 316 and -- I don’t believe this is -- this is
not marked blue?

MR HOSKINS: No.

MR BREALEY: 316 to 324, Mastercard is referring to the
Australian experience and how retail prices were not
higher than they would otherwise have been. And
Mastercard, it is one of the first instances that I can
find of Mastercard saying there is no pass-off.

So we can pick this up at paragraph 324. So it
refers to certain remarks, and we will come onto the
Reserve Bank of Australia a bit later on:
"For the following reasons above, the RBA remarks
should be treated as scepticism."

So it is referring to the Reserve Bank of

Australia’s confidence that there will be some degree of pass-on. So Mastercard is saying about this confidence that: “The reduction of MSC will be passed onto the consumer ... is interesting, but clearly not sufficient to form the basis of policy decisions and competition proceedings.”

“Second, it should be noted that almost 50% of retail spending in Australia is controlled by two large merchant groups ...”

I would imagine they do compete: “... Woolworths and the Coles group. It is therefore absurd for the RBA to argue that the normal dynamics of a competitive market place are more likely to operate in the Australian retail market than the credit card industry.”

“Third, a review of the annual reports of some of Australia’s largest annual retailers suggest that there is no direct correlation between changes and retail cost basis and consumer prices. But rather retailers tend to absorb small cost changes regardless of the direction of the cost change. The following table contained data extracted from Woolworths’ and Coles’ 2006 financial statements.”

We can go over the page. It shows clearly that there is no correlation between cost reduction, reduced merchant fees and retail prices. Indeed, says Mastercard, retailers often take cost changes to their margin as there are many factors other than costs that influence their prices.

If one just goes back to 941 and the OECD document, in the footnote at 310, where it is said: “It is not possible to measure these price changes and their timing, particularly given other more significant changes in firms’ costs and prices that are going on all the time.”

Obviously Mr Coupe, Sainsbury’s CEO, and Mr Rogers, Sainsbury’s CFO, two very senior people within Sainsbury’s, are going to be cross-examined by Mr Hoskins as to this issue of pass-on, but it is quite clear that Mastercard at this time was presenting a very similar story to the one that Sainsbury’s is painting now.

It is rather bizarre, and they rely on studies that have done, and we will see it time and time again, studies that they have undertaken. And they are arguing it completely opposite to this Tribunal.

So that is the response to the letter of facts. At paragraph 8 of the skeleton, which says it is for us to prove. There is simply a statement at the beginning in paragraph 8 of the skeleton, which says it is for us to prove. Well, clearly, it is for us to prove, but I would make the clear point that Mastercard are simply not engaged in its skeleton on this issue, which is quite strange because they themselves sought to amend to include various facts that they said distinguished their situation from the decision by the Commission, the general court and the ECJ, all of which said there is a decision of association of undertakings. And if my Lord remembers, there was this application to amend, to raise these facts which said actually, although this European Court has rejected the appeal we still win on this, and there’s no positive reliance on any of these facts in the skeleton.

MR HOSKINS: I don’t want Mr Brealey to be caught out, because we have pleaded a case on association of undertakings, and in particular that pleaded case is based on things that happened after the IPO. So there’s not an issue about the existence of association of undertakings up to the date as found by the Commission. But then we put in issue certain facts of things that happened afterwards. And what’s happened, then really I need to go to the Mastercard infringement decision itself just to see how the Commission picks up a lot of the points that have been argued in the Visa decision and by Mastercard. So I don’t know where the Tribunal has the Mastercard infringement decision. I had to put it in a different tab. It may be in E2.2; I put it in E2.3 just because there was more space.

(Pause)

So this is the infringement decision, 19th December 2007. Clearly I will ask the Tribunal to read it, and you probably have. I just want to emphasise some key points that come out of this. The first relates to the IPO and the decision in the association of undertakings point. That is at 1099 of the bundle, paragraph 331.

Now, I’m not going to dwell on this, and when I come to the breach of article 101, I’m not going to dwell on this, but I’m just highlighting the passages in the decision which refer to this decision of association of undertakings. The reason is because in their skeleton, paragraph 8, Mastercard simply say the burden is for Sainsbury’s to prove the decision of association of undertakings, and leaves it at that.

So actually, in its section on infringement of 101, there is nothing advanced by Mastercard on this decision of association of undertakings concerted practice point. There is simply a statement at the beginning in paragraph 8 of the skeleton, which says it is for us to prove.

Well, clearly, it is for us to prove, but I would make the clear point that Mastercard are simply not engaged in its skeleton on this issue, which is quite strange because they themselves sought to amend to include various facts that they said distinguished their situation from the decision by the Commission, the general court and the ECJ, all of which said there is a decision of association of undertakings. And if my Lord remembers, there was this application to amend, to raise these facts which said actually, although this European Court has rejected the appeal we still win on this, and there’s no positive reliance on any of these facts in the skeleton.

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January 25, 2016
Sainsbury’s Supermarkets Ltd v (1) MasterCard Inc, (2) MasterCard International Inc, (3) MasterCard Europe S.P.R.L.

Day 1

MR BREALEY: It may be still live, but the whole purpose of
MR JUSTICE BARLING: Right.
MR HOSKINS: That is correct, because it is about the nature
of the Mastercard system, rather than anything that’s UK
specific.
MR JUSTICE BARLING: Right.
MR HOSKINS: So it is still live.
MR BREALEY: It may be still live, but the whole purpose of
having detailed written openings is to put us on notice
how they seek to rely on these three facts. We have
done it in some detail and I am not going to shy away
from it.
But if one goes to our opening submission at

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1 up the flag. We don’t concede that point at all.
2 Sainsbury’s are going to have to prove either that,
3 association of undertakings after 2007. Of course the
4 claim here starts to the end of 2006. Or it is going to
5 have to make good its concerted practice in agreement
6 case, which they haven’t themselves tried to do.
7
8 MR JUSTICE BARLING: But there’s no issue up to the date of
9 the Commission decision?
10 MR HOSKINS: Yes.
11 MR JUSTICE BARLING: In respect of the --
12 MR HOSKINS: We don’t agree, but we are bound.
13 MR JUSTICE BARLING: You are bound as far as the -- yes.
14 And you are bound on that point regardless of the fact
15 that we are dealing with the UK?
16 MR HOSKINS: That is correct, because it is about the nature
17 of the Mastercard system, rather than anything that’s UK
18 specific.
19 MR JUSTICE BARLING: Right.
20 MR HOSKINS: So it is still live.
21 MR BREALEY: It may be still live, but the whole purpose of
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Anyway, with that, back into the decision and it is 1 o'clock. It's time for lunch.

MR JUSTICE BARLING: I think probably it is a good time. We will see you at 2 o'clock.

(1.00 pm)

(The short adjournment)

(2.00 pm)

MR JUSTICE BARLING: Mr Brealey.

MR BREALEY: We were just about to go to the Mastercard 2007 infringement decision. We have agreed that it is in E2.2.

MR JUSTICE BARLING: Yes.

MR BREALEY: So the decision has been replaced. I think we have a common version now. I was just about to go to the passages relating to the decision of association of undertakings.

MR JUSTICE BARLING: Yes.

MR BREALEY: So the decision has been replaced. I think we have a common version now. I was just about to go to the passages relating to the decision of association of undertakings.

MR JUSTICE BARLING: Yes.

MR BREALEY: Obviously the decision is a big document, and I just want to kind of flag some of the key paragraphs. But the paragraphs on the decision of association of undertakings goes from paragraph 331 to 399.

MR JUSTICE BARLING: Yes.

MR BREALEY: Again, I will just flag some important paragraphs. If we start at 331, Mastercard does not contest that it was an association of undertakings within the meaning of article 81 in the period before May 2006. That is the day when the IPO of Mastercard Incorporated took place.

It then submits that: "Since the listing of Mastercard, it would not qualify as an association of undertakings, but it became an independent undertaking pursuing its own commercial interests for the benefit of its stockholders who are detached from those of its customers." I, really, imagine that that's what they are arguing now. They are saying that they are still essentially a separate undertaking acting on its own.

So that is what the situation was and what was being argued. If we could go to paragraph 373 where the Commission refers to the continuing effects of Mastercard's MIF after the IPO.

So Mastercard argues about the changes of governance: "The changes in governance incorporated on 25th May 2006 did not affect the interchange fee fallback mechanism, such modifications were limited to a transfer of powers. The principle that some multilaterally-set fallback interchange fee will always apply as a fallback to a payment card transaction in the absence of a bilateral agreement remains rooted in a network rule that was adopted before the IPO."

So the fallback remains rooted even after the IPO: "The effect of this decision of an association of undertakings therefore continues until today. As far as the nominal level of the interchange fees are concerned, it is important to note the fees remain entirely unchanged."

The point is that this principle of a MIF, a fallback, was pre-IPO and is post-IPO.

Then we can go to paragraph 390, which refers to the argument, well, hey, it is Mastercard now sets the MIF. 390: "The fact that the banks delegate now no longer decide upon interchange fee-related matters cannot be decisive. According to the jurisprudence, the decision of association of undertakings does not require that all members of the association agree upfront on a non-binding recommendation for that recommendation to be caught by article 81. Even such a non-binding recommendation was found to be anti-competitive, and the fact that the banks in the present case could not formally influence the decision-making on the MIF is not important as long as the member banks adhere to decisions on interchange fees and that they remain licensees and members of the organisation. This is the case."

This actually is the core behind the degree of consensus necessary for the application of article 101. That point is essentially made good in its conclusion at 397 to 399:

"The Commission disagrees with Mastercard's argument that since the IPO interchange fees are unilaterally imposed on member banks in a supplied customer-like relationship, rather as any other decision of the organisation's managing bodies, the MIF remains [this is the language really of article 80/101] remains to be the faithful expression of the association's resolve to coordinate the faithful conduct of its members."

Then 398 is about what one can call the horizontal nature of the consensus:

"For the above reasons, the association's network rules that form part of Mastercard's MIF as well as decisions taken by the European board and by Mastercard, which implement these rules by setting concrete levels and types of fallback interchange fees have been and still remain decisions of an association of undertakings."

That is kind of the competing banks, if one goes
back to 390, they buy into it. They are licensees. 

They buy into the default mechanism.

Then 399: 

"At any rate, even after the IPO, in relation to bank’s qualified, is that of a franchisor to franchisee rather than being a horizontal form of co-operation, this is no reason why the MIF should fall outside the scope of article 81/101. As is apparent from the regulation anti-competitive aspects of franchise agreements may restrict article 81(2)"

So drawing all this together, whether you call it a horizontal agreement, because obviously the banks compete, or it is Mastercard at the top and the banks down below, ultimately in order to be part of the Mastercard scheme the banks have to sign the standard terms and conditions, they have got to be licensees and they acquiesce in the scheme and they acquiesce in the MIF, they acquiesce in the fallback. 

It is kind of textbook competition law. As soon as you have a franchisor and franchisees down there, all signing up to the same common terms and conditions, that is an agreement between undertakings. You only have to look at the case law relating to network effects, franchises, exclusive purchasing agreements, Courage v Crehan. As soon as you get a network effect, a system of licences and each licence is signing on the standard terms and conditions, you have this consensus necessary for the application of 101. 

Now, it will be horizontal, paragraph 398, if the licensees who sign up to the scheme are competitors and agree to a MIF, thereby not competing individually anymore. Or even if they are not competitors, it can be the standard franchise-type arrangement: the person at the top, franchisor at the top, franchisees down below, ultimately in order to be part of the Mastercard scheme the banks have to sign the standard terms and conditions, they have got to be licensees and they acquiesce in the scheme and they acquiesce in the MIF, they acquiesce in the fallback.

So the market definition is 278 to 279.

"As set out in Visa 1 and Visa 2, two types of competition can be distinguished in the payment cards business: Competition between different payment card networks and competition between individual financial institutions. Competition can take place upstream at the level of networks, and downstream at the level of individual financial institutions in the value chain. Accordingly, the Commission has distinguished between an upstream system network market and downstream issuing and acquiring markets."

That’s exactly what the Commission had done in 2002. 

If we go to 283: 

"Acquirers provide a wide range of services which..."
are of a technical and of a financial nature. Their customers are merchants wishing to accept payment cards. The product characteristics of acquiring services are fundamentally different from those of issuing services. The pricing of acquiring services is structurally different from the pricing of issuing services since it is based on a fee paid for each transaction whereas cardholders typically pay annual fees.”

I could go on. At 307, to the conclusion:

“The supply and demand side analysis show that card acquiring services are neither sufficiently substitutable cash and cheque nor ... The Commission therefore retains as a relevant product market for assessing the MIF the market for acquiring payment card transactions.”

The final conclusion is at 316:

“The relevant product market in this case is the market for acquiring payment cards.”

So 316:

“The relevant product market in this case is the market for acquiring payment cards.”

We don’t actually know whether Dr Niels disagrees with this because he refers to the joint service again, which has been rejected in the Visa and the Mastercard.

We see this, but he doesn’t actually -- he refers to “the acquiring market”, but he doesn’t actually say whether it is a relevant market that this Tribunal can accept.

We will wait to see what he says. But clearly the European Commission has said the relevant market is the acquiring market and Mr von Hinten-Reed agrees.

So that is the relevant market. Can I then go to a few paragraphs on restriction of competition.

Remembering I mentioned three vices, the three vices being the restriction to compete on an individual basis, the minimum price, ie the floor, and the upward pressure, the floor is getting higher and higher. Those are the three vices that are identified in the restriction of competition.

We can start this at paragraph 400. The Tribunal probably marked a lot of this, but sometimes there are just paragraphs that it is good just to emphasise. So paragraph 400, again, it is consistent:

“In its Visa decision, the Commission considered that a multilateral interchange fee restricts competition within the meaning of article 81 by restricting competition between payment card systems and competition amongst issuers and acquirers. The Commission’s finding in this case confirmed that a MIF, “[a MIF] “distorts competition between acquiring banks and the effects of the MIF in the network and issuing markets reinforce the restrictive effects in the acquiring markets.”

So that is 400. At 404 it seems that:

“In this respect, Mastercard does not contest that the MIF will typically fix a floor [so paragraph 404] for MSCs because, as Mastercard realises, it is reasonable to assume that the interchange fee affects to some degree MSCs and that a MSC typically reflects the MIF. The fact that the MIF typically determines the floor for the price which merchants must pay for accepting payment cards is indeed an indication that Mastercard’s MIF may by its very nature have the potential of fixing prices.”

Actually, it gets quite close to saying it has its object, the distortion of competition, but doesn’t quite.

So that is the floor. Again, at paragraph 408, you see the effects of the MIF:

“The assessment of Mastercard’s MIF as a restriction of competition is based on its restrictive effects of competition in the acquiring markets. In the absence of a bilateral agreement, the multilateral rule fixes the level of the interchange fee rate for all acquiring banks alike, thereby inflating the base on which acquiring banks set charges to merchants.”

Thereby inflating the base on which acquiring banks set charges to merchants.

“Prices set by acquiring banks would be lower in the absence of the multilateral rule and in the presence of a rule that prohibits ex-post pricing.”

That, as we saw, is wholly consistent with that footnote that I referred to. It is footnote 360 on page 131 of Mastercard’s opening submission where they say that the system of bilaterals would exclude lower prices.

Then 409:

“In evaluating those restrictive effects, the Commission also takes account ...”

410 gives some colour to the inflated base:

“Mastercard’s MIF constitutes a restriction of price competition in the acquiring markets. In the absence of bilateral agreement, the multilateral default rule fixes the level of the interchange fee rate for all acquiring banks alike, thereby inflating the base on which acquiring banks set charges to merchants.”

Again, the point is so made:

“The prices set by acquiring banks would be lower in
the absence of this rule and the presence of a rule that prohibits ex-post pricing."

I shall come onto that in a moment:

"The Mastercard MIF therefore creates an artificial cost base that is common for all acquirers, and the merchant fee would simply reflect the cost of the MIF. This leads to a restriction of price competition between acquiring banks to the detriment of merchants and subsequent purchasers."

Then over the page at 412:

"The collective decision by the Mastercard organisation to set a MIF inflates prices charged by acquirers to merchants requiring cross-border credit. This finding is in line with the Commission's case practice. The Commission found in Visa 2 that a MIF has the effect of distorting the behaviour of acquirers vis-a-vis their customers, because it creates an important cost element which is likely to constitute a de facto floor for fees charged to merchants they acquire."

I have to go through all of this because Mastercard still to this day are submitting to the Tribunal that there is no restriction of competition. So I can't just ignore it, I have to take it seriously.

Page 1134, 467, again, is a relevant passage relating to upward pressure on interchange fees, the third vice I refer to.

Paragraph 467: "Upward pressure on interchange fees. Mastercard believes that the competitive process and the market forces will best ensure that the average MIF is close to an optimum."

Just pausing there.

That's in quotes. Again, Dr Niels makes exactly the same point in his first report where he says that this whole thing should be left "to the market." The market knows best, he says. You leave it to the market, they will come close to an optimum, he says. To which the Competition Authority says, no, it gets inflated and essentially it is turkeys voting for Christmas, in the reverse sort of way.

Anyway, I will go on:

"As set out, the forces of intersystem competition do not sufficiently constrain the level of interchange fees in the Mastercard scheme and even exert an upward pressure."

Just pausing there. That reference to upward pressure, we refer in our written opening to the purpose of the EU regulation on interchange fees where the European Union continues to refer to this upward pressure:

"The evidence at the end of the 1990s when Mastercard raised its interchange fees to the level of Visa's interchange fee is consistent with this observation. The upward pressure effect of intersystem competition on interchange fee rates is due to the fact that issuing banks are attracted by revenues from a MIF. Any card scheme operating with a MIF will take this into account in its competitive behaviour towards other schemes. Mastercard does not contest that its methodology for setting interchange fee ..."

I'm double checking. I'm going through my comfort blanket decision. That is not in blue?

MR HOSKINS: No.

MR BREALEY: "Mastercard does not contest that its methodology for setting interchange fee rates takes account of the rates of competing schemes."

Just pausing there. Again, we saw in the Visa exemption decision, the Visa 2 decision, that the Commission objected to Visa setting rates where you didn't really have any objective criteria to go by.

That's why they modified the Visa system to have these three categories of cost which ultimately then got abandoned.

But the real problem, according to the Commission in 2002, was that Visa was just setting the rate on unidentified criteria, one of which obviously is by reference to competing card schemes. Again, I said earlier it is a slight irony in the case that Mastercard in their witness statements are saying these interchange fees are necessary because I need to put more money into the issuers, whereas the Competition Authority has taken that same fact and is saying, well, that actually is the third vice. And so is the European Union in its interchange fee regulation, saying it is the third vice.

Whilst as a matter of fact it may be correct that these card schemes want to throw as much money at issuers as they can, it doesn't mean to say that the merchants have to pay for it. As Mr von Hinten-Reed says, and then we have quoted it in the skeleton, essentially what is happening is that the merchants are paying for a price war between the competing schemes.

We will come onto it if I see it in the opening submissions. That is the ultimate effect. The Visa and Mastercard are competing, throwing money at the issuers and the merchants are essentially paying for that competition. So that is the restriction of competition.

The upward pressure.

If I could then go to again -- Mastercard, like Visa, was saying, well, the MIF is necessary. And this
is part of the first counterfactual which I will call the ex-post pricing counterfactual. They say it is necessary because if you have a system of bilaterals in the honour all cards rule, the scheme is going to shrink to the point of collapse. I can pick that up at paragraph 548.

1. I just note here, from memory, I think it is recital 59 of Visa. Yes, recital 59. This paragraph 548 is essentially referring back to recital 59. It is actually in footnote 365: "As already set out in Visa 2 decision with respect to the Visa MIF, the only provision necessary for the operation of an open payment card system, apart from the technical arrangements on message form and the like, are the obligation on the creditor bank to accept any payment validly entered into the system by the debtor bank and a prohibition on ex-post pricing by one bank to the other."

So Mastercard is saying, again, if we have got the honour all cards rule, the MIF acts as some constraint on the issuers. That is the default mechanism. If I don’t have that default mechanism, that MIF, I’m in trouble. So says Mastercard, and this is where we get the argument and the rejection.

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So the argument is at 553. This is essentially quoting from the passages that I referred to earlier, the response to the statement of objections, Professor Von Weizsaecker. So: "Mastercard argues the issuing banks and open payment card systems would be at the mercy of issuers, because without a MIF that applies by default in the absence of bilaterally agreed interchange fees, the scheme’s issuing banks would be in a position to deduct unilaterally any interchange fee they wish."

Dr Niels makes the same point: "Acquiring banks could then not prevent issuing banks from retaining excessive interchange fees as acquirers are bound under Mastercard’s honour all cards rule to process all transactions properly presented to them. Based on an opinion of its experts..."

This is the economic opinion that we saw in tab 5: "... Mastercard concludes that due to HACR, there must be some kind of arrangement..." And I emphasise "must be some kind of arrangement": "... which sets out the terms and conditions under which issuers and acquirers agree to provide payment services to cardholders and merchants."

They say: if I have got the honour all cards rule, the system, the payment card system, the Mastercard system it says, first line, would be at the mercy of issuers and therefore I need some kind of arrangement which is going to check the abuse of that issuer’s bank card.

"That argument cannot be accepted. As already set out in the Commission’s Visa 2 decision, the possibility that some issuing banks might hold up..." That’s why it is called the hold-up problem: "... acquirers who are bound by the HACR... could be solved by a network rule that is less restrictive of competition," hence why it is a counterfactual in the analysis of objective necessity, "than Mastercard’s current solution that by default a certain level of interchange fees applies."

"The alternative solution would be a rule that imposes a prohibition on ex-post pricing on the banks in the absence of a bilateral agreement between them. The rule would oblige the creditor banks to accept any payment validly entered into the system by a debtor bank while prohibiting each bank from charging the other bank in the absence of a bilateral agreement on the level of such charges."

"That solution to protect acquirers if issuers should indeed abuse their powers under HACR is less restrictive of competition than a MIF as it does not set a minimum price level on either side of the scheme."

So Mastercard appealed that conclusion. So it made the argument 553, it appealed that conclusion by the Commission at 554 all the way up to the ECJ and said -- and similar to the points they make now: we don’t really think about an ex-post pricing rule, we have never given it that consideration even though they have known about it since 2002. They have made exactly the same point to the ECJ and the ECJ, we will see it a bit later on, said: such a rule is likely. It uses the word "likely". And that it is likely that Mastercard would adopt such a rule if it had no MIF. And the reason is he needs some sort of mechanism, and that is what you can call the ex-post pricing counterfactual.

MR SMITH: Mr Brealey, I think it is Dr Niels in his reports who says something about the inefficiency of bilaterally agreed interchange fees. Is it implicit in paragraph 554 and, indeed, your submissions that that is
Mr Brealey: It does clarify it and I will come onto your
point in a moment, but when I read Mastercard saying "It
is obvious that", I feel that I’m quite entitled to take
that is the submission.
Dealing with Dr Niels’ point, the Commission has
said that if you have a MIF, obviously you don’t have to
have a system of bilaterals and they can see that as
an efficiency. Because you don’t have to have all the
individual bilaterals. One has to be careful about it,
and this, again, will come out of the evidence, because
it may be the case that it would push up -- whilst I’m
not giving evidence at the moment -- on an EEA basis
where you have lots of agreements, it may not be the
case where you have a domestic MIF and you have only got
a few acquirers.
So there is evidence in the decisions which say that
the domestic MIF is not necessarily going to be the
same. So whether it pushes up the cost is completely up
in the open. Certainly it is not a given on a UK MIF
basis where there are only a few acquirers, there are
not many acquirers that the system of bilaterals, and
I’m kind of putting what I’m going to put to Dr Niels,
but it is certainly not the case where you have only got
a few acquirers that you can realistically say, well, it
is going to push up the price.

Mr Smith: If I can summarise what your position is,
I appreciate this is in anticipation of the evidence and
it is to be read in that light.
Mr Brealey: Yes.
Mr Smith: Your position is that bilaterals will cause the
IF to fall.
Mr Brealey: Correct.
Mr Smith: But that if you have a MIF default position, that
will actually act as a floor and there won’t be any
independently negotiated bilaterals because everyone
will revert in default.
Mr Brealey: Correct, and that’s what the Commission has
said. The Commission has said that if you don’t have
the MIF, the Commission has said in its decision that if
you don’t have the MIF you will get lower interchange
fees for the very reason that’s in that footnote 360,
which Mastercard apparently now disavow.
I can go to it, but the Commission does accept that
there can be certain efficiencies in a MIF. And that’s
why, really, I’m almost in the wrong place here. I’m
looking at article 117 and this debate should be in
101(3) because we know that -- I submit, and I submit on
the basis of Mr von Hinten-Reed and I also submit on the
basis of the Commission decision, the unsuccessful
Mastercard of bills and the EU regulation that if you
a question. I think I had seen it somewhere, but I just couldn't remember.

MR BREALEY: Just to pick up on the point. If one goes back to the Visa decision, or I can just give you the --

MR JUSTICE BARLING: Yes.

MR BREALEY: It is recital 101 and footnote -- I think it is 45. The printing is very bad. But in recital 101 --

and this is why this is an evidential point, but rectical 101, the Commission is looking at Visa's EEA MIF and saying "When you come to the EEA, you are looking at quite a few banks" and the figure there is with more than 5,000 banks in the Visa EU region.

Then they say in the footnote:

"This conclusion is not necessarily valid. In a domestic context, where the number of banks may well be far fewer and the efficiency gains of a multilateral arrangement, vis-a-vis bilateral agreements, may not outweigh the disadvantage of the creation of a restriction of competition."

So one immediately sees that it is not just the case that as a matter of evidence these bilateral are going to increase costs, but certainly even if they do, does it outweigh the inefficiencies of a MIF? And that there you are in 101(3) territory because you are balancing -- the whole point, and we will have to come onto this, but the scheme shrinking and collapsing because of the cards rule.

And that's why Mastercard and the intervening banks are submitting that the scheme would collapse without the MIF to the European Court, and the European Court upheld what the Commission ruled at 554, that you can have a default system -- so if you are going to have the honour all cards rule and a system of bilaterals, it is basically accepted that you need some sort of default system so that the issuers don't abuse their power.

The question is -- you have two that have been put forward. One is the MIF, but that kind of takes up the interchange fee, and one is this prohibition on ex-post pricing which now brings it down, and the interchange fee is lower than it would be --

MR JUSTICE BARLING: If you want to have the honour all bilateral.

MR BREALEY: Yes.

MR JUSTICE BARLING: You can only get it now through bilateral.

MR BREALEY: You can only get it now through bilateral.

Now, the issuers have got to negotiate with the acquirers.

MR JUSTICE BARLING: There has to be an agreement in place.

MR BREALEY: There has to be an agreement in place.

MR JUSTICE BARLING: If you want to have the honour all...
MR JUSTICE BARLING: You don't even get to restriction of competition.

MR BREALEY: No, that is right.

MR JUSTICE BARLING: Because you are on objective necessity now.

MR BREALEY: I'm on objective necessity.

You can see what the restrictive effects are. You can see that it creates an inflated floor and you can see that competition between the banks is restricted, it doesn't exist. So all those vices, those restrictive effects, don't constitute, on Mastercard's view, a restriction of competition.

MR JUSTICE BARLING: Because without them you can't have the thing which is good, namely, a four-party payment of cards.

MR BREALEY: That's what they say. To which the European Court says: yes, you can, you can have the honour all cards rule. You don't need the default mechanism, which is the MIF. There is, to use the words "a less restrictive of competition default mechanism" and that is you can have a system of bilaterals with the prohibition on ex-post pricing.

MR SMITH: Or could you equally have a default MIF of zero and financial pricing? Could that have worked equally well?

MR BREALEY: I don't see why not. I will put that to the witnesses. I'm not the commercial -- yes, I mean, as a European -- as the Commission and the European General Court say, you don't need a MIF at all. The issuing banks can get the money from the cardholders. Schemes do operate without MIFs, they don't go bust. So you don't actually have to have a system of bilaterals, is what I'm saying.

So if you had a rule saying no bilaterals -- let me put it this way, if you said to Visa and Mastercard: you can't have any interchange fee at all, will the system collapse? The answer is no because in the decision, the Commission refers to instances of open payment card schemes without a MIF. It just means you don't take the money from the merchant, you take it from the cardholder, or you realise you are making so much money in interest that you don't even have to go to the cardholder.

So the MIF is not absolutely essential for a four-party payment card scheme anyway.

MR SMITH: No, I see that. I mean, what you have got is a situation where issuing banks are providing services to acquiring banks and vice versa.

MR BREALEY: Yes.

MR JUSTICE BARLING: There isn't any real distinction, is there, between a zero MIF and a no ex-post pricing?

MR BREALEY: I think the difference is that you can agree a fee under bilateral, but if you don't agree, then the issuer can't say, "Aha, we haven't agreed and this price is going to be x times 100".

MR JUSTICE BARLING: I'm struggling. You can have bilaterals in both cases, but is there any distinction in reality between a zero MIF and a no ex-post pricing?

MR BREALEY: I think to be fair, Dr Niels says it is basically a zero MIF. As I understand it, if you had a rule which said zero MIF, it would be zero.

MR JUSTICE BARLING: There would be no payment. There would be no deduction by the acquiring bank which would be the same as --

MR BREALEY: But in a system of bilaterals ex-post pricing, you at least have the ability to agree something. But if you don't agree --

MR JUSTICE BARLING: Yes, of course. If you are assuming one has a bilateral possibility and the other doesn't, I agree there is a difference. I thought that the bilateral option was open to -- no one was suggesting you get rid of that in any of these counterfactuals.

MR BREALEY: I think the point and the thing that's put to me is I think, and we don't quite work out where Mastercard are coming from in their skeleton, or for that matter Dr Niels, because he seems to kind of slightly pooh pooh bilaterals in his first report. But when it comes to his second report they seem to be more accepted, and that leads him into further arguments about the prices going up.

Even when you read Dr Niels' report, we are not quite sure the extent to which you can't have bilaterals. Certainly when you read his first report he doesn't like bilaterals. You read Mastercard's skeleton and it seems to be premised on bilaterals. Again, this is just me opening. We are going to have to find out
MR BREALEY: Yes. So this, as I said, in the skeleton, they are on objective necessity, I think there is a bit of a debate about to what extent you look at the counterfactual to see whether something is objectively necessary, and you look at it in a world that, as it were, might be said to exist now, a real world, or you look at it feeding into a certain more theoretical approach, lawful, which involves looking at the legalities.

In other words, what is objectively necessary?

Let's assume that payment card X is the target of the Commission investigation and they have evidence to say that if they abolish the MIF or there was no payment by the acquiring bank to the issuing bank, then they would lose 100% market share in about two years and, therefore, for them it was objectively necessary. And the answer to that is the Commission might say, or the Authority might say, you can't, you have got to assume that is applied to everyone, the law is the law, and if it is not objectively necessary for you, then it is not objectively necessary for anybody and that's the assumption you have got to make. No one needs that. So you will all be in the same boat.

That is the controversy, isn't it, that to some extent it is visible on your openings on this and on restriction of competition?

MR BREALEY: Yes. So this, as I said, in the skeleton, they don't deal with decision of association on takings, they don't deal with market definition, they don't really deal with the three vices: the floor, the upward pressure and the non-compete between the banks. The whole thrust of the case on distortion of competition really is the two counterfactuals.

The first counterfactual is the one I have just been exploring, which is Professor Von Weizsacker's ex-post pricing, which was the subject of big debate in the European Court.

The second is a half new one I think. We will call that the competitive counterfactual. That is to say if I, Mastercard, have a zero MIF, then I'm going to bleed market share to Amex and Visa, but I think it is particularly Amex. And the question is where does that fit into the legal analysis?

Before I actually -- I will deal with it because I might as well raise it. I might as well deal with it and come onto it again tomorrow, but where does it fit into the legal analysis? Let's just take a step back. They are saying 0%, 0.9. Is that an objective necessity? I don't think it is because even on
that you are all equally vulnerable to having your
correct counterfactuals. The European Court has referred to
the Visa, with impunity? Particularly if Visa are being
sued in October?
MR SMITH: I tried to impress on the Tribunal this morning, this
infringement point. Really. So it is not just a question of
a counterfactual in the commercial world. What would
MR SMITH: Do carry on. I won’t interrupt, I will come in
after you have finished.
MR SMITH: If I understand you correctly, you are saying
four-party systems, they have been treated exactly the
same by the Commission, exactly the same considerations
apply. Is it realistic that the banks, knowing that the
Mastercard scheme is being attacked and underwater, that
they are just simply going to cross Mastercard off and
go to the same almost identical scheme, but it is called
Visa, with impunity? Particularly if Visa are being
sued in October?
MR SMITH: I want to come in at the end, but I will come in
when the evidence said it was likely to be the
MR SMITH: If I understand you correctly, you are saying
Mastercard scheme is being attacked and underwater, that
they are just simply going to cross Mastercard off and
go to the same almost identical scheme, but it is called
Visa, with impunity? Particularly if Visa are being
sued in October?
MR SMITH: If I understand you correctly, you are saying
MR BREALEY: The old-fashioned Amex.
MR SMITH: Then as the follow-on to that, does it extend to
the -- I'm not sure what to call it -- the three and
a half party system where one has Amex operating as the
scheme operator and the acquirer bank, but licensing
issuers?
MR BREALEY: The answer to that is when it comes to the Duo,
in my submission, you can treat the Duo in the same way
as -- so the new Amex, which hasn't been that
successful. Again, this is evidence to a certain
extent -- but the Duo hasn't been that successful
because customers are confused.

But if you are saying "I am going to treat
Mastercard and Visa the same", which is exactly what's
happened, you can treat the Duo, because there is the
beginnings of a relationship now between Amex and the
issuer. That's the first point. The second point is it
doesn't really matter, it does not matter about Amex
because, again, what is -- again, it is very important
to focus on the legal relevance of what is being
submitted. It is not being submitted that Mastercard
will go bust or will lose significant market shares not
to be the sort of Mastercard scheme if it can't issue
premium cards.

Amex is only about its premium card market, and the
witnesses are not saying that the Mastercard scheme will
bleed market share and hit whatever -- what that
ultimately lands on, 5, 10% of whatever, they will lose
just on, for the sake of argument, their premium card
business. To which one says, well, so what? If you are
only gaining that competing with Amex by a price fixing
agreement, well, the competition law doesn't come to
your assistance.

Let's take it back. I want to have a price fixing
agreement in order to compete with somebody. So as
a matter of legal analysis, we say "So what?" But it is
not at all as a matter of fact, and certainly we
take issue with it, the premise that if Mastercard were
to reduce its premium card to zero, or 0.3, or whatever,
it would lose all its premium card business to Amex.
Why? Because we see in this decision, and we shall see
elsewhere, that Amex, when it sees Visa and Mastercard
lowering its fees, doesn't keep its fee up here, it
lowers it and keeps the differential as a matter of
fact.

So the nuances are quite (inaudible) and there's a
factual analysis here and it is just too glib to say,
well, if we are at zero or 0.3, we are going to lose
everything to Amex because the experience that Amex can
see that merchants can vote with their feet comes down

and the differential stays the same.

So this Amex thing is, we would say, legally
irrelevant and factually highly suspect. Their big
point is Visa.

MR JUSTICE BARLING: Returning to Visa for one second,
I want to be quite clear what we have to decide, and
just to repeat or paraphrase what you said, how likely
is it -- this is one of your points -- that Mastercard's
bank would migrate to Visa in the present context
knowing what they know, and all the rest of it.

That is a pure question of fact, is it? And in
order to resolve that we have to assess evidence and
judge whether, on the evidence we have, how likely or
otherwise it is, and that would feed into our decision
on objective necessity?

Supposing we found that it was likely that they
would migrate if we or any other court found that
Mastercard had to have a zero, or was only exempt to
whatever the decision was. If we found it was likely as
a matter of fact that there would be, do we have to look
over what period of time and how long would it take to
reduce, how long would they want before -- they would
want to have a good look at the situation first and try
and predict. I'm just wondering how elaborate the
fact-finding that seems to be implicit --
MR BREALEY: Under exemption. If you apply paragraph 59 of the case, you will see that there is a greater restriction of competition. If Mastercard will not be around; indeed, the evidence in the witness statements say we will do something about it, we will not let the system collapse. So this is not an objective necessity point. They are not saying the scheme will disappear; they are saying we need it to compete with Visa.

MR JUSTICE BARLING: You say that’s a point that can only be raised under exemption.

MR BREALEY: So you are looking at two restrictions of competition. This is not the case here. All they are saying is without the money, I can’t compete with the Visa. They are not arguing about lesser restrictions of competition. If they are saying that, then they are confusing 101(1) and 101(3).

Again, I come back to the Tribunal has to take a fairly pragmatic view on this. That’s one of the reasons I wanted to emphasise this morning how intertwined Visa and Mastercard have been; each making submissions on each other’s statements of objections, intervening. One gives undertakings to reduce to 0.3, the other follows, giving the commitments to reduce to 0.3. The EU regulating them both, 0.3, not making any distinction about them at all. And then you get this rather absurd situation where both companies are arguing “Without the MIF, we can’t compete, or we find it more difficult to compete, and therefore 101 doesn’t apply”.

MR JUSTICE BARLING: You say they stand or fall together --

MR BREALEY: They must do.

MR JUSTICE BARLING: -- effectively.

MR BREALEY: It would be a travesty if they could just -- it was a wheeze like that. Again, I come back, if they were being sued at the same time, could they make the same point? Does it make a difference that one is a few weeks after, a few months after?

MR JUSTICE BARLING: We haven’t given our transcript writers a break. That’s probably what the note is about.

MR BREALEY: Yes, I’m sorry.

(3.32 pm) (A short break) (3.40 pm)

MR JUSTICE BARLING: We will take 10 minutes, thank you.

MR BREALEY: Mr Brealey, I volunteered to show myself ignorant now. One merchant typically would have one acquiring bank, who dealt with it, say, in relation to all card

MR BREALEY: Correct. So the European Court has said that any counterfactual, whether it is a counterfactual under objective necessity or a counterfactual to determine whether there is a restriction of competition. And there you are looking at two restrictions of competition. In the restriction of competition counterfactual, like the ex-post pricing, you are looking at two restrictions of competition. One is the restriction with the MIF and one is the restriction of competition bilaterals in the honour all cards rule. And it is said the honour all cards rule is a greater restriction of competition, whereas the European Court says actually not, if you have the other default mechanism which is the ex-post pricing.

So you are looking at two restrictions of competition. This is not the case here.

MR BREALEY: It would be a travesty if they could just -- it was a wheeze like that. Again, I come back, if they were being sued at the same time, could they make the same point? Does it make a difference that one is a few weeks after, a few months after?
transactions of any payment system, or would merchants typically tend to have a different acquiring bank, a single merchant have a different acquiring bank for each payment system’s cards, or is there nothing typical at all? MR BREALEY: I know that some merchants can have two. Can I just --

MR JUSTICE BARLING: Or, indeed, you could give us the answer any time. But don’t interrupt, if you like.

MR BREALEY: I will get the answer. I don’t know about the typical merchant. Sainsbury’s, as I understand it, for Visa has Barclaycard, and Mastercard has Worldpay and another bank, HSBC maybe. So you can --

MR JUSTICE BARLING: So you can --

MR BREALEY: -- you can play them off.

MR JUSTICE BARLING: But you could have just one acquiring bank?

MR BREALEY: Absolutely.

MR JUSTICE BARLING: There’s nothing in the rules that prevents that!

MR BREALEY: No. I imagine the little corner shop in Essex Street would just have one acquirer.

MR JUSTICE BARLING: Thank you very much.

MR BREALEY: We will probably come back to what we say is the unrealistic counterfactual of one of the major schemes having 0.9 and the other major scheme being zero. I’m probably going to come back to it time and time again, but if I can move on.

MR JUSTICE BARLING: Certainly we are talking about Visa. Shall I just show the Tribunal paragraph 620 of the decision?

And again, this is 620 essentially to 648 where Mastercard were arguing that without the MIF it could not compete with Amex. So at least this is passages in the decision -- again, it is referring to facts prior to 2007, but it shows the same argument being used. So 620:

"Mastercard argues that closed payment card systems such as American Express have a number of distinct advantages."

"Mastercard concludes that a MIF was objectively necessary for Mastercard to compete with American Express."

And then what the Commission does is it rejects it on the facts. It refers to the Australian -- again, I won’t go through it all, but it goes through the Australian evidence, for example, at 634.

"In 2001, Mastercard argued towards the Reserve Bank of Australia that the regulation of the scheme’s interchange fees lead to a death spiral," that is the phrase we see repeatedly “death spiral”, “of its scheme in Australia if interchange fees were reduced and set too low as Mastercard’s member bank would be motivated to evolve towards three-party systems. That argument is not dissimilar to key elements of Mastercard’s defence in this case."

We have been through this sort of thing before:

“As the Reserve Bank of Australia set out in a public document, Mastercard’s death spiral argument was proven wrong by events following the regulation of interchange fees.”

That is 636. Why?

"The decrease of interchange fees for Mastercard and Visa credit cards in Australia was followed by a sharp decrease of the merchant fees in both schemes. The fees of the closed schemes, American Express and Diners, were not regulated, but their merchant fees also decreased even though in a less pronounced manner."

We will see some documents on this a bit later on.

But what the Commission is referring to -- and this is 2007 and some of it has been updated, as I said earlier on -- is just not a given fact that if Mastercard is forced to reduce its interchange fees, American Express will say, "Ha, ha, fantastic, I’m going to take all their business". Why? American Express has acceptance issues. Merchants have a choice whether to take the American Express. They are not bound like the honour all cards rule. They can choose. If they see a Mastercard premium card being used at a lower rate and they see an American Express card three times, four times the rate of the Mastercard, American Express gets extremely nervous about acceptability. And that is the reason why in Australia -- and, again, this is not the complete picture -- American Express reduced its fees when it saw Mastercard and Visa reducing its fees.

Then I think if I could go to the exemption. So just so that the Tribunal know. I think, I’m at paragraph 23(d) of the opening submissions. I shall speed up tomorrow, but I have gone through, as you would expect, some of the arguments.

MR JUSTICE BARLING: Well, we have slowed you down.

MR BREALEY: Not at all.

(d):

"How did the Commission look at exemption?"

Points to note. I go to paragraph 679. We will see some documents on this a bit later on.

"How did the Commission look at exemption?"

Points to note. I go to paragraph 679. We won’t go through all the things on exemption because I shall do that when I deal with the exemption. That is very a important point; it is only three lines, but we see it in the Commission’s decision, we see it in the
MR BREALEY: Absolutely. I have not put it quite right. It is true that the Commission has not said or implied that the link between the MIF and the alleged efficiencies is that the money that is transferred from the merchant to the acquirer to the issuer, how is it that money creates the alleged efficiencies? How is it that the money that is used in the shops etc.

If we get to the exemption stage, we have got to focus on what is the link between the MIF and the alleged efficiencies. How is it that the money that is transferred from the merchant to the acquirer to the issuer, how is it that money creates the alleged efficiencies? It is a brilliant scheme and benefits consumers, the scheme does this and the scheme does that. It is a brilliant scheme and benefits consumers, the scheme does this and the scheme does that.

During his opening submission on exemption. There is a big difference between saying the scheme creates efficiencies and the MIF. So we haven’t seen, but the Commissioner has shown, that you can have a four-party payment scheme without a MIF, and it still allows people to use credit cards, it uses them in the shops etc.

If we get to the exemption stage, we have got to focus on what is the link between the MIF and the alleged efficiencies. How is it that the money that is transferred from the merchant to the acquirer to the issuer, how is it that money creates the alleged efficiencies?

PROFESSOR JOHN BEATH: Presumably we should be talking about it in relation to the additional efficiencies, because the scheme creates a set of efficiencies. Is that set enhanced by any one of them? It’s that marshalled effect that we should be thinking about.

MR BREALEY: Absolutely. I have not put it quite right. It is the additional efficiencies created by the MIF. Those efficiencies that would not otherwise be there.

MR JUSTICE BARTLING: You accept, don’t you, so we are quite clear, it is not your case that there can be no -- you accept that there is a level at which it can be exempt?

MR BREALEY: Yes. We have always said we have never gone into court saying “This is a restriction of competition, it is a zero MIF”. We have always said, right at the beginning, all that’s happened is that Mastercard has said when it comes to exemption they have set it too high, they have imposed too many costs on the merchant. If you adopt the proper test, the MIT one, the one that has been applied since its decision, the efficiencies are, and we shall see this tomorrow, the transaction costs.

So Sainsbury’s saves money if I use a card as opposed to cash. This is the MIT MIF. And when you calculate those, and it is not just a transaction cost, you may have an element of the fraud costs which are saved over and above the cash. That factors in, but those are the efficiencies; it is said that the MIF creates those efficiencies.

Now, Mr von Hinten-Reed, he will say, well, actually that is quite conservative. The application of the MIF test is actually quite a conservative test in the card system’s favour. But we have settled on the application of the MIT MIF test, recognising that merchants do save money, there are efficiencies. Therefore, we have come out at 0.15. We have seen earlier on that if you strip out the funding cost, even Dr Niels on the cost methodology, which is the cost to the issuers, not the savings to the merchants, comes out roughly the same, 0.2. It is only when you load on the funding costs, this cost of the free funding, do you then rocket up.

So we accept that there is, in this case, a lawful level of MIF that can be accepted. So 679 is extremely important, but we will see that this paragraph is endorsed by the General Court and endorsed by the CJEU. Mastercard are told to focus on the MIF, not the scheme. Having said looking at funding costs, could I just finish, I think I will finish the decision by reference to the funding costs. So if I can go to 684. We saw this morning about Visa and the funding costs.

This is the funding of credit. For the sake of argument, it is a 28-day period. Visa allowing it for EEA, saying it is unlikely, or it is maybe not going to be permitted for domestic. Then the parties finding out the exemption is unsound, and now we see the Commission’s view on EEA free funding.

Again, when one sees 684 it is very similar to the witness statements in this case and Dr Niels’ evidence in his reports.

So 684: “One of the crucial assumptions underlying the Mastercard MIF is a perceived imbalance between the issuing and the acquiring business in the scheme. Mastercard derives that imbalance from the fact that the average issuer will incur the vast majority of the scheme costs, because in the UK market 95% of the costs are skewed towards the issuing side.”

I just add here that when it comes to a read across from this decision to the present case, it is quite illustrative to note that a lot of the evidence in the Commission’s decision relates to the UK. So Mastercard are referring essentially to the UK in saying...
that there should be free funding.

So over the page, 685:

"The argument that a MIF was required because
issuing banks incurred 95% of the total cost in the UK
is a circular reason because it is precisely due to the
MIF that issuing banks incur certain costs they would
not incur in the absence of a MIF. To the extent a MIF
provides a situation to issuing banks to issue cards,
they may incur all kinds of marketing costs to push card
usage and these costs then determine ex-post the
objective necessity for MasterCard to cover these costs.
In economic terms, Mastercard’s argument suffers from
endogeneity."

Also:

"An imbalance between issuing and acquiring cannot
be assumed on the basis of cost considerations only, but
has to comprise analysis of revenues as well. A cost
imbalance is as such no sufficient evidence to explain
why Mastercard’s MIF is always paid by the acquirer to
the issuer irrespective of the concrete market
situation. If we seek interest money, exchange fees,
penalty fees or other monetary benefits, cost
savings etc from payment card issuing provides
sufficient commercial incentives for banks to invest in
incremental card issuing, a transfer from acquiring to
issuing may be superfluous and even counterproductive as
the revenue transfer dampens card acceptance due to the
increasing costs on the merchant’s side."

I rely in particular on the first sentence of 686,
because Mastercard is being told that if you are going
to base it on cost, you have to look at the revenues.
And one sees at footnote 829:

"In the UK, for instance, issuing banks generated
90% of their revenues with income from cardholders,
mainly interests, and only 10% from interchange fees.
The magnitude of issuer revenues from cardholders in the
UK show that not only the costs, but also the revenues
of credit cards must be skewed to the issuing side in
the UK market. Mastercard neglects this in assuming
an imbalance. Moreover, it should be clarified in this
context that at the Visa 2 decision, the Commission
accepted a cost benchmark for exempting MIF for a
five-year period until 2000."

Then they refer it expires.

"I know Visa have proposed this cost benchmark in
order to meet the Commission’s concern that Visa’s board
had unlimited discretion for setting interchange fee
rates."

I wanted to emphasise that, because the
General Court endorses this and says that if you are
going to start arguing about an imbalance and you are
going to start arguing about merchants paying for the
cost of free funding, you can’t just look at that
imbalance and say, well, I’m going to look at the costs.
You have got to look at the interest that issuing banks
get which, on these figures, constitutes 90% of the
revenue from credit cards.

Clearly, that is a fact that is relevant to the
death spiral that, again, Mastercard submit in the
present proceedings about losing business to Visa.
But we will come onto that.

PROFESSOR JOHN BEATH: Really I wondered if you wanted to
draw our attention to the closing sentence of
paragraph 686 about robust and empirical evidence and
underlining the word robust?

MR BREALEY: You are absolutely right, sir and it is
something that I will touch on:

"Robust empirical evidence is therefore required to
establish the necessity for and the direction of
a fallback interchange fee."

I shall pick up at this point --

PROFESSOR JOHN BEATH: That’s fine if we are going to --

MR BREALEY: No, you are absolutely -- because, again, it is
something that the Commission say in its decision. We
haven’t seen robust evidence, and when we come to

annex 6, again, the Commission says that the evidence is
not robust. But I am obliged.

Again, I’m on the free funding period. If I could
go to paragraph 742.

Having said at the last sentence of 741:

“The Commission’s concerns under the second
condition of 81(3) relate to the customer group which
bears the cost of the MIF, that is the merchants.”

At 742.1:

"While merchants may benefit through enhanced
network effects ..."

(Pause)

"While merchants may benefit through enhanced
network effects from the issuing side, this does not
necessarily offset their losses which result from paying
inflated merchant fees. The Commission has therefore
reviewed how Mastercard sets an upper limit to its
interchange fee. Mastercard in practice ..."

Then the rest is a business secret, I won’t read it
out:

"As set out in detail in the supplementary
statement of objections, this benchmark includes cost elements
that are not related to services which sufficiently
benefits merchants. It remains unproven that merchants
benefit from bearing the financial burden of issuers for
the provision by issuers to cardholders of a so-called free funding period. Moreover, the Commission doubts that merchants sufficiently benefit from bearing the financial cost of issuers writing off bad debts and collecting debts from cardholders. Again, these are the sort of costs being offloaded onto merchants.

We see from the witnesses of fact that with the monoline banks, Capital One -- this is their own evidence -- that there was more competition in the UK, more people coming into the market, more banks, financial institutions lending money to people, taking risks, lending money to customers who could not pay and yet this is being offloaded onto the merchants. It is something we will have to explore in the evidence, but this is why the Commission is so against it. That is blanked out, but the name of the consultant one can see from the report of Dr Niels: "... evidence on the benefits to merchants form the extension of credit. In the Commission’s view, that study does not establish that merchants sufficiently benefit from a cost benchmark, which includes the cost of a free funding period, that is a period during which a cardholder makes use of free credit. For details, and then we see annex 6.

Annex 6 is at page 1242. So Mastercard submitted a study apparently which said that merchants do benefit from the free funding. It was rejected, and I just ask the Tribunal to note, but 746 finally:

"A bank in the UK submitted on 22nd September to a study conducted by ..." That is blanked out, but the name of the consultant one can see from the report of Dr Niels: "... evidence on the benefits to merchants form the extension of credit. In the Commission’s view, that study does not establish that merchants sufficiently benefit from a cost benchmark, which includes the cost of a free funding period, that is a period during which a cardholder makes use of free credit. For details,"

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as to under what headings they are talking about.  
So paragraph 31 and 32 is the objective necessity, and I can just pick this up at 106 to 121.

"Insofar as the MIF constitutes a mechanism for the transfer of funds to issuing banks, its objective
necessity for the operation of the Mastercard system
must be examined in the wider context of the resources
and economic advantage, which the banks derive from
their card issuing business."

Now, 107 is a reference to the interest point which it picks up later and we shall see this tomorrow:

"... but it must be noted that credit cards generate significant revenues for issuing banks consistent, in particular, with the interest charged to cardholders.

It is thus clear from recital 346 to the SSO, to which reference is made in 162 of the decision, therefore
issuing banks' importance of lending money via credit cards may be high, especially in markets where credit cards are widely used, such as in the UK, the country with the highest number of MasterCards with a credit facility. This assessment also appears in footnote 829 to the contested decision in which it is pointed out that in the UK the issuing banks generate 90% of their revenue from interest and only 10% from interchange fees."

fees."

Then they deal with debit cards. 109:

"It must be observed that the existence of such revenues and benefits make it unlikely that without a MIF an appreciable proportion of banks would cease or significantly reduce their MasterCard issuing business."

Again, MasterCard seems to have been arguing these points before the General Court:

"... unlikely that without a MIF an appreciable proportion of banks would cease or significantly reduce their MasterCard business or would change the terms of issue in holders of their cards or favouring other forms of payment ...[this is for the transcript 109] Or turning to cards issued under three-party schemes which might effect the viability. ... In other words, while a reduction in the benefit conferred on cardholders and the profitability of the card... issuing business might be expected in a system without operating a MIF. It is reasonable to conclude that such a reduction would not be sufficient to effect the viability of the MasterCard system."

Then 111 refers to the Australian evidence. That conclusion is reinforced by the Australian example to which the Commission referred. It is clear from that example that a substantial reduction in the MasterCard's system that was imposed by the Reserve Bank of Australia had no notable impact on the system's viability and in particular did not lead to a move towards three-party schemes even though such schemes were not affected by the regulations.

We can go on but 114:

"The fact remains that if such a mechanism were objectively necessary as claimed by the applicants, the significant reduction in interchange fees imposed in Australia could reasonably be expected to have an adverse impact on the operation of the MasterCard system. No such impact was produced."

It goes through some of the facts. So we don't know precisely the sort of arguments that were being advanced to the General Court, but, clearly, similar sort of arguments that we have been debating before the break about the migration of business to others was raised and the General Courts are saying well you have got all this interest --

MR JUSTICE BARLING: In 110 they seem to be drawing a distinction between the reduction in profitability and an absence of viableness.

MR BREALEY: Correct. That is the mission impossible test and we will see this becomes -- it is not mission difficult under whatever, it is mission impossible, and...
MR JUSTICE BARLING: It is an exemption point you say.

MR BREALEY: This is the CJEU and paragraph 232 referring to: you have got to look at the efficiencies created by the MIF not the scheme.

MR JUSTICE BARLING: If we --

MR BREALEY: Then I can almost --

MR JUSTICE BARLING: If we read those... 

MR BREALEY: If my Lord has questions on that, I can then just go straight onto the next section, which is infringement. I have covered a lot of the ground in infringement because of the discussion we have been having today.

MR JUSTICE BARLING: Right, is that a convenient moment?

MR BREALEY: Yes.

MR JUSTICE BARLING: Then we will see you again at 10.30 am. Thank you.

(4.30 pm)

(The court adjourned until 10.30 am on Tuesday, 26th January 2016)
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