

OPUS 2

INTERNATIONAL

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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1 Monday, 25th January 2016
 2 (10.30 am)
 3 MR JUSTICE BARLING: Good morning, Mr Brealey.
 4 MR BREALEY: Good morning, my Lord.
 5 MR JUSTICE BARLING: Good morning, everyone.
 6 MR BREALEY: Here at last. My Lord, if I could just make
 7 the formal introductions.
 8 MR JUSTICE BARLING: Yes.
 9 MR BREALEY: I appear on behalf of Sainsbury's Supermarkets
 10 Ltd. with Mr Derek Spitz and Ms Sarah Love. And
 11 Mark Hoskins QC appears on behalf of MasterCard Inc and
 12 the related MasterCard companies along with
 13 Mr Matthew Cook, and Mr Hugo Leith, who is behind
 14 Mr Cook.
 15 I suppose we should just very quickly take a rain
 16 check on the bundles.
 17 MR JUSTICE BARLING: Yes. We have got a few bits and pieces
 18 just to talk to you about.
 19 MR BREALEY: Yes.
 20 Housekeeping
 21 MR JUSTICE BARLING: You want to do your rain check first?
 22 MR BREALEY: It is just that we have obviously got the core
 23 bundles. I can see really you have got the whole set.
 24 MR JUSTICE BARLING: Yes.
 25 MR BREALEY: I will be going mainly to some of the documents

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1 in the E bundles.
 2 MR JUSTICE BARLING: Right. I think we have got a question
 3 relating to bundles, which is to what extent the
 4 F bundles will be needed for witnesses or there are
 5 documents in the F bundles that the witnesses refer to.
 6 MR BREALEY: I think it is almost inevitable. So, we could
 7 play it two ways. Either we get a set of F bundles or,
 8 in advance, at least one tries to highlight those
 9 documents that we will be referring to.
 10 MR JUSTICE BARLING: That's something we will leave to you
 11 and Mr Hoskins.
 12 MR BREALEY: And we can then just have a witness -- Yes, I
 13 do understand the logistics of having all those
 14 documents.
 15 MR JUSTICE BARLING: We might need another set of them, you
 16 see. Because I think for economy's sake we have only
 17 got one here, haven't we?
 18 MR BREALEY: Correct, yes.
 19 MR JUSTICE BARLING: Which we have in our retiring room and
 20 which obviously we would prefer to keep there. So if
 21 you did need a whole set for the witnesses then you
 22 would probably have to provide it, or obviously if you
 23 can extract things and make a sort of mini F, then --
 24 MR BREALEY: I, for my part, and I should imagine
 25 Mr Hoskins -- I can speak for him -- well, I can't

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1 actually. But I will, for my part, try and do a mini F.
 2 I mean, I know for a fact there are documents I want to
 3 put to certain witnesses which are not in the core
 4 bundle.
 5 MR JUSTICE BARLING: Okay.
 6 MR HOSKINS: For our part, we have tried to make sure that
 7 all the documents we are going to refer to in
 8 cross-examination are in the E bundles.
 9 MR JUSTICE BARLING: You are going to try to --
 10 MR HOSKINS: No, we have done that. I might have further
 11 thoughts, but to be honest, then I would probably just
 12 add them into the E bundles. That is the basis on which
 13 we have prepared them.
 14 MR BREALEY: I can go E whatever it is.
 15 MR JUSTICE BARLING: We will leave that with you then for
 16 the moment.
 17 Is there anything else before we start? Probably
 18 our list might pick up quite a lot --
 19 MR BREALEY: Shall I go with my Lord's list?
 20 MR JUSTICE BARLING: Let's see where we get to.
 21 In no particular order, I think so far as the trial
 22 timetable is concerned, everyone is now assuming that we
 23 will be going into the week of 14th March. I think that
 24 is right, isn't it? Because we are all assuming that
 25 the days of the 15th, 16th and 17th February might have

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1 to be non-sitting days. I mention this just to make
 2 sure that people are singing from the same hymnsheet.
 3 MR BREALEY: The most recent hymnsheet is Monday, 14th is
 4 Mr Hoskins' oral closing.
 5 MR JUSTICE BARLING: Of March?
 6 MR BREALEY: Of March, yes.
 7 MR JUSTICE BARLING: How much of that --
 8 MR HOSKINS: Sir, I have not seen one to that effect. The
 9 most recent one I have is non-sitting days, sir, as you
 10 said.
 11 MR JUSTICE BARLING: March. You are probably looking at
 12 February.
 13 MR HOSKINS: I'm looking at 14th March. It says "Claimant,
 14 oral closing". Sorry, I thought it said "Mr Hoskins,
 15 oral closing". My mistake.
 16 MR BREALEY: Okay, I have been truncated then.
 17 I'm starting my closing on the Friday and continuing
 18 on the Monday, and then Mr Hoskins goes on the Tuesday.
 19 MR JUSTICE BARLING: Yes. Okay. So it sounds as though we
 20 are all roughly on the same page on that point.
 21 Then there are a few points in relation to
 22 confidentiality arrangements. I don't know to what
 23 extent you have been alerted to this, but at the moment
 24 the confidentiality ring is purely one in the High
 25 Court. And, well, speaking for myself, it seemed to me

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1 that there ought to be something in this Tribunal as
2 well, to make the matter effective. Because presumably
3 it would be this Tribunal who had to deal with any
4 problems.

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

10 What we would propose to do would be to let you have
11 some hard copies some time today to take home, but also
12 email you the drafts. But the feeling is, because the
13 High Court orders are very wide indeed, there is over
14 100 people, I think, on -- and they cover virtually all
15 the material and the undertakings are in very wide
16 terms, that, therefore, the new orders in the CAT ought
17 probably ideally to be culled and to reflect the people.
18 That's one thing.

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

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1 who are going to be involved in these proceedings.

2 So I'm afraid that's another burden that we ought to
3 try to cover off.

4 MR BREALEY: We will definitely have a look at that today.

5 MR JUSTICE BARLING: As soon as possible.

6 Then --

7 MR BREALEY: It does impact to a certain extent, I don't
8 know if my Lord and the Tribunal have had updated
9 opening submissions that are coloured yellow and
10 coloured blue?

11 MR JUSTICE BARLING: We understand they have been put in our
12 bundles; is that right? Further skeletons --

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

18 I will be referring to some of MasterCard's --

19 MR JUSTICE BARLING: Yes. Are they unchanged apart from
20 that?

21 MR BREALEY: Word for word.

22 MR JUSTICE BARLING: Right.

23 MR BREALEY: But it will mean that some of it I will not go
24 into the detail in opening.

25 MR JUSTICE BARLING: Sure.

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1 MR BREALEY: Because it is just --

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

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

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

11 Effectively there's no objection from your side to that;
12 is that right?

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

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

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

23 MR BREALEY: I'm sorry.

24 MR JUSTICE BARLING: You weren't aware of that?

25 MR BREALEY: No, I'm sorry.

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

4 MR BREALEY: Who are the recipients, yes.

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

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

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

18 MR JUSTICE BARLING: Who would be watching it. All right,
19 that's probably something just to discuss with your
20 opposite numbers too, isn't it?

21 Moving away from confidentiality onto evidence, we
22 have got, as you are aware, a fourth expert report on
23 behalf of Mr Greg Harman dated 20th January. There has
24 been a request for it to be put into the core bundle,
25 and we haven't done that at this stage because we

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1 haven't had a reaction yet from the claimants. Indeed,
 2 I think I'm right in saying that none of us have read it
 3 for the same reason. We thought we ought to wait and
 4 see what the position was on that.
 5 I don't know whether you are in a position to tell
 6 us what we should do.
 7 MR BREALEY: I will double check and take instructions, but
 8 I'm almost certain that you can read it. And there is
 9 a further expert report, very short, from our side which
 10 replies to it, then really the Tribunal has all the
 11 evidence which the parties want to adduce.
 12 MR JUSTICE BARLING: We will assume that is the case then
 13 unless you tell us pretty soon that it is not. We have
 14 dealt with the bundle F matter and we can leave that.
 15 Is there anything else on the bundles?
 16 MR SMITH: Yes, Ms Boyle has our scheduled information
 17 which, when we did our prereading, we thought it might
 18 be helpful to have compiled. By way of example, from
 19 Mr von Hinten-Reed says a great deal about the effect of
 20 MIF regulation in Australia, and Dr Niels says a great
 21 deal about the MIF differential as regards Maestro.
 22 We appreciate that those points are controversial in
 23 terms of what one reads into the examples of what
 24 happens in the market. But it did occur to us that it
 25 would be helpful to have some form of agreed matrix of

1 the underlying facts so that we could confine ourselves
 2 to debating their significance.
 3 Additionally, there were some more general facts and
 4 figures which I am sure could be culled from the bundles
 5 which we have. But we wondered whether the parties
 6 might be able to agree the basic underlying information
 7 regarding certain aspects of card payments without going
 8 through them orally. We have set them out in a schedule
 9 which, either now or during the short break, Ms Boyle
 10 can hand out to the parties --
 11 MR BREALEY: Thank you very much.
 12 MR JUSTICE BARLING: Then, the other brief matters are -- we
 13 will have a look at those and then we hope you will be
 14 able to, as Mr Smith says, perhaps provide us with some
 15 facts and figures.
 16 We propose on sitting days to take a short break.
 17 I assume the shorthand would appreciate short breaks in
 18 the morning and afternoon to sort yourselves out, so we
 19 will do that at some convenient moment on each session.
 20 If we forget, just let someone know if your fingers are
 21 very tired.
 22 Then I think, probably this should have been
 23 mentioned sooner but unsurprisingly we have all got
 24 credit cards and debit cards. Some of us have
 25 MasterCard. Actually, both my debit and credit are

1 Visas, but I think my colleagues have got some
 2 MasterCards.
 3 PROFESSOR JOHN BEATH: I have two MasterCards.
 4 MR JUSTICE BARLING: I certainly haven't got a Nectar card.
 5 I don't think any of us have Nectar cards. We are not
 6 sure whether any members of our family have.
 7 MR SMITH: I noticed that one of the experts comes from FTI,
 8 and I should just mention that in another case that I'm
 9 dealing with as counsel, we have FTI as an expert.
 10 There's no overlap in terms of personnel, but I just
 11 thought --
 12 MR BREALEY: I'm grateful.
 13 MR JUSTICE BARLING: I think, Mr Brealey, those are the sort
 14 of initial points we have got and we needn't delay you
 15 any longer now.
 16 I don't know whether you have any other housekeeping
 17 points or whether we have covered everything?
 18 Opening submissions by MR BREALEY
 19 MR BREALEY: No, I think we are in a good place.
 20 I'm more or less going to go through the opening
 21 submissions. I mean, I'm obviously not going to read it
 22 out. I want to highlight the key documents, draw things
 23 together that might not otherwise seem crystal clear.
 24 If I could just summarise, I'm going to go, that
 25 means, to the regulatory context first, but can I just

1 summarise where Sainsbury's is coming from, just to
 2 formally open this case.
 3 So, as the Tribunal will be aware, Sainsbury's seek
 4 damages running into many tens of millions of pounds in
 5 relation to the amounts it paid in merchant service
 6 charges, called the MSCs. And these MSCs were paid for
 7 the processing of purchases made by MasterCard credit
 8 and debit cards from December 2006.
 9 Those MSCs consisted mainly of interchange fees set
 10 by MasterCard which we say breached article 101 of the
 11 treaty.
 12 We set out the issues; there are quite a lot of it.
 13 This is quite an exam question at the end of the day.
 14 But if I could just summarise very quickly where we are
 15 coming from on the issues.
 16 So first on the regulatory context, we shall see
 17 that both MasterCard and Visa have been investigated at
 18 length by the competition authorities. Neither payment
 19 card scheme has received an exemption for the UK MIF.
 20 Both payment card schemes were informed, were told,
 21 in around 2006, and we shall see this a bit later on,
 22 that the Visa exemption for the Visa EEA MIF was
 23 unsound. That's the quotes: Was "unsound". So they
 24 were told in 2006 that the Visa exemption was unsound
 25 and unlikely to be renewed, and that's why it was not

1 renewed. It expired in 2007 and so that Visa 2002
 2 exemption for five years was not renewed.
 3 We know that MasterCard knew from 2007 that the
 4 basis upon which it set the EEA MIF was unlawful. So it
 5 knew that, if not before, certainly in 2007. As
 6 a result of which MasterCard offered the undertakings to
 7 reduce the EEA MIF to 0.3, those undertakings were in
 8 2009, and Visa made similar commitments as regards the
 9 EEA MIF. So there was the infringement decision,
 10 undertakings and commitments.
 11 But, and this is quite important, MasterCard did not
 12 follow the logic of the infringement decision and of
 13 MasterCard's unsuccessful appeals to reduce the MIFs
 14 generally, let alone the UK MIF.
 15 It is clear from the documents that both Visa and
 16 MasterCard were told that the level of MIFs generally
 17 were inefficient, and when we get to the EU regulation,
 18 the EU has told both card companies that as a result of
 19 their unwillingness and, I quote, "proactively to adjust
 20 their practices", they would be regulated, and indeed
 21 they were so.
 22 We have seen that the regulation EU wide was adopted
 23 because both payment card companies were unwilling to
 24 adjust their practices. I'm going to spend most of this
 25 morning on the regulatory context because there are some

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1 important documents.
 2 After this regulatory context, I shall explain why
 3 the UK MIF set by MasterCard distorts competition. In
 4 short, the MIF, the UK MIF, affects price competition
 5 between competitor banks. It imposes an inflated
 6 minimum price on the MSC.
 7 One could not really think of a more classic case
 8 for article 101 to intervene to some sort of consensus
 9 collective price agreement that imposes a minimum price
 10 and which is, to boot, inflated.
 11 And MasterCard does not, when one sees the skeleton,
 12 really dispute that the MIF sets a minimum price, which
 13 can go higher. We will come onto their skeleton in
 14 a moment, but one really doesn't see this denied at all.
 15 Instead, in the section on infringement it relies on
 16 a few counterfactuals to suggest that this collective
 17 price cannot restrict competition.
 18 One such counterfactual has already been expressed,
 19 rejected by the Court of Justice, and the other appears
 20 new, but we say is totally and utterly unrealistic. And
 21 this is essentially the Visa counterfactual. And in any
 22 event is incorrect as a matter of legal analysis.
 23 Just to recap, they don't really deny that it sets
 24 a floor. They didn't really deny that competition
 25 between competing banks is somehow restricted, but they

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1 rely on two counterfactuals to say actually this
 2 restriction is not a restriction of competition within
 3 article 101. We say that these two counterfactuals are
 4 wholly unrealistic.
 5 After that, I shall move to exemption and what the
 6 lawful level of the UK MIF should have been. I shall
 7 explain how the merchant indifferent test works and how
 8 this was adopted by the EU, DG Comp, in its
 9 investigations, and in regulation 215751, the
 10 interchange fee regulation. This merchant indifferent
 11 test which the Tribunal has picked up is now adopted at
 12 EU level.
 13 I note, and the Tribunal may have seen this,
 14 MasterCard it seems does not justify any calculation
 15 made by it at all. And I emphasise the word
 16 "calculation". We do not see really any calculations
 17 that have been made by MasterCard, which then receive
 18 the level of MIF.
 19 In all the disclosed documents we do not see
 20 a detailed account of how the UK MIF was arrived at. X,
 21 Y, Z, whatever. And certainly their expert, Dr Niels,
 22 does not purport to justify any MasterCard calculations.
 23 Instead, Dr Niels takes the levels that were actually
 24 set by MasterCard and then seeks to justify them ex post
 25 facto by reference to his own methodologies.

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1 One of the methodologies is the same discredited
 2 methodology that we have seen in the Commission
 3 investigation. Essentially, we can call it the issue
 4 with cost methodology, whereby MasterCard imposes the
 5 cost of free funding onto the merchants.
 6 The other methodology appears to be some sort of
 7 methodology by reference to the Amex card, but I shall
 8 take you no further than that. But I do emphasise the
 9 point that we do not see in the documents any real
 10 calculation made by MasterCard as to how it calculated
 11 the MIF, and in the economic evidence you don't see the
 12 economist picking up the calculation and saying the
 13 process was actually spot on. We get the level and then
 14 Dr Niels tries to justify the level by reference to his
 15 own methodologies.
 16 MR JUSTICE BARLING: So just pause for a second. Just for
 17 the sake of the transcript writers, as you are going to
 18 be using the phrase "MIF" for quite a lot of the
 19 hearing, it is M-I-F. It is a shorthand rather than, it
 20 might be a bit easier for you to type it.
 21 MR BREALEY: I'm sorry. So MIF. It has been coming out
 22 slightly strangely.
 23 So that is exemption. Obviously that's quite
 24 a complicated area, but a big, big issue here. And
 25 I shall come onto this a bit later on, is this cost of

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1 free funding.
 2 Because this really seems to be, in a nutshell,
 3 I mean, it is a very complicated case and you can always
 4 look for bright line points, and this is one such bright
 5 line point, the cost of free funding is an important
 6 issue.

7 After exemption, obviously that leads to the
 8 overcharge and after the overcharge I shall explore
 9 pass-on. MasterCard says that Sainsbury's has not
 10 suffered any loss because it will have priced higher
 11 than it would otherwise have. And this is extremely
 12 interesting, and the Tribunal have picked it up from our
 13 opening, because as you will have seen, MasterCard has
 14 for over a decade, for over ten years, forcefully
 15 submitted -- Mr Smith has referred to the Australian
 16 scenario -- has forcefully submitted for over a decade
 17 that there is zero pass-on.

18 This is not just statements; they have relied on
 19 economists' reports and studies to support this. It is
 20 quite striking that they have been submitting for all
 21 these years that there is zero pass-on, and now they
 22 come to this Tribunal and they say, "Well, actually, it
 23 is 100% pass-on".

24 Whatever you make of it, we shall see, but certainly
 25 when they come to this Tribunal and refer to economic

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1 theory and presumptions, it is an extremely bizarre
 2 approach.

3 But, in any event, Sainsbury's denies that the
 4 overcharge was passed on to its customers in the form of
 5 higher prices. After that, I shall very briefly look at
 6 interest, but you will have picked up that both experts
 7 accept that any interest should be compounded and they
 8 simply differ on how the compound interest should be
 9 calculated.

10 After that, I shall deal with the last issue, what
 11 is called the *ex turpi causa* defence. MasterCard argues
 12 that because Sainsbury's Supermarkets had a half sister
 13 called Sainsbury's Bank, the whole of its claim should
 14 be dismissed, and we disagree. In a nutshell,
 15 MasterCard have to prove at least two fundamental facts.
 16 First, that the supermarket and the bank were one
 17 economic unit. And we say that can't be established, at
 18 least because, for regulatory reasons, the bank had to
 19 act independently in the market. Sainsbury's
 20 Supermarkets had no decisive influence or control over
 21 the bank. And second, MasterCard must show that the
 22 bank was significantly responsible for the breach, which
 23 is the test adopted in *Courage v Crehan*, as my Lord well
 24 knows. And we say MasterCard can't establish that
 25 Sainsbury's Bank had to sign on MasterCard's standard

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1 terms and conditions, a factor that the
 2 European Court of Justice in *Courage v Crehan* referred
 3 to. And it is quite clear, and MasterCard makes the key
 4 point time and time again, that it was MasterCard alone
 5 that set the interchange fee, and had it set
 6 an interchange fee at a correct level, there would have
 7 been no infringement of article 101.

8 So that is essentially kind of in the nutshell where
 9 we are coming from and why we are here.

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

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

20 MR BREALEY: I'm not sure why --

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

23 PROFESSOR JOHN BEATH: The charge.

24 MR BREALEY: Certainly, if it is the flow of funds, it is
 25 the other way round. One day it might be the other way,

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1 but not ...

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

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

6 MR JUSTICE BARLING: Yes.

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

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

11 MR BREALEY: Sure.

12 So regulatory context. What I would like to do is
 13 start with the Visa exemption decision and go through
 14 that. You have probably seen it, but I'm surprised
 15 every time I read these documents that one sees new
 16 points.

17 I think because this is the start of the
 18 investigation we should look at it in some detail, so
 19 could we go to bundle E1, tab 2 because clearly when one
 20 sees the economic evidence and MasterCard's submissions,
 21 they are still coming back to this exemption decision.
 22 They still rely on it.

23 It is important to see what it does. So in the
 24 opening submissions, I describe it to a certain extent,
 25 but I'm going to highlight various recitals in the

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1 decision, and the first one is recital 9, to see what
 2 actually they were looking at.
 3 Bundle E1, tab 2, the Visa exemption decision.
 4 Start with recital 9.
 5 So:
 6 "The present decision relates to the proposed
 7 modified Visa EU intraregional interchange reimbursement
 8 fee scheme for consumer cards to be implemented in the
 9 Visa rules in the course of 2002. The interchange fee
 10 scheme is applicable to cross-border Visa consumer card
 11 transactions and merchant outlets in the EEA [15 in
 12 those days] and by default to domestic Visa card
 13 payments operations within a member state in cases where
 14 no distinct Visa interchange fee rate has been set by
 15 the national Visa member for that member state."
 16 As far as Visa was concerned, if I can call it the
 17 EEA MIF applied by default to certain domestic MIFs.
 18 But then:
 19 "However, the present decision relates only to the
 20 notified intraregional interchange fee of Visa as
 21 applied to cross-border Visa card payment operations
 22 between EU member states, not to any domestic
 23 interchange fees set by national Visa members, nor to
 24 the application of the intraregional interchange fee of
 25 Visa to domestic Visa card payment operations within a

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1 member state."
 2 So although the EEA MIF did apply in certain
 3 circumstances to the domestic MIF -- I guess because,
 4 whatever, the costs were the same, I just don't know --
 5 when it comes to what was exempted, it is only the EEA
 6 MIF. They were not exempting the EEA MIF insofar as it
 7 applied to domestic MIFs.
 8 We shall see that in this Visa exemption decision
 9 the Commission is quite careful to distinguish at times
 10 between the EEA MIF and any domestic MIF.
 11 Then, if one goes to recital 13:
 12 "As from its introduction, the MIF set by the Visa
 13 EU board has been set as a percentage of net sales.
 14 Despite the carrying out of a cost study for reference
 15 purposes, the Visa EU board has been free to set the MIF
 16 at any level it considers appropriate independently of
 17 any specific services provided by issuing banks to the
 18 benefit of acquiring banks."
 19 Quite an important point for present purposes, and
 20 at some point we are going to have to sort out the
 21 confidentiality. Certainly that is the case in the 2007
 22 infringement decision insofar as regards MasterCard.
 23 That is exactly the same logic that MasterCard was
 24 applying, that MasterCard in the 2007 infringement
 25 decision said that the EEA MIF was not geared to

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1 a particular service or to certain costs. It had a free
 2 rein to set the MIF at the level it wants. One of the
 3 reasons, and I think this is common ground, that the
 4 card companies want to set the level of MIF to be
 5 competitive.
 6 So they are always looking, and this is one of
 7 Mr Hoskins' counterfactuals, over their shoulder to see
 8 what the competitor is doing.
 9 Why is this relevant? If one goes to paragraph 80
 10 of this decision, to recital 80:
 11 "Prior to the modifications described above ..."
 12 Now, just pausing there, as you will have picked up
 13 what the Commission did was say "Well, you can't have
 14 a free rein, you just can't have an open-ended
 15 discretion, you have got to do it by reference to some
 16 criteria". And in this decision, they set it by
 17 reference to certain costs, one of which was the free
 18 funding, the payment guarantee and the transaction
 19 costs.
 20 But insofar as -- I can call it the free rein:
 21 "The Visa MIF was considered by the Commission in
 22 its supplementary statement of objections on
 23 29th September 2000 as not satisfying in particular the
 24 second condition of article 81(3), notably because the
 25 Visa EU board was free to set the MIF at any level it

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1 wished, independently of the costs of the specific
 2 services provided by issuing banks to the benefit of
 3 merchants."
 4 I just pause there.
 5 I'm obviously not going to go through the whole --
 6 so just to pick up this point of the free rein and when
 7 we see the evidence in this case. If it is seen that
 8 the payment card companies say they should have a free
 9 rein, Dr Niels says they should be determined by -- let
 10 the market decide. If they shall have a free rein, we
 11 see here even in 2002 the Commission is saying that sort
 12 of approach cannot be exempted. You cannot have
 13 a situation where the payment card company is, for any
 14 old reason, just setting a MIF which is ultimately going
 15 to be borne by the merchants. It has to be done by
 16 reference to certain criteria, which in this case it
 17 fixed on certain costs. And we will then see how those
 18 costs panned out later on in the investigation.
 19 But the point I'm trying to emphasise here is even
 20 in these early stages the Commission was saying to the
 21 card companies you can't just have a free rein by
 22 reference to unlimited set of factors if you want
 23 an exemption.
 24 Then recitals 21 and 22, we see what Visa was forced
 25 to do in this, to modify, in order to get this

24

1 exemption, it had to abandon this kind of free rein and
 2 use -- this is recital 21:
 3 "Under the modified scheme, Visa will use these
 4 three categories of issuer's costs involved in supplying
 5 Visa payment services as an objective criterion against
 6 which to assess the Visa intraregional MIFs currently
 7 paid by acquirers to issuers."
 8 We see these costs time and time again in all the
 9 cases:
 10 "These three cost categories are the cost of
 11 processing transactions, the cost of the free funding
 12 period for cardholders, the cost of providing the
 13 payment guarantee."
 14 Then we see some footnotes.
 15 We will come onto this in the evidence, we will go
 16 into this in far more detail.
 17 In a nutshell, what is this cost of free funding?
 18 It is essentially if you have got your credit card, you
 19 make a purchase, you have 28 days in order to pay
 20 it off.
 21 If you don't pay it off, for example, in 28 days you
 22 start paying interest. So what the credit card
 23 companies do, Visa and MasterCard -- well, certainly
 24 this is essentially what it is all about, the issuers
 25 incur costs of the 28-day period and those costs are

25

1 then offloaded onto the merchant. So maybe the issuing
 2 bank has to borrow the money in order to -- we will come
 3 onto this in the evidence, but there is a cost to
 4 an issuer bank in giving the credit to the cardholder
 5 for 28 days.
 6 What the schemes have done is offload these costs
 7 onto the merchant. The significance of this I'm going
 8 to refer to in a moment, but what doesn't happen is that
 9 then obviously if the cardholder doesn't pay it off,
 10 pays interest, the merchant takes no share of that. So
 11 the issuing bank retains the interest after, say, the
 12 28-day period.
 13 And the European Commission has objected in itself
 14 to this cost of free funding, saying this is not a cost
 15 a merchant should bear; the 28-day period is essentially
 16 between the issuing bank and the cardholder. It should
 17 not be offloaded onto the merchant. And the Commission
 18 said even if you were going to take it into
 19 consideration, you have to also take into consideration
 20 the substantial revenues that you have obtained from
 21 interest. That has been the case of the European
 22 Commission for almost ten years and it has been endorsed
 23 by the General Court.
 24 If you are going to adopt the cost methodology you
 25 cannot just offload the 28-day period cost onto the

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1 merchant and then just ignore the vast sums that you
 2 earn in interest. We will come onto this in a moment.
 3 I'm trying to explain the fundamental reasons.
 4 You see at paragraph 22 that the Commission is to
 5 a certain extent feeling its feet on these costs because
 6 it says that Visa will submit to the Commission within
 7 12 to 18 months of the adoption of the decision the
 8 first cost study showing the calculations based on the
 9 three cost categories mentioned above.
 10 It is quite clear, as I say, that the Commission was
 11 feeling its feet, didn't actually have any detailed cost
 12 calculations on which it could make a definitive view.
 13 But since, obviously, it was a very important point in
 14 order to -- you can just see that the Commission almost
 15 took Visa at its word and said, "Right, I'm going to
 16 exempt you for five years, I'm actually going to sound
 17 the market out. You have got to give me some detailed
 18 cost studies. I'm going to listen more to third
 19 parties, what they are going to say, but you can have
 20 an exemption for five years."
 21 I will come onto this cost of free funding again in
 22 a moment. Objective necessity, if I could just pick
 23 this up at 58 and 59.
 24 Now, 58 and 59 is about objective necessity. So
 25 Visa was arguing that, or to a certain extent, this MIF

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1 was important. And one has seen this from the
 2 MasterCard submissions. They say that article 101
 3 doesn't really apply because the MIF is essential for
 4 the operation of the scheme.
 5 One sees in Dr Niels' report and
 6 Mr von Hinten-Reed's report this reference to ex-post
 7 pricing.
 8 The counterfactual, the hold-up issue, so that if
 9 you get rid of the MIF but you still have the honour all
 10 cards rule, issuing banks get into a position of power.
 11 We will come onto this again, but I'm trying to flag the
 12 point and then they will abuse the system and the whole
 13 system starts to collapse. This is what the payment
 14 card scheme operator was saying: that without the MIF,
 15 if you have got the honour all cards rule it is going to
 16 collapse.
 17 I refer to this, particularly paragraph 59. There's
 18 a lot in paragraph 59, but it is concerned in large part
 19 with this hold-up problem.
 20 If I can just take 58 or 59 more slowly:
 21 "The Commission disagrees with the argument put
 22 forward by Visa that the MIF falls outside the scope
 23 of 101."
 24 This is what Dr Niels is saying in this case:
 25 "For a start, the Commission doubts whether it is

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1 correct that none of the Visa members can carry out the
 2 project or activity covered by the ...(Reading to the
 3 words)... It seems that at least the Visa group members
 4 and larger banks are capable of offering a card payment
 5 system alone."
 6 59 is important:
 7 "Secondly, the Commission accepts that at least as
 8 concerns the medium-sized and small banks and Visa, the
 9 cooperation enables them to provide a service that they
 10 could not provide individually. This is why
 11 the Commission has not objected to the majority of the
 12 rules notified by Visa concerning the functioning of the
 13 Visa international payment card system. However, it
 14 cannot be argued that the MIF itself enables the Visa
 15 member banks to offer the Visa card service since Visa
 16 itself admits that the Visa scheme would exist without
 17 MIF."
 18 This is very important when it comes to Mr Hoskins'
 19 counterfactuals:
 20 "Visa only says that without the MIF the scale of
 21 Visa's operations would be greatly reduced and so would
 22 its competitive impact."
 23 Again, Visa only says that without the MIF the scale
 24 of Visa's operations would be greatly reduced and so
 25 would its competitive impact.

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1 So we can flip that and say that Visa only says that
 2 without the MIF -- sorry, we will go back sorry to the
 3 transcript:
 4 "MasterCard only says that without the MIF the scale
 5 of MasterCard's operations would be greatly reduced and
 6 so would its competitive impact. The product offered to
 7 both classes of user could be different and inferior.
 8 Cardholders would not get access to a smaller network of
 9 merchants and ...(Reading to the words)... cardholders."
 10 This is the bit I really want to emphasise:
 11 "Such arguments, however, are to be considered under
 12 article 81(3)" that is 101(3) "and not 81.1,
 13 ie article 101."
 14 That is the first point that I want to get from
 15 this, that when the Tribunal sees Mr Hoskins saying, on,
 16 if the MIF is at zero, we are not going to be as
 17 competitive vis-a-vis Amex and Visa -- and I'll come on
 18 to this again. I know I keep on saying I'm going to
 19 come onto things, but these points are important.
 20 It is a 101(3) point and not a 101(1) point. That
 21 is the first thing. If one is looking about the MIF
 22 being necessary to be competitive, the Commission is
 23 saying here that is a 101(3) point, not a 101(1) point.
 24 Then we go on, again we are talking about objective
 25 necessity, is this MIF necessary? I apologise to the

30

1 transcript:
 2 "Where the question is whether the clause is
 3 technically necessary for the operation of the Visa
 4 payment scheme, the only provisions necessary for the
 5 operation of the Visa four-party payment scheme, apart
 6 from technical arrangements on message formats and the
 7 like, are the obligation of the creditor bank to accept
 8 any payment validly entered into the system by the
 9 debtor bank."
 10 This is the important bit:
 11 "And the prohibition of ex-post pricing by one bank
 12 to the other. Accordingly, it is in theory technically
 13 feasible for the Visa scheme to function with
 14 alternative arrangements than a MIF not involving
 15 collective price agreements between undertakings, for
 16 example, the issuing bank could recover their costs in
 17 whole or in part from cardholders."
 18 I rely on 59 for various reasons.
 19 The first bit, as I have just said, one has to be
 20 very careful about if one is looking at 101(1) or
 21 101(3), and also this is in the context of the ex-post
 22 pricing, where the card companies are saying: issuers
 23 will have substantial market power.
 24 They will be able to hold the acquirers to ransom.
 25 The acquirers will be, and we see this from the text,

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1 "at the mercy of the issuers and the whole scheme will
 2 collapse". And the European Commission even in these
 3 days said that is not correct because you can have
 4 a lesser restriction of competition, you can have
 5 a network rule which has ex-post prohibition on ex-post
 6 pricing, and the General Court accepted that and so did
 7 the ECJ.
 8 So when we come to, a bit later on, the MasterCard
 9 counterfactuals which say, well, this MIF is absolutely
 10 necessary, this ex-post pricing point is quite
 11 important, but the germ of it -- we see it far more when
 12 it comes to the MasterCard infringement decision and we
 13 see it again in the European Court of Justice.
 14 I think Mr Hoskins in Luxembourg was arguing it big
 15 time, but we see it even in 2002, the Commission saying,
 16 well, where one is looking at lesser restrictions of
 17 competition, this ex-post pricing rule would be a lesser
 18 restriction of competition than what you are submitting
 19 to me, which is the issuing banks are going to have this
 20 huge market power, abuse it and the system is going to
 21 shrink.
 22 I emphasise that because it does become an important
 23 point and the Tribunal should know that this is where
 24 this ex-post pricing point starts.
 25 MR SMITH: Mr Brealey, when in paragraph 59 the Commission

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1 refers to without the MIF and you are saying this MIF,
 2 you are talking about a payment that was moving from the
 3 acquiring bank to the issuing bank?
 4 MR BREALEY: Yes.
 5 MR SMITH: That's what "this MIF" means.
 6 MR BREALEY: Yes.
 7 MR SMITH: That one wouldn't pertain if you had, for
 8 instance, a MIF of zero?
 9 MR BREALEY: I think --
 10 MR SMITH: Or the Commission talking about any level of MIF,
 11 whatever the level might be?
 12 MR BREALEY: I will have to come onto this on the
 13 counterfactual. I think this is a zero MIF. You can't
 14 have a MIF, there is no MIF at all. So in the
 15 counterfactual you are saying if I can't have any MIF,
 16 then what is the position going to be? That's
 17 MasterCard's counterfactual when we come onto --
 18 MR JUSTICE BARLING: You have a bilateral payment on
 19 an interchange fee, but if you can't agree a bilateral,
 20 there must be no -- whether it is zero or just no MIF,
 21 but the fact is you can't have anything?
 22 MR BREALEY: So the way it goes, I think, is that the MIF is
 23 a collective agreement.
 24 For the sake of argument, let's assume it is
 25 a collective price fixing agreement. Just for the sake

1 of argument. So that creates a floor. You do away with
 2 it. Then MasterCard say and Visa say "If I can't have
 3 this collective price agreement, what's going to
 4 happen?" They then fall back into a system of
 5 bilaterals.
 6 So if I just go to -- I'm on the system of
 7 bilaterals to MasterCard's skeleton. It is right at the
 8 end on page 131. Essentially, I think the parties are
 9 all agreed on this, and so if one goes to page 131, so
 10 you can't have this multilateral interchange fee, this
 11 collective price movement, so now what are you going to
 12 do? You are going to have a system of bilateral rules.
 13 At footnote 360, MasterCard say the following:
 14 "It is obvious that an acquirer, and particularly
 15 an acquirer under pressure from Sainsbury's, one of the
 16 largest merchants in the UK, would have been willing to
 17 agree a reduction in interchange fees since this would
 18 have reduced the payments which that acquirer had to
 19 make, and in turn they were charging merchants putting
 20 them in a commercially advantageous position."
 21 I'm just going to flag that point now because that's
 22 exactly what our expert says.
 23 If we have this system of bilaterals, interchange
 24 fees will go down. But then MasterCard and Visa say
 25 that's not correct because they will not go down,

1 because actually in this system of bilaterals, the
 2 issuers, if you retain this honour all cards rule, so
 3 the merchants have to accept all cards that are
 4 presented to them, the issuers now have essentially
 5 almost nigh on monopoly power. And this is how Visa and
 6 MasterCard have argued the point: they will then be in
 7 this position of market power, start to charge excessive
 8 fees and the whole scheme starts to collapse.
 9 I'm going to come onto Professor von Weizsaecker
 10 that MasterCard relied on in a moment. So they say
 11 that's actually a greater restriction of competition.
 12 We need this MIF in order to prevent that greater
 13 restriction from happening, to which the European
 14 Commission and the Court of Justice says: no, you won't
 15 allow that to happen, you will have a system of
 16 a prohibition on ex-post pricing so you have to agree
 17 bilaterally, but you can't have a system where issuers
 18 just hold the acquirer to ransom.
 19 Again, we will come onto how the
 20 European Court of Justice dealt with it. So both
 21 the Commission and the courts have always said, well, we
 22 understand what you are saying because a system of
 23 bilaterals plus the honour all cards rule will put the
 24 issuer in this position of market power. But you will
 25 not allow -- you, MasterCard; you, Visa -- the issuers

1 to abuse that market power because it is likely, says
 2 the European Court, you will adopt this rule which
 3 prohibits that.
 4 That's essentially what our expert
 5 Mr von Hinten-Reed says as well. But the important
 6 point is that even back in 2002 the germ of this point
 7 was being debated.
 8 So that is the counterfactual and objective
 9 necessity. Then how does the Commission in Visa deal
 10 with restriction of competition?
 11 We then go to recital 64. In our opening
 12 submission, and again, we will come onto this a bit
 13 later but I just flag it now, there are three vices in
 14 the MIF, three anti-competitive vices in the MIF.
 15 The first is that it prevents competing banks
 16 competing individually. It is a multilateral
 17 interchange fee. It is a common agreement on price.
 18 That's the first part, the banks are not competing. The
 19 second is that this -- I can call it a price fixing
 20 agreement -- this price fixing agreement imposes a floor
 21 on the MSC because the interchange fee constitutes such
 22 a substantial part of the MSC, it constitutes a floor.
 23 So it is a collective pricing arrangement, it creates
 24 a floor in the MSC which ultimately the merchants bear.
 25 That is the second vice. It creates a floor. And the

1 third vice is that this floor actually gets higher and
 2 higher because of this competition.
 3 This competition between payment schemes, so the
 4 payment schemes are competing for issuer's business and
 5 essentially throwing money at the issuers in order to
 6 get them to issue their cards. As opposed to the
 7 competing card scheme, that then raises the MIF because
 8 the more money they are throwing at the issuers, the
 9 more money they need to get from the merchants.
 10 Those are the three vices: the restriction on
 11 competition from the banks, the floor and the upward
 12 pressure.
 13 One of the strange aspects of this case, when one
 14 looks at the witness evidence, is that MasterCard
 15 emphasise the competition between the issuers and how
 16 they need the interchange fees to compete. They say,
 17 well if I can see the commercial logic of that, but the
 18 European Commission upheld by the courts see that, but
 19 see that it is a competition problem.
 20 So whilst it is a commercial advantage for the
 21 payment card companies, and they extol the virtues of
 22 this, we need this money in order to compete, they
 23 slightly lose sight of, well, is this a restriction of
 24 competition? Which then allows the European Commission
 25 to say, actually, if you are going to have a MIF, you

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1 have got to have an efficient level.
 2 That is the restriction of competition, so we see at
 3 recital 64:
 4 "The Commission considers that the MIF in the Visa
 5 system restricts competition within the meaning of
 6 article 81(1) by restricting the freedom of banks
 7 individually to decide their own pricing policies. MIF
 8 has a restricted effect on competition among Visa
 9 issuers and among Visa acquirers."
 10 I won't go through the whole of this bit, but we see
 11 here again one reads the expert report of Dr Niels from
 12 MasterCard saying this is a joint service, two-sided
 13 markets etc. Exactly the same arguments were being made
 14 at paragraph 65, 66.
 15 I want to emphasise paragraph 68. So 64 is what
 16 I call the first vice and paragraph 68 is the second
 17 vice:
 18 "The MIF, moreover, has its effect to distort the
 19 behaviour of the acquiring banks vis-a-vis their
 20 customers because it creates an important cost element.
 21 According to EuroCommerce on average approximately 80%
 22 of the merchant fee, which is likely to constitute a de
 23 facto floor for the fees charged...(Reading to the
 24 words)... would make a loss on its acquiring activity."
 25 We will see a bit later on, exactly the same

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1 analysis in the MasterCard infringement decision.
 2 Then I come to exemption. So, again, we have the
 3 Visa system, we know that the exemption is not applying
 4 to domestic MIFs, we know that the MIF is not necessary
 5 for the scheme to operate and we know that it is
 6 a restriction of competition, it creates a floor, it
 7 restricts banks from competing. But we also know that
 8 Visa got an exemption for a period of five years based
 9 essentially on this issue with cost methodology.
 10 I want to just emphasise little bits about that. So
 11 if we go to paragraph 84. Again, we know that Visa is
 12 told that it could not get exemption if it just had
 13 a free rein criteria that was just within its gift. So
 14 it modified the scheme.
 15 Recital 84:
 16 "To this end, Visa has in its proposal for
 17 a modified MIF identified three main cost categories
 18 which in its view constitute an objective benchmark for
 19 the level of costs of supplying Visa payment services
 20 and constitute an objective benchmark against which to
 21 assess the Visa intraregional MIFs paid by acquirers for
 22 issuers for POS transactions."
 23 These are the three categories of cost we see time
 24 and time again:
 25 "These cost categories are the cost of processing

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1 transaction, the cost of providing the payment guarantee
 2 and the cost of the free funding period."
 3 So I just want to focus on the cost of the free
 4 funding period because I think it is important to see.
 5 The pedigree of this in its relevance to domestic MIFs
 6 is, again, MasterCard rely to a certain extent on this
 7 as somehow endorsing this free funding period. It has
 8 been rejected time and time again, since the expiry of
 9 the decision of the EEA MIF, but I just want to
 10 emphasise its relevance to any domestic MIF.
 11 If I can go back to recital 36. I just want to
 12 focus for the next few minutes on what the Commission
 13 said about the free funding period. Everything I'm
 14 going to say next on the free funding period.
 15 Recital 36, this is all on the free funding period.
 16 At the beginning, I'm not sure if this is relating to
 17 the free funding, but I will go for it:
 18 "One of the card payment systems [these are comments
 19 from third parties] commented that it failed to
 20 understand how in law a reduction in the level of a
 21 price could have any relevance for the granting of
 22 an exemption ... that is what one card system said."
 23 What I would like to do is focus on the line
 24 beginning:
 25 "The second card payment system to reply ..."

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1 MR JUSTICE BARLING: Yes.
 2 MR BREALEY: "While defending MIFs in a four-party card
 3 payment system considered that the cost of any free
 4 funding period concerns only the relationship between
 5 a card issuer and a cardholder and noted that the cost
 6 is excluded from the calculation of its own MIF."
 7 So even there, we see -- I don't know who it is --
 8 one card payment system saying actually this cost of
 9 free funding is not to be borne by the merchant, it is
 10 ...
 11 [Technical crash; audio loss]
 12 That's recital 36. Recital 37, this is national
 13 authorities.
 14 One of the national authorities that replied:
 15 "Consider that the changes to the Visa MIF did not
 16 justify ...(Reading to the words)... but did not state
 17 whether they merited an exemption. In its view,
 18 according to another national authority, a MIF in
 19 a four-party payment is a price fixing agreement within
 20 the ...(Reading to the words)... In this context it held
 21 that the cost processing and some of the cost payment
 22 guarantee relating to fraud may be included in
 23 calculating the appropriate level of the MIF. However,
 24 it did not consider the free funding period and the
 25 cardholder default element in the payment guarantee as

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1 justified cost components in the MIF."
 2 So that national authority was saying the cost of
 3 the free funding period should not be borne by the
 4 merchant.
 5 Then if one goes almost to the right-hand side of
 6 the page. So recital 38 are the principles from
 7 retailers and specific points on consumer cards and the
 8 following.
 9 Then (e), this again relating to the free funding
 10 period:
 11 "Merchants should not pay for the free funding
 12 period, in particular since they consider it is not at
 13 all to be to their benefit, but only that of the
 14 cardholder. In particular, they denied that it led to
 15 any increase in aggregate consumer spending."
 16 So the merchant was saying they should not pay for
 17 the free funding period, that is 28 days, for example,
 18 and they deny that (inaudible) aggregate consumer
 19 spending. That's what the retailers were saying to the
 20 Commission.
 21 Then if one goes to over the page to 39.
 22 MR JUSTICE BARLING: Sorry, Mr Brealey, there is a technical
 23 problem, so we might --
 24 MR BREALEY: Might as well adjourn.
 25 MR JUSTICE BARLING: We will take a 10-minute break.

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1 (11.50 am)
 2 (A short break)
 3 (12.00 pm)
 4 MR JUSTICE BARLING: All fixed?
 5 MR BREALEY: Yes, I'm fixed, we are all fixed.
 6 I think we were on recital or paragraph 39 of the
 7 decision. It is on the top right of the page, so this
 8 is section 6.3 of the decision, "Observations of the
 9 commission".
 10 In the observations, it goes through certain of the
 11 points made by Visa and by the people who have made
 12 submissions.
 13 But then at the first indent, it says:
 14 "The free funding period mentioned in recital 36 and
 15 recital 37 and recital 38(e) is dealt with in recital 89
 16 below."
 17 So again, all I'm doing is concentrating on this
 18 free funding period.
 19 So we need to go to recital 89 to see how
 20 the Commission, even in this Visa exemption decision
 21 upon which the card companies still rely for their UK
 22 domestic MIFs and other MIFs, see how the Commission
 23 dealt with the free funding period.
 24 This is recital 89:
 25 "Thirdly, the free funding period allows

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1 Visa cardholders to make purchases at any merchant who
 2 accept Visa cards as if they all offered free credit.
 3 According to Visa, this benefits merchants because it
 4 encourages cardholders to increase their consumption by
 5 making additional purchases which otherwise they may not
 6 have made. While it is not proven that this facility
 7 increases total aggregate consumption ..."
 8 That is quite an important point:
 9 "While it is not proven that this facility increases
 10 total aggregate consumption, it is plausible that it may
 11 well stimulate cross-border purchases by cardholders
 12 travelling abroad who usually do not have the means to
 13 check their account balance and cannot delay their
 14 purchase to later. Without the free funding period,
 15 cardholders travelling abroad are likely to be more
 16 prudent with regard to their overall spending for fear
 17 of taking their account into the red. While this
 18 phenomenon may have a neutral overall effect on total
 19 consumption in Europe ...(Reading to the words)... as
 20 opposed to domestic spending.
 21 "In this light, the inclusion of the free funding
 22 period in a MIF for cross-border purchases can be
 23 discussed primarily as it benefits merchants with whom
 24 such purchases are made, but also as it promotes
 25 cross-border purchases within a single market.

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1 "The Commission, therefore, sees no reason for the
 2 purposes and duration of the present exemption [note the
 3 footnote; I will come onto in a moment] to consider
 4 unjustified the inclusion in the Visa intraregional MIF
 5 of the cost of the free funding period. As a feature of
 6 international charge and credit cards, it partly
 7 benefits the merchants for cross-border transactions."

8 Footnote 44:
 9 "It should be re-emphasised in this context that the
 10 present exemption only applies to the Visa intraregional
 11 MIF as applied to cross-border transactions.
 12 An analysis of the exemptability of the inclusion of the
 13 free funding period in a MIF for domestic card payments
 14 might conceivably reach a different conclusion."

15 I should just add, just when one goes to
 16 recitals 109 to recitals 110, you see the exemption
 17 should take effect as and when the proposed modified
 18 Visa scheme has been implemented enforced until
 19 31st December 2007.

20 MR JUSTICE BARLING: Sorry?
 21 MR BREALEY: My fault, I was going to quickly. Recital 109.
 22 So this is in an exemption for essentially cross-border
 23 transactions. It takes effect as and when the proposed
 24 modified Visa scheme has been implemented. That is to
 25 say Visa no longer has this free rein to decide on any

1 factor, and it is in force until 31st December 2007.
 2 It says:
 3 "This period of time will allow the Commission to
 4 re-examine the practical impact of the modified Visa
 5 scheme on the market and in particular its expected
 6 effect on merchant fees also in the light of the
 7 comments made by third parties to the 1993 notice."

8 So as Mastercard, what would Mastercard get out of
 9 reading this exemption decision?

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

17 The Commission has rejected this notion of a joint
 18 service. The Commission rejects that in this decision
 19 and it rejects it in Mastercard's own 2007 infringement
 20 decision. But even in 2002, Mastercard would have seen
 21 that you have got to focus on an acquiring market.

22 The second thing they would have noticed is that
 23 a MIF in a four-party system is liable to be regarded as
 24 an inflated minimum price. It is looked at by the
 25 Authority as a collective price agreement, which sets

1 a minimum price, so they would have been on notice of
 2 that.

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

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

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

24 Could I go please to Mr von Hinten-Reed's second
 25 report, which is at D2.1, tab 3. It is page 551 of the

1 bundle, internal 128. In my version, table 8.1 has
 2 blue, but table 8.2 does not.

3 MR HOSKINS: Correct.
 4 MR BREALEY: So it is table 8.2 that I want to emphasise.

5 Now, this is, as I understand it, all accepted
 6 figures. So this is Mr von Hinten-Reed taking Dr Niels'
 7 figures and Dr Niels relies on figures prepared for or
 8 on behalf of Mastercard.

9 I'm pretty certain there is no doubt about these
 10 percentages that I'm going to show the Tribunal.
 11 Table 8.2, "Benefits according to Dr Niels'
 12 corresponding costs and the cost base credit card MIF".

13 To take this slowly, so the benefit: reduction in
 14 transaction costs and risks, and then corresponding
 15 costs, processing costs and fraud costs, and we look at
 16 2008, is 0.2%.

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

24 It is only when you offload the costs that the
 25 issuer incurs credit write-offs, collection from the

1 credits department, letters saying "You are in arrears"
 2 and the funding costs, what I can call the 28-day
 3 period, that you jump to a MIF of 2.22%.
 4 Sorry, you would add that, that 2.22, to the 0.2,
 5 and you would have a total MIF, total costs. So if one
 6 is looking at 2008, right on the right-hand side you get
 7 to a figure of 2.41%. You then -- this is Dr Niels --
 8 if you say, well, the merchants should bear 25% of the
 9 credit costs, you get to a MIF of 0.76. If you say that
 10 you should bear 50% of the credit costs, you get to
 11 a MIF of 1.31.
 12 But if you exclude this cost of free funding and
 13 instances where the issuers advance credit to people who
 14 can't pay and you have a credit write-off, you come back
 15 to 0.2%. I explain that because the methodologies that
 16 are being put forward to the Tribunal are, on any view,
 17 sometimes quite complicated, but the bright line point
 18 that I want to emphasise is that you get to the much
 19 higher MIF if you include this cost of free funding.
 20 If you look at how the European Commission does it
 21 and Mr von Hinten-Reed does it, you come out at around
 22 0.2, and 0.3. But if you offload all these costs of
 23 free funding onto the merchants, that is how you come to
 24 this much higher MIF that Mastercard seek to justify in
 25 these proceedings.

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1 Table 8.2 I would ask the Tribunal to note because
 2 it is quite illuminating. That is the end of the Visa
 3 exemption.
 4 If I can go back to the opening submissions. At
 5 paragraph 18, so we see at paragraph 18:
 6 "Following the Visa decision, the Commission opened
 7 an investigation into both Visa's and Mastercard's intra
 8 EA MIFs for commercial cards. On 24th September 2003,
 9 they sent a statement of objections to Mastercard in
 10 relation to its network rules and decisions. Mastercard
 11 responded to that statement of objections on
 12 5th January 2004. Its response included 120 pages of
 13 written submissions, three annexed reports, including
 14 economic evidence from DotEcon ..."
 15 Who is giving evidence in these proceedings:
 16 "... and an expert analysis of the MIF by
 17 Professor Christian von Weizsaecker."
 18 I want to just, obviously given the time we can't go
 19 through the whole of this and really we need to go to
 20 the court judgments and the Commission decision, but
 21 I do want to flag certain points relating to the
 22 investigation.
 23 For that purpose can I go to bundle E2, tab 4, which
 24 is Mastercard's response to the statement of objections
 25 on 5th January 2004. So the document at tab 4 is

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1 Mastercard's response to the statement of objection.
 2 So, I mean, one only has to look at the contents
 3 page, which is at page 167, to see the detailed
 4 submissions that they are making. This is just the
 5 start of it all, going over a lot of the ground that we
 6 are going to have to go over with Dr Niels in these
 7 proceedings.
 8 That's the point I will come onto in a moment. What
 9 I would also like to emphasise -- and if one can go
 10 to -- this is page 178 of the bundle, page 13,
 11 paragraphs 41. I'm not going to go through it all, but
 12 41 to 63. I emphasise this is the procedural history.
 13 We will just go through a few facts in a moment.
 14 I emphasise these paragraphs because they are relevant
 15 to Mr Hoskins' -- what I call the Visa counterfactual,
 16 his Visa counterfactual, saying what if Mastercard is at
 17 zero and Visa is still at 0.9%.
 18 You quite clearly see here that Visa is intervening
 19 in Mastercard's proceedings, Mastercard is intervening
 20 in Visa's proceeding. They are completely at one when
 21 this comes to fighting off the European Commission.
 22 The notion that a counterfactual is going to end up
 23 in a situation where Visa is at 0.9 and Mastercard is at
 24 zero is, in my respectful submission, fanciful. And
 25 I shall explain that a bit later on.

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1 But we see the principal steps in the investigation.
 2 Paragraph 41. EPI is the Europay International, so that
 3 is essentially Mastercard Europe. So Mastercard Europe
 4 responded to the first statement of objections.
 5 The Commission also addressed an SO to Visa. Visa
 6 responded. This is Mastercard. So Mastercard knows all
 7 these facts about what Visa is up to. At 44, again we
 8 see statement of objections sent to Visa. Over the page
 9 we see at the top:
 10 "The press release mentioned that the Commission had
 11 several pending cases relating to payment card systems
 12 which raised similar issues, and therefore, the
 13 envisaged Commission decision in the Visa case were
 14 important in setting the pace for the resolution of the
 15 other cases."
 16 Again, I'm referring to this because it is quite
 17 clear that Mastercard and Visa, maybe at slightly
 18 different times, are being treated in the same way.
 19 We see at 46:
 20 "Following the press release and publication in the
 21 OJ, Mastercard immediately applied for a meeting with
 22 the case handlers."
 23 The meeting was held on the 17th.
 24 It goes on:
 25 "It requested a non-confidential version of the SO

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1 addressed to Visa ..."
 2 So Mastercard is getting non-confidential versions
 3 of the SO sent to Visa:
 4 "... and formally applied to intervene in the Visa
 5 case. The Commission took note and then Mastercard
 6 obtained a copy of the Visa SO. By letter of
 7 30th November 2000, Mastercard also applied to be heard
 8 as an interested third party in the Visa case."
 9 48:
 10 "On 15th December 2000, Mastercard filed written
 11 observations in the Visa case. Mastercard, as well as
 12 Mastercard International, were heard at the hearing held
 13 on 6th February 2001."
 14 Then they submitted further written observations.
 15 Again, it is more or less of the same things, but I do
 16 want to -- I don't want to overemphasise the point, but
 17 at paragraph 52, the last paragraph on page 180:
 18 "In other words, Mastercard, they say, were expected
 19 to change their rules voluntarily without the Commission
 20 formulating its objections, forcing the notifying party
 21 to assess the rules on a basis of the precedent created
 22 by the Visa case under the so-called 'leading case
 23 theory'. "
 24 So clearly there had been some discussion about Visa
 25 being a precedent for Mastercard, and Mastercard saying

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1 "Well, I want also to have my say".
 2 Almost lastly, paragraph 57 over the page:
 3 "On 24th July [this is the decision we have just
 4 seen], the Commission adopted a decision in the Visa
 5 case. The Commission's press release explicitly stated
 6 that the notification of the Mastercard system remained
 7 pending. The adoption of that decision confirmed
 8 Mastercard's concerns about the Commission's procedural
 9 position. Indeed, under that decision Visa's MIF was
 10 found to infringe 81.1. Although addressed to Visa
 11 [this is Mastercard saying it], it is evident that this
 12 decision could be put forward as a precedent in the
 13 assessment of Mastercard's MIF to the extent it presents
 14 essentially the same characteristics."
 15 So Mastercard is saying we have the same
 16 characteristics here. The Visa decision, it looks as if
 17 it is going to be some sort of precedent for
 18 Mastercard's own MIF.
 19 Then just to finish it off, we have the
 20 modernisation reg where the system's notifications fell
 21 away. We get Mastercard saying that really we have got
 22 to issue proceedings almost. And you get to
 23 paragraph 63:
 24 "It is in those circumstances that the Commission
 25 finally decided to initiate proceedings by the dispatch

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1 of the SO dated 21st September 2003."
 2 Again, I emphasise that this notion that somehow
 3 this whole case collapses because Visa are going to be
 4 at 0.9 and Mastercard at zero is not -- and I will
 5 expand on this later on -- a realistic counterfactual.
 6 Just very quickly, when one looks at the SO, just
 7 for the Tribunal's note, just briefly look at the
 8 headings. So if one goes to page 191 of the bundle,
 9 again we see Mastercard in 2004 "Optimal pricing
 10 strategies in two-sided markets".
 11 Again, we see exactly the same in Dr Niels' first
 12 report. Page 194, at the top:
 13 "The service by a four-party system is a joint
 14 service."
 15 That had been rejected in the Visa exemption
 16 decision.
 17 Mastercard are making the same point. It is
 18 ultimately rejected by the Commission and by the court.
 19 Page 194:
 20 "The service of the four-party system is a joint
 21 system."
 22 Page 224, again, this is at the SO stage. I'm just
 23 referring to the heading:
 24 "Restriction is no more than what is necessary."
 25 Again, objective necessity.

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1 I'm going to come onto the Professor von Weizsaecker
 2 in a moment, but at 236, we get again the exemption.
 3 Then at 281, something I would like the Tribunal to
 4 note, this is the section 6, "Undesired consequences".
 5 Essentially, what is being said here by Mastercard is --
 6 I have already flagged the point, but they are going in
 7 in some detail here and it is this ex-post pricing
 8 point, which is that if you prohibit the MIF, it will
 9 destroy Mastercard's four-party card payment system.
 10 You need, it is said, some -- if you are going to
 11 have an honour all cards rule, you need some default
 12 mechanism in order to prevent the abuse of the system by
 13 the issuers.
 14 So you can't have a multilateral interchange fee.
 15 You end up with bilaterals, but you have bilaterals plus
 16 the honour all cards rule, that gives the issuer a power
 17 they can abuse, and Mastercard is saying that cocktail
 18 is going to lead to the scheme shrinking and ultimately
 19 collapsing. That is why the European Commission and the
 20 European Court says, actually, that will not happen,
 21 because you will not have another default mechanism to
 22 prevent that abuse.
 23 Again, we will see that. So that is what is being
 24 argued here: the issuers will have the power to abuse
 25 the system and that will lead to the collapse of the

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1 Mastercard system.
 2 The reason I'm referring to this is these are the
 3 arguments that the Commission refers to in the 2007
 4 infringement decision. So all of this section 6, you
 5 will see the name time and time again at paragraph 490,
 6 Professor von Weizsaecker, he is giving evidence which
 7 is on the next tab. I'm just trying to pick out the
 8 bright line -- at paragraph 493, the very last
 9 sentence -- again, this is a word that is repeated again
 10 and again -- refers to the downward spiral that will
 11 ultimately lead to the demise of the system.
 12 So this word "downward spiral" appears again and
 13 again. So Mastercard again is saying: I need the MIF,
 14 I need this default mechanism to prevent the issuers
 15 having this power. And they rely on the evidence of
 16 Professor von Weizsaecker, and his report is at tab 5,
 17 which is the next tab, and the relevant bit basically is
 18 at paragraphs 27 to 43.
 19 MR JUSTICE BARLING: Paragraphs 27 ...?
 20 MR BREALEY: Bundle 295, internal 6, paragraphs 27 to 43.
 21 For example, he is saying, paragraph 30:
 22 "Consider now that a four-party credit card system
 23 with an honour all cards rule but without any fallback
 24 way of setting interchange fees ..."
 25 This is paragraph 30 on page 296.

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1 So what economic evidence is being put to
 2 the Commission here? Again, there are some phrases that
 3 crop up time and time again.
 4 He says:
 5 "Consider now a four-party credit card system with
 6 an honour all cards rule, but without any fallback way
 7 of setting interchange fees. The only way to set
 8 interchange fees will therefore be to negotiate
 9 bilaterally between each issuer and each acquirer.
 10 However, if there is no final agreement in existence
 11 between an individual issuer and an individual acquirer
 12 on the interchange fee between them, the issuer is
 13 effectively free to decide which interchange fee to
 14 deduct from its payment to the acquirer while at the
 15 same time, owing to the honour all cards rule, the
 16 acquirer cannot refuse to accept that issuer's cards.
 17 That acquirer will therefore be 'at the mercy' of the
 18 issuer, subject to the only extreme option of leaving
 19 the system altogether.
 20 "As a result, the issuer would be in a very strong
 21 position in negotiations with the acquirer, since the
 22 alternative would be for the issuer to have a free rein
 23 to set the interchange fee."
 24 He goes on, and he basically says it will lead to
 25 the shrinkage of the system. And so we see "shrink" in,

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1 for example, paragraph 36.
 2 It says:
 3 "As a result, the business of the system begins to
 4 shrink."
 5 MR JUSTICE BARLING: They rely upon a particular example,
 6 don't they, which we see time and time again in the
 7 papers? I don't know whether Professor von Weizsaecker
 8 was also relying upon that or not. Was it before?
 9 MR BREALEY: This is --
 10 MR JUSTICE BARLING: Maestro.
 11 MR BREALEY: No, because this was -- I am not sure,
 12 actually.
 13 MR JUSTICE BARLING: The timing may have been different.
 14 MR BREALEY: I'm not sure whether Maestro was in here
 15 because of the timing.
 16 MR HOSKINS: For the record, it is bundle A, tab 2, page 172
 17 is the table we rely on, and you can see the way the
 18 market shares fall, and the effect is indeed after 2007.
 19 That's when the shares start to plummet. So it is
 20 bundle A, tab 2, page 172.
 21 MR JUSTICE BARLING: Thank you.
 22 MR BREALEY: I should say, I haven't read any of the
 23 document that Miss Smith has handed up, but just, we do
 24 not accept the Maestro story.
 25 MR JUSTICE BARLING: No, no --

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1 MR BREALEY: It is laboured in the skeleton time and time
 2 again. It is laboured in the witness statements and --
 3 MR JUSTICE BARLING: Is it the causation part you don't
 4 accept rather than the actual bare facts?
 5 MR BREALEY: 90% causation, 10% bare facts.
 6 MR JUSTICE BARLING: Right.
 7 MR BREALEY: There are some facts which we just do not, that
 8 are incorrect.
 9 MR JUSTICE BARLING: Anyway, we will come on --
 10 MR BREALEY: We will come to that. Essentially for
 11 cross-examination and trying to find out exactly -- we
 12 will definitely try our best. But to a certain extent
 13 it is finding out from the witnesses exactly what they
 14 mean. I certainly don't accept the way that it is
 15 portrayed. This Maestro thing shouldn't be -- but the
 16 Maestro is an indication of the competition between the
 17 card schemes, clearly. This is a slightly different
 18 point.
 19 This is not really about competition between
 20 Mastercard and Visa. The Mastercard -- if I could just
 21 take again -- I apologise, but in Mastercard's skeleton
 22 argument they put forward two counterfactuals. One is
 23 without the MIF as a default mechanism the whole system
 24 can be abused, which is what we are talking about here.
 25 The other is without a MIF or with a MIF at zero, I'm

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1 going to lose market share to Visa, and the Maestro goes
 2 to that second counterfactual.
 3 MR JUSTICE BARLING: Yes. This is a free-standing --
 4 MR BREALEY: This is a free-standing one, which is what the
 5 European Court has dealt with. So this is the --
 6 MR JUSTICE BARLING: So my question was misconceived because
 7 really, first of all, Professor von Weizsaecker isn't
 8 dealing with the Maestro situation.
 9 MR BREALEY: Not really. He is talking about how internally
 10 within the Mastercard system the issuers will abuse
 11 their position in order to get more money and the whole
 12 thing starts to shrink and become unattractive.
 13 PROFESSOR JOHN BEATH: I think it is clear from reading
 14 Professor von Weizsaecker that this analysis is based
 15 upon his expertise in something called bargaining
 16 theory. It is a theoretical argument he has presented
 17 here.
 18 MR BREALEY: Right. It may well be, but it is one that
 19 Mastercard pursued for quite some time. And it may be
 20 a principle of economics, although that's what happens.
 21 But certainly if -- I showed the passage in Mastercard's
 22 skeleton saying that if you have -- without the honour
 23 all cards rule, I think they are saying, if you had
 24 a system of bilaterals the prices will come down. The
 25 problem is if you fit in the honour all cards rule, so

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1 you take away the power of the merchants to accept the
 2 cards, then you get the power in the hands of the
 3 issuers.
 4 So that is essentially what he is saying.
 5 And at 43, he says:
 6 "This approach will eventually collapse."
 7 He is bringing his expertise to it.
 8 Mastercard is relying on his expert economic
 9 evidence, and obviously the Commission had to take it
 10 very seriously. And this argument was pursued all the
 11 way up to the European Court.
 12 So that is -- it cannot be said that Mastercard
 13 didn't have the opportunity to put forward its arguments
 14 in front of the Commission prior to the 2007 decision.
 15 Could I then put E2 away and just go to E2.1, tab 9.
 16 Again, I simply don't think it is necessary to go
 17 through this in great detail. This is tab 9. This is
 18 the reply of Mastercard to the supplementary statement
 19 of objections.
 20 I just draw the Tribunal's note to page 657. It is
 21 the fourth bullet point down. I said earlier on that at
 22 some point 2006 Mastercard would have known that the
 23 Visa exemption was not going to be renewed.
 24 So that fourth bullet point:
 25 "There is no mention of the fact that the Commission

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1 later decided to inform Mastercard, if not Visa, that
 2 its decision concerning Visa's interchange fee is no
 3 longer sound and the exemption decision will not be
 4 replicated."
 5 Just at that point Mastercard will know that those
 6 three categories of cost that served to justify the EEA
 7 MIF, even the cost of free funding for the EEA MIF, that
 8 exemption is not going to be renewed.
 9 MR JUSTICE BARLING: Mr Brealey, we can hear you very well
 10 here and there is great temptation when you have got
 11 a mike and it is all being recorded, but I'm told that
 12 people right at the back are struggling.
 13 MR BREALEY: Sorry.
 14 MR JUSTICE BARLING: It may be there's nothing we can do
 15 about it because the acoustics are not that brilliant in
 16 here, but we won't take offence if you bawl at us a bit.
 17 MR BREALEY: Shout. I apologise. Okay.
 18 MR JUSTICE BARLING: So 657, that was bullet 4.
 19 MR BREALEY: 657. While we are here, can we just go to
 20 tab 10.
 21 MR JUSTICE BARLING: Yes.
 22 MR BREALEY: Some of this is, again, I don't know how much
 23 of this is confidential. This is tab 10 and this is a
 24 letter of facts. We refer to this in paragraph 20 of
 25 the opening submissions.

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1 So, again, we have seen a response to the statement
 2 of objections, we have seen a response to the
 3 supplemental statement of objections and we were going
 4 to see the letter of facts. So it is a response to the
 5 letter of facts.
 6 So we see that at 831, Mastercard's response to
 7 the Commission's letter of facts dated 23rd March 2007.
 8 Again, just looking at the table of contents we see the
 9 sort of arguments that are being advanced, although
 10 I won't go through these again.
 11 But I would like to go to page 938 where, between
 12 paragraphs 316 and -- I don't believe this is -- this is
 13 not marked blue?
 14 MR HOSKINS: No.
 15 MR BREALEY: 316 to 324, Mastercard is referring to the
 16 Australian experience and how retail prices were not
 17 higher than they would otherwise have been. And
 18 Mastercard, it is one of the first instances that I can
 19 find of Mastercard saying there is no pass-off.
 20 So we can pick this up at paragraph 324. So it
 21 refers to certain remarks, and we will come onto the
 22 Reserve Bank of Australia a bit later on:
 23 "For the following reasons above, the RBA remarks
 24 should be treated as scepticism."
 25 So it is referring to the Reserve Bank of

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1 Australia's confidence that there will be some degree of
 2 pass-on.
 3 So Mastercard is saying about this confidence that:
 4 "The reduction of MSC will be passed onto the
 5 consumer ... is interesting, but clearly not sufficient
 6 to form the basis of policy decisions and competition
 7 proceedings.
 8 "Second, it should be noted that almost 50% of
 9 retail spending in Australia is controlled by two large
 10 merchant groups ..."
 11 I would imagine they do compete:
 12 "... Woolworths and the Coles group. It is
 13 therefore absurd for the RBA to argue that the normal
 14 dynamics of a competitive market place are more likely
 15 to operate in the Australian retail market than the
 16 credit card industry.
 17 "Third, a review of the annual reports of some of
 18 Australia's largest annual retailers suggest that there
 19 is no direct correlation between changes and retail cost
 20 basis and consumer prices. But rather retailers tend to
 21 absorb small cost changes regardless of the direction of
 22 the cost change. The following table contained data
 23 extracted from Woolworths' and Coles' 2006 financial
 24 statements."
 25 We can go over the page. It shows clearly that

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1 there is no correlation between cost reduction, reduced
 2 merchant fees and retail prices. Indeed, says
 3 Mastercard, retailers often take cost changes to their
 4 margin as there are many factors other than costs that
 5 influence their prices.
 6 If one just goes back to 941 and the OECD document,
 7 in the footnote at 310, where it is said:
 8 "It is not possible to measure these price changes
 9 and their timing, particularly given other more
 10 significant changes in firms' costs and prices that are
 11 going on all the time."
 12 Obviously Mr Coupe, Sainsbury's' CEO, and Mr Rogers,
 13 Sainsbury's' CFO, two very senior people within
 14 Sainsbury's, are going to be cross-examined by
 15 Mr Hoskins as to this issue of pass-on, but it is quite
 16 clear that Mastercard at this time was presenting a very
 17 similar story to the one that Sainsbury's is painting
 18 now.
 19 It is rather bizarre, and they rely on studies that
 20 they have done, and we will see it time and time again,
 21 studies that they have undertaken. And they are arguing
 22 it completely opposite to this Tribunal.
 23 So that is the response to the letter of facts. At
 24 paragraphs 21, we set out the arguments that they did
 25 adopt. Then really I need to go to the Mastercard

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1 infringement decision itself just to see how
 2 the Commission picks up a lot of the points that have
 3 been argued in the Visa decision and by Mastercard.
 4 So I don't know where the Tribunal has the
 5 Mastercard infringement decision. I had to put it in
 6 a different tab. It may be in E2.2; I put it in E2.3
 7 just because there was more space.
 8 (Pause)
 9 So this is the infringement decision,
 10 19th December 2007. Clearly I will ask the Tribunal to
 11 read it, and you probably have. I just want to
 12 emphasise some key points that come out of this. The
 13 first relates to the IPO and the decision in the
 14 association of undertakings point. That is at 1099 of
 15 the bundle, paragraph 331.
 16 Now, I'm not going to dwell on this, and when I come
 17 to the breach of article 101, I'm not going to dwell on
 18 this, but I'm just highlighting the passages in the
 19 decision which refer to this decision of association of
 20 undertakings. The reason is because in their skeleton,
 21 paragraph 8, Mastercard simply say the burden is for
 22 Sainsbury's to prove the decision of association of
 23 undertakings, and leaves it at that.
 24 So actually, in its section on infringement of 101,
 25 there is nothing advanced by Mastercard on this decision

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1 of association of undertakings concerted practice point.
 2 There is simply a statement at the beginning in
 3 paragraph 8 of the skeleton, which says it is for us to
 4 prove.
 5 Well, clearly, it is for us to prove, but I would
 6 make the clear point that Mastercard are simply not
 7 engaged in its skeleton on this issue, which is quite
 8 strange because they themselves sought to amend to
 9 include various facts that they said distinguished their
 10 situation from the decision by the Commission, the
 11 general court and the ECJ, all of which said there is
 12 a decision of association of undertakings. And if
 13 my Lord remembers, there was this application to amend,
 14 to raise these facts which said actually, although this
 15 European Court has rejected the appeal we still win on
 16 this, and there's no positive reliance on any of these
 17 facts in the skeleton.
 18 MR HOSKINS: I don't want Mr Brealey to be caught out,
 19 because we have pleaded a case on association of
 20 undertakings, and in particular that pleaded case is
 21 based on things that happened after the IPO.
 22 So there's not an issue about the existence of
 23 association of undertakings up to the date as found by
 24 the Commission. But then we put in issue certain facts
 25 of things that happened afterwards. And what's happened

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1 is we have put that in the pleading. When Sainsbury's
 2 saw that, what they did was they amended to say
 3 actually, well, we are pleading association of
 4 undertakings or an agreement or a concerted practice and
 5 opened it up. Yet we don't see that developed by
 6 Sainsbury's.
 7 So it is not that we are sitting in silence. We are
 8 genuinely not clear what they say to our case in the
 9 association of undertakings. And I want to know what
 10 they say on agreement on concerted practice. If I stand
 11 up and deal with this in closing, I do not want
 12 Mr Brealey to say "I don't know where this has come
 13 from".
 14 MR JUSTICE BARLING: There are two different dates at the
 15 back of my mind, but I may be confusing it with one of
 16 the other cases. But there was the IPO date, which at
 17 one stage was the relevant one, and then there was the
 18 2009 date and then a 2014 date, or am I confusing that
 19 with another case?
 20 MR HOSKINS: I'm trying to remember off the top of my head
 21 myself. There are three dates subsequent to 2007 that
 22 were pleaded.
 23 MR SMITH: June 2009, alternatively June 2010, alternatively
 24 April 2014.
 25 MR HOSKINS: Thank you. That's live, so that is why we put

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 MR JUSTICE BARLING: But there's no issue up to the date of
 8 the Commission decision?
 9 MR HOSKINS: Yes.
 10 MR JUSTICE BARLING: In respect of the --
 11 MR HOSKINS: We don't agree, but we are bound.
 12 MR JUSTICE BARLING: You are bound as far as the -- yes.
 13 And you are bound on that point regardless of the fact
 14 that we are dealing with the UK?
 15 MR HOSKINS: That is correct, because it is about the nature
 16 of the Mastercard system, rather than anything that's UK
 17 specific.
 18 MR JUSTICE BARLING: Right.
 19 MR HOSKINS: So it is still live.
 20 MR BREALEY: It may be still live, but the whole purpose of
 21 having detailed written openings is to put us on notice
 22 how they seek to rely on these three facts. We have
 23 done it in some detail and I am not going to shy away
 24 from it.
 25 But if one goes to our opening submission at

1 paragraph 72 to 73, just to pick up the point that
 2 Mr Smith has just made, 72 to 73:
 3 "Decision of association of undertakings."
 4 This is in our written submission.
 5 So the position in relation to the period between
 6 June 2009 was clear:
 7 "Mastercard did not contest in the proceedings
 8 before the Commission in relation to the intra EEA MIF
 9 that it was an association of undertakings until its IPO
 10 took place in May 2006.
 11 "Mastercard sought to argue before the Commission
 12 that the IPO meant it was no longer an association of
 13 undertakings. The Commission rejected that argument.
 14 Mastercard now accepts that it formed part of
 15 an association of undertakings at least until June 2009,
 16 June 2010 or April 2014 (see re-amended defence). It is
 17 Mastercard's case now that one or other of the three
 18 events below had the effect that it ceased to be
 19 an association of undertakings."
 20 So it says, and we are taking this from the
 21 pleadings:
 22 "By June 2009, Mastercard had withdrawn all of the
 23 specific authorities it previously granted to the
 24 European board. In June 2010, certain shares held by
 25 Mastercard and member banks, class M, ceased to exist.

1 In April 2014, the UK member bank of Mastercard ceased
 2 to have any power in relation to Mastercard's UK
 3 domestic rules."
 4 These are three positive facts that are being
 5 alleged by Mastercard in order to distinguish the clear
 6 finding by the European Court that there was a decision
 7 of association of undertakings, to which I then say,
 8 well, when we look to see how they amplify this, explain
 9 this to us, in their defence, it is their defence, all
 10 we get, paragraph 8, in the introduction:
 11 "It is for Sainsbury's to prove the existence of
 12 an agreement ...(Reading to the words)... decision.
 13 Mastercard reserves its position until it has seen how
 14 Sainsbury's puts its case at trial."
 15 With great respect to Mr Hoskins, that is a pretty
 16 unsatisfactory way of going about it when you are asked
 17 to put in detailed written submissions to the Tribunal
 18 to explain your point. And we haven't, for example,
 19 said on pass-on, when the burden is on Mastercard to
 20 prove pass-on, well, we will just see how they put their
 21 case in the skeleton. We engaged in the debate. And
 22 I will take the Tribunal through our skeleton and why
 23 those three facts don't amount to a row of beans. But
 24 I do put a marker down saying it is pretty
 25 unsatisfactory.

1 Anyway, with that, back into the decision and it is
2 1 o'clock. It's time for lunch.
3 MR JUSTICE BARLING: I think probably it is a good time. We
4 will see you at 2 o'clock.
5 (1.00 pm)
6 (The short adjournment)
7 (2.00 pm)
8 MR JUSTICE BARLING: Mr Brealey.
9 MR BREALEY: We were just about to go to the Mastercard 2007
10 infringement decision. We have agreed that it is
11 in E2.2.
12 MR JUSTICE BARLING: Yes.
13 MR BREALEY: So the decision has been replaced. I think we
14 have a common version now. I was just about to go to
15 the passages relating to the decision of association of
16 undertakings.
17 MR JUSTICE BARLING: Yes.
18 MR BREALEY: Obviously the decision is a big document, and
19 I just want to kind of flag some of the key paragraphs.
20 But the paragraphs on the decision of association of
21 undertakings goes from paragraph 331 to 399.
22 MR JUSTICE BARLING: Yes.
23 MR BREALEY: Again, I will just flag some important
24 paragraphs.
25 If we start at 331, Mastercard does not contest that

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1 it was an association of undertakings within the meaning
2 of article 81 in the period before May 2006. That is
3 the day when the IPO of Mastercard Incorporated took
4 place.
5 It then submits that:
6 "Since the listing of Mastercard, it would not
7 qualify as an association of undertakings, but it became
8 an independent undertaking pursuing its own commercial
9 interests for the benefit of its stockholders who are
10 detached from those of its customers."
11 I, really, imagine that that's what they are arguing
12 now. They are saying that they are still essentially
13 a separate undertaking acting on its own.
14 So that is what the situation was and what was being
15 argued.
16 If we could go to paragraph 373 where the Commission
17 refers to the continuing effects of Mastercard's MIF
18 after the IPO.
19 So Mastercard argues about the changes of
20 governance:
21 "The changes in governance incorporated on
22 25th May 2006 did not affect the interchange fee
23 fallback mechanism, such modifications were limited to
24 a transfer of powers. The principle that some
25 multilaterally-set fallback interchange fee will always

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1 apply as a fallback to a payment card transaction in the
2 absence of a bilateral agreement remains rooted in
3 a network rule that was adopted before the IPO."
4 So the fallback remains rooted even after the IPO:
5 "The effect of this decision of an association of
6 undertakings therefore continues until today. As far as
7 the nominal level of the interchange fees are concerned,
8 it is important to note the fees remain entirely
9 unchanged."
10 The point is that this principle of a MIF,
11 a fallback, was pre-IPO and is post-IPO.
12 Then we can go to paragraph 390, which refers to the
13 argument, well, hey, it is Mastercard now sets the MIF.
14 390:
15 "The fact that the banks delegate now no longer
16 decide upon interchange fee-related matters cannot be
17 decisive. According to the jurisprudence, the decision
18 of association of undertakings does not require that all
19 members of the association agree upfront on
20 a non-binding recommendation for that recommendation to
21 be caught by article 81. Even such a non-binding
22 recommendation was found to be anti-competitive, and the
23 fact that the banks in the present case could not
24 formally influence the decision-making on the MIF is not
25 important as long as the member banks adhere to

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1 decisions on interchange fees and that they remain
2 licensees and members of the organisation. This is the
3 case."
4 This actually is the core behind the degree of
5 consensus necessary for the application of article 101.
6 That point is essentially made good in its conclusion
7 at 397 to 399:
8 "The Commission disagrees with Mastercard's argument
9 that since the IPO interchange fees are unilaterally
10 imposed on member banks in a supplied customer-like
11 relationship, rather as any other decision of the
12 organisation's managing bodies, the MIF remains [this is
13 the language really of article 80/101] remains to be the
14 faithful expression of the association's resolve to
15 coordinate the faithful conduct of its members."
16 Then 398 is about what one can call the horizontal
17 nature of the consensus:
18 "For the above reasons, the association's network
19 rules that form part of Mastercard's MIF as well as
20 decisions taken by the European board and by Mastercard,
21 which implement these rules by setting concrete levels
22 and types of fallback interchange fees have been and
23 still remain decisions of an association of
24 undertakings."
25 That is kind of the competing banks, if one goes

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1 back to 390, they buy into it. They are licensees.
 2 They buy into the default mechanism.
 3 Then 399:
 4 "At any rate, even after the IPO, in relation to
 5 bank's qualified, is that of a franchisor to franchisee
 6 rather than being a horizontal form of co-operation,
 7 this is no reason why the MIF should fall outside the
 8 scope of article 81/101. As is apparent from the
 9 regulation anti-competitive aspects of franchise
 10 agreements may restrict article 81(2)"

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

19 It is kind of textbook competition law. As soon as
 20 you have a franchisor and franchisees down there, all
 21 signing up to the same common terms and conditions, that
 22 is an agreement between undertakings. You only have to
 23 look at the case law relating to network effects,
 24 franchises, exclusive purchasing agreements,
 25 *Courage v Crehan*. As soon as you get a network effect,

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1 a system of licences and each licence is signing on the
 2 standard terms and conditions, you have this consensus
 3 necessary for the application of 101.

4 Now, it will be horizontal, paragraph 398, if the
 5 licensees who sign up to the scheme are competitors and
 6 agree to a MIF, thereby not competing individually
 7 anymore. Or even if they are not competitors, it can be
 8 the standard franchise-type arrangement: the person at
 9 the top, franchisor at the top, franchisees down below.
 10 I understand there are some students at the back from
 11 King's College. It is just so blindingly obvious.

12 The notion that the issuing banks do not consent to
 13 (a) the system or (b) the level of the MIF, is just --
 14 I wait to see how Mr Hoskins deals with it; he waits to
 15 see how I deal with it. I shall wait to see how he
 16 deals with it.

17 But that is what the Commission is saying, and
 18 I will go into more detail when I come to the section in
 19 the skeleton. But that essentially is the nub of it,
 20 that all the issuing banks and acquiring banks, they
 21 sign on the dotted line, become members of the scheme,
 22 bulletins come out with a level of MIF, they apply that
 23 level, they are buying in, they are acquiescing in the
 24 scheme. And it is just too easy to say, well, this is
 25 a unilateral act by some player at the top of the tree.

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1 So that is how the Commission at least dealt with
 2 decision of association of undertakings.
 3 Didn't even get to concerted practice, but similar
 4 principles apply. So it is a mechanism whereby
 5 competing banks put forward a common price, which is
 6 ultimately paid by merchants. That's how the Commission
 7 dealt with the IPO, and how it was not a unilateral act
 8 by the person at the top of the tree. It formed part of
 9 the consensus.

10 Then we get to -- I'm at paragraph 23 of our opening
 11 submissions -- 23(b), Mastercard's approach to market
 12 definition. So the Commission said Mastercard's
 13 approach to market definition was an inappropriate tool
 14 for the assessment of competition; in particular, for
 15 the analysis of restraints within payment card systems.

16 Again, we have seen this to a certain extent, but if
 17 I can go to paragraph 278, so back a bit, where we see
 18 the Commission's analysis to market definition.

19 Before I go through the Commission's -- some of the
 20 paragraphs on market definition, I will make a similar
 21 point that I made as regards the decision of association
 22 undertakings. If one reads Mastercard's skeleton, there
 23 is absolutely no analysis on market definition. There
 24 is not even a paragraph 8, which is we will leave it to
 25 see what Sainsbury's say and we will reserve our

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1 position.

2 Mr Hoskins will probably say, well, he has not given
 3 it up. But all I'm saying is that we do not know why,
 4 in the light of the Commission's decision, the
 5 General Court and the ECJ, there is still a debate about
 6 the relevant product market being the acquiring market.
 7 But I will go through some of the paragraphs of the
 8 decision. The Tribunal, again, should note that there
 9 is absolutely no analysis on this point in their written
 10 opening submissions.

11 So the market definition is 278 to 279.

12 278:

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

23 That's exactly what the Commission had done in 2002.

24 If we go to 283:

25 "Acquirers provide a wide range of services which

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1 are of a technical and of a financial nature. Their
 2 customers are merchants wishing to accept payment cards.
 3 The product characteristics of acquiring services are
 4 fundamentally different from those of issuing services.
 5 The pricing of acquiring services is structurally
 6 different from the pricing of issuing services since it
 7 is based on a fee paid for each transaction whereas
 8 cardholders typically pay annual fees."
 9 I could go on.
 10 At 307, to the conclusion:
 11 "The supply and demand side analysis show that card
 12 acquiring services are neither sufficiently
 13 substitutable cash and cheque nor ... The Commission
 14 therefore retains as a relevant product market for
 15 assessing the MIF the market for acquiring payment card
 16 transactions."
 17 The final conclusion is at 316:
 18 "The relevant product market in this case is the
 19 market for acquiring payment cards."
 20 So 316:
 21 "The relevant product market in this case is the
 22 market for acquiring payment cards."
 23 We don't actually know whether Dr Niels disagrees
 24 with this because he refers to the joint service again,
 25 which has been rejected in the Visa and the Mastercard.

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1 We see this, but he doesn't actually -- he refers to
 2 "the acquiring market", but he doesn't actually say
 3 whether it is a relevant market that this Tribunal can
 4 accept.
 5 We will wait to see what he says. But clearly the
 6 European Commission has said the relevant market is the
 7 acquiring market and Mr von Hinten-Reed agrees.
 8 So that is the relevant market. Can I then go to
 9 a few paragraphs on restriction of competition.
 10 Remembering I mentioned three vices, the three vices
 11 being the restriction to compete on an individual basis,
 12 the minimum price, ie the floor, and the upward
 13 pressure, the floor is getting higher and higher. Those
 14 are the three vices that are identified in the
 15 restriction of competition.
 16 We can start this at paragraph 400. The Tribunal
 17 probably marked a lot of this, but sometimes there are
 18 just paragraphs that it is good just to emphasise.
 19 So paragraph 400, again, it is consistent:
 20 "In its Visa decision, the Commission considered
 21 that a multilateral interchange fee restricts
 22 competition within the meaning of article 81 by
 23 restricting competition between payment card systems and
 24 competition amongst issuers and acquirers.
 25 The Commission's finding in this case confirmed that

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1 a MIF,"[a MIF] "distorts competition between acquiring
 2 banks and the effects of the MIF in the network and
 3 issuing markets reinforce the restrictive effects in the
 4 acquiring markets."
 5 So that is 400.
 6 At 404 it seems that:
 7 "In this respect, Mastercard does not contest that
 8 the MIF will typically fix a floor [so paragraph 404]
 9 for MSCs because, as Mastercard realises, it is
 10 reasonable to assume that the interchange fee affects to
 11 some degree MSCs and that a MSC typically reflects the
 12 MIF. The fact that the MIF typically determines the
 13 floor for the price which merchants must pay for
 14 accepting payment cards is indeed an indication that
 15 Mastercard's MIF may by its very nature have the
 16 potential of fixing prices."
 17 Actually, it gets quite close to saying it has its
 18 object, the distortion of competition, but doesn't
 19 quite.
 20 So that is the floor. Again, at paragraph 408, you
 21 see the effects of the MIF:
 22 "The assessment of Mastercard's MIF as a restriction
 23 of competition is based on its restrictive effects of
 24 competition in the acquiring markets. In the absence of
 25 a bilateral agreement, the multilateral rule fixes the

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1 level of the interchange fee rate for all acquiring
 2 banks alike, thereby inflating the base on which
 3 acquiring banks set charges to merchants."
 4 Thereby inflating the base on which acquiring banks
 5 set charges to merchants.
 6 "Prices set by acquiring banks would be lower in the
 7 absence of the multilateral rule and in the presence of
 8 a rule that prohibits ex-post pricing."
 9 That, as we saw, is wholly consistent with that
 10 footnote that I referred to. It is footnote 360 on
 11 page 131 of Mastercard's opening submission where they
 12 say that the system of bilaterals would exclude lower
 13 prices.
 14 Then 409:
 15 "In evaluating those restrictive effects,
 16 the Commission also takes account ..."
 17 410 gives some colour to the inflated base:
 18 "Mastercard's MIF constitutes a restriction of price
 19 competition in the acquiring markets. In the absence of
 20 bilateral agreement, the multilateral default rule fixes
 21 the level of the interchange fee rate for all acquiring
 22 banks alike, thereby inflating the base on which
 23 acquiring banks set charges to merchants."
 24 Again, the point is so made:
 25 "The prices set by acquiring banks would be lower in

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1 the absence of this rule and the presence of a rule that
 2 prohibits ex-post pricing."
 3 I shall come onto that in a moment:
 4 "The Mastercard MIF therefore creates an artificial
 5 cost base that is common for all acquirers, and the
 6 merchant fee would simply reflect the cost of the MIF.
 7 This leads to a restriction of price competition between
 8 acquiring banks to the detriment of merchants and
 9 subsequent purchasers."
 10 Then over the page at 412:
 11 "The collective decision by the Mastercard
 12 organisation to set a MIF inflates prices charged by
 13 acquirers to merchants requiring cross-border credit.
 14 This finding is in line with the Commission's previous
 15 case practice. The Commission found in Visa 2 that a
 16 MIF has the effect of distorting the behaviour of
 17 acquirers vis-a-vis their customers, because it creates
 18 an important cost element which is likely to constitute
 19 a de facto floor for fees charged to merchants they
 20 acquire."
 21 I have to go through all of this because Mastercard
 22 still to this day are submitting to the Tribunal that
 23 there is no restriction of competition. So I can't just
 24 ignore it, I have to take it seriously.
 25 Page 1134, 467, again, is a relevant passage

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1 relating to upward pressure on interchange fees, the
 2 third vice I refer to.
 3 Paragraph 467:
 4 "Upward pressure on interchange fees. Mastercard
 5 believes that the competitive process and the market
 6 forces will best ensure that the average MIF is close to
 7 an optimum."
 8 Just pausing there.
 9 That's in quotes. Again, Dr Niels makes exactly the
 10 same point in his first report where he says that this
 11 whole thing should be left "to the market". The market
 12 knows best, he says. You leave it to the market, they
 13 will come close to an optimum, he says. To which the
 14 Competition Authority says, no, it gets inflated and
 15 essentially it is turkeys voting for Christmas, in the
 16 reverse sort of way.
 17 Anyway, I will go on:
 18 "As set out, the forces of intersystem competition
 19 do not sufficiently constrain the level of interchange
 20 fees in the Mastercard scheme and even exert an upward
 21 pressure."
 22 Just pausing there. That reference to upward
 23 pressure, we refer in our written opening to the purpose
 24 of the EU regulation on interchange fees where the
 25 European Union continues to refer to this upward

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1 pressure:
 2 "The evidence at the end of the 1990s when
 3 Mastercard raised its interchange fees to the level of
 4 Visa's interchange fee is consistent with this
 5 observation. The upward pressure effect of intersystem
 6 competition on interchange fee rates is due to the fact
 7 that issuing banks are attracted by revenues from a MIF.
 8 Any card scheme operating with a MIF will take this into
 9 account in its competitive behaviour towards other
 10 schemes. Mastercard does not contest that its
 11 methodology for setting interchange fee ..."
 12 I'm double checking. I'm going through my comfort
 13 blanket decision. That is not in blue?
 14 MR HOSKINS: No.
 15 MR BREALEY: "Mastercard does not contest that its
 16 methodology for setting interchange fee rates takes
 17 account of the rates of competing schemes."
 18 Just pausing there. Again, we saw in the Visa
 19 exemption decision, the Visa 2 decision, that
 20 the Commission objected to Visa setting rates where you
 21 didn't really have any objective criteria to go by.
 22 That's why they modified the Visa system to have these
 23 three categories of cost which ultimately then got
 24 abandoned.
 25 But the real problem, according to the Commission in

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1 2002, was that Visa was just setting the rate on
 2 unidentified criteria, one of which obviously is by
 3 reference to competing card schemes. Again, I said
 4 earlier it is a slight irony in the case that Mastercard
 5 in their witness statements are saying these interchange
 6 fees are necessary because I need to put more money into
 7 the issuers, whereas the Competition Authority has taken
 8 that same fact and is saying, well, that actually is the
 9 third vice. And so is the European Union in its
 10 interchange fee regulation, saying it is the third vice.
 11 Whilst as a matter of fact it may be correct that
 12 these card schemes want to throw as much money at
 13 issuers as they can, it doesn't mean to say that the
 14 merchants have to pay for it. As Mr von Hinten-Reed
 15 says, and then we have quoted it in the skeleton,
 16 essentially what is happening is that the merchants are
 17 paying for a price war between the competing schemes.
 18 We will come onto it if I see it in the opening
 19 submissions. That is the ultimate effect. The Visa and
 20 Mastercard are competing, throwing money at the issuers
 21 and the merchants are essentially paying for that
 22 competition. So that is the restriction of competition.
 23 The upward pressure.
 24 If I could then go to again -- Mastercard, like
 25 Visa, was saying, well, the MIF is necessary. And this

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1 is part of the first counterfactual which I will call
 2 the ex-post pricing counterfactual. They say it is
 3 necessary because if you have a system of bilaterals in
 4 the honour all cards rule, the scheme is going to shrink
 5 to the point of collapse. I can pick that up at
 6 paragraph 548.
 7 I just note here, from memory, I think it is
 8 recital 59 of Visa. Yes, recital 59. This
 9 paragraph 548 is essentially referring back to
 10 recital 59. It is actually in footnote 365:
 11 "As already set out in Visa 2 decision with respect
 12 to the Visa MIF, the only provision necessary for the
 13 operation of an open payment card system, apart from the
 14 technical arrangements on message form and the like, are
 15 the obligation on the creditor bank to accept any
 16 payment validly entered into the system by the debtor
 17 bank and a prohibition on ex-post pricing by one bank to
 18 the other."
 19 We see that in its full glory at 553 and 554.
 20 So Mastercard is saying, again, if we have got the
 21 honour all cards rule, the MIF acts as some constraint
 22 on the issuers. That is the default mechanism. If
 23 I don't have that default mechanism, that MIF, I'm in
 24 trouble. So says Mastercard, and this is where we get
 25 the argument and the rejection.

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1 So the argument is at 553. This is essentially
 2 quoting from the passages that I referred to earlier,
 3 the response to the statement of objections,
 4 Professor Von Weizsaecker. So:
 5 "Mastercard argues the issuing banks and open
 6 payment card systems would be at the mercy of issuers,
 7 because without a MIF that applies by default in the
 8 absence of bilaterally agreed interchange fees, the
 9 scheme's issuing banks would be in a position to deduct
 10 unilaterally any interchange fee they wish."
 11 Dr Niels makes the same point:
 12 "Acquiring banks could then not prevent issuing
 13 banks from retaining excessive interchange fees as
 14 acquirers are bound under Mastercard's honour all cards
 15 rule to process all transactions properly presented to
 16 them. Based on an opinion of its experts ..."
 17 This is the economic opinion that we saw in tab 5:
 18 "... Mastercard concludes that due to HACR, there
 19 must be some kind of arrangement ..."
 20 And I emphasise "must be some kind of arrangement":
 21 "... which sets out the terms and conditions under
 22 which issuers and acquirers agree to provide payment
 23 services to cardholders and merchants."
 24 They say: if I have got the honour all cards rule,
 25 the system, the payment card system, the Mastercard

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1 system it says, first line, would be at the mercy of
 2 issuers and therefore I need some kind of arrangement
 3 which is going to check the abuse of that issuer's bank
 4 card.
 5 So Mastercard say the MIF is such an arrangement and
 6 without the MIF it would be impossible to sustain the
 7 honour all cards rule. That is the argument. The same
 8 argument essentially as Visa, but there you see it in
 9 more detail.
 10 554:
 11 "That argument cannot be accepted. As already set
 12 out in the Commission's Visa 2 decision, the possibility
 13 that some issuing banks might hold up ..."
 14 That's why it is called the hold-up problem:
 15 "... acquirers who are bound by the HACR ... could
 16 be solved by a network rule that is less restrictive of
 17 competition," hence why it is a counterfactual in the
 18 analysis of objective necessity, "than Mastercard's
 19 current solution that by default a certain level of
 20 interchange fees applies.
 21 "The alternative solution would be a rule that
 22 imposes a prohibition on ex-post pricing on the banks in
 23 the absence of a bilateral agreement between them. The
 24 rule would oblige the creditor banks to accept any
 25 payment validly entered into the system by a debtor bank

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1 while prohibiting each bank from charging the other bank
 2 in the absence of a bilateral agreement on the level of
 3 such charges.
 4 "That solution to protect acquirers if issuers
 5 should indeed abuse their powers under HACR is less
 6 restrictive of competition than a MIF as it does not set
 7 a minimum price level on either side of the scheme."
 8 So Mastercard appealed that conclusion. So it made
 9 the argument 553, it appealed that conclusion by
 10 the Commission at 554 all the way up to the ECJ and
 11 said -- and similar to the points they make now: we
 12 don't really think about an ex-post pricing rule, we
 13 have never given it that consideration even though they
 14 have known about it since 2002.
 15 They have made exactly the same point to the ECJ and
 16 the ECJ, we will see it a bit later on, said: such
 17 a rule is likely. It uses the word "likely". And that
 18 it is likely that Mastercard would adopt such a rule if
 19 it had no MIF. And the reason is he needs some sort of
 20 mechanism, and that is what you can call the ex-post
 21 pricing counterfactual.
 22 MR SMITH: Mr Brealey, I think it is Dr Niels in his reports
 23 who says something about the inefficiency of bilaterally
 24 agreed interchange fees. Is it implicit in
 25 paragraph 554 and, indeed, your submissions that that is

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1 right; in other words, that if one sets a MIF, which is
 2 after all a default position on something, that doesn't
 3 need to be the case, can be varied, but the costs of
 4 variation are such that it is much more than a default,
 5 it is in fact the price?
 6 MR BREALEY: Well, we do say that if there is a system of
 7 bilaterals it would lead to lower prices.
 8 MR HOSKINS: It is not our evidence. I have sat on my
 9 hands, we will come to it. That is not our evidence
 10 from the experts.
 11 MR SMITH: It is not what I got from Dr Niels, I have to
 12 say. I thought his position was that if one had
 13 a series of bilaterals that would push up the costs, in
 14 other words, push up the --
 15 MR BREALEY: We will have to find out. He is giving
 16 evidence. He has not given his evidence yet and
 17 Mr Hoskins can sit on his hands, but I'm just reading
 18 what he submitted to the Tribunal.
 19 MR HOSKINS: I'm sorry, the footnote 360 is in a section
 20 dealing with ex turpi causa. If there is any
 21 discrepancy between Dr Niels' evidence, which is that
 22 bilaterals would cause the MIF to increase, which is
 23 quite clearly what he says, and a footnote in
 24 an ex turpi causa section of the skeleton, you can
 25 prefer Dr Niels' evidence. I hope that clarifies it.

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1 MR BREALEY: It does clarify it and I will come onto your
 2 point in a moment, but when I read Mastercard saying "It
 3 is obvious that", I feel that I'm quite entitled to take
 4 that that is the submission.
 5 Dealing with Dr Niels' point, the Commission has
 6 said that if you have a MIF, obviously you don't have to
 7 have a system of bilaterals and they can see that as
 8 an efficiency. Because you don't have to have all the
 9 individual bilaterals. One has to be careful about it,
 10 and this, again, will come out of the evidence, because
 11 it may be the case that it would push up -- whilst I'm
 12 not giving evidence at the moment -- on an EEA basis
 13 where you have lots of agreements, it may not be the
 14 case where you have a domestic MIF and you have only got
 15 a few acquirers.
 16 So there is evidence in the decisions which say that
 17 the domestic MIF is not necessarily going to be the
 18 same. So whether it pushes up the cost is completely up
 19 in the open. Certainly it is not a given on a UK MIF
 20 basis where there are only a few acquirers, there are
 21 not many acquirers that the system of bilaterals, and
 22 I'm kind of putting what I'm going to put to Dr Niels,
 23 but it is certainly not the case where you have only got
 24 a few acquirers that you can realistically say, well, it
 25 is going to push up the price.

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1 MR SMITH: If I can summarise what your position is,
 2 I appreciate this is in anticipation of the evidence and
 3 it is to be read in that light.
 4 MR BREALEY: Yes.
 5 MR SMITH: Your position is that bilaterals will cause the
 6 IF to fall.
 7 MR BREALEY: Correct.
 8 MR SMITH: But that if you have a MIF default position, that
 9 will actually act as a floor and there won't be any
 10 independently negotiated bilaterals because everyone
 11 will revert in default.
 12 MR BREALEY: Correct, and that's what the Commission has
 13 said. The Commission has said that if you don't have
 14 the MIF, the Commission has said in its decision that if
 15 you don't have the MIF you will get lower interchange
 16 fees for the very reason that's in that footnote 360,
 17 which Mastercard apparently now disavow.
 18 I can go to it, but the Commission does accept that
 19 there can be certain efficiencies in a MIF. And that's
 20 why, really, I'm almost in the wrong place here. I'm
 21 looking at article 117 and this debate should be in
 22 101(3) because we know that -- I submit, and I submit on
 23 the basis of Mr von Hinten-Reed and I also submit on the
 24 basis of the Commission decision, the unsuccessful
 25 Mastercard of bills and the EU regulation that if you

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1 have a collective price system, which the MIF is, the
 2 merchants pay more than they would otherwise do.
 3 MR SMITH: And that's because of the market weakness of the
 4 acquiring banks?
 5 MR BREALEY: The market weakness of the acquiring banks.
 6 And if you will just allow the Mastercard or Visa to
 7 have a free rein, and throw money in order to compete,
 8 it goes up.
 9 MR SMITH: Thank you.
 10 MR JUSTICE BARLING: I can't remember whether this is one of
 11 Mr Smith's schedule points, but do we happen to have
 12 anywhere in the evidence, I can't remember, what the
 13 number of UK market acquirers and issuers are?
 14 MR BREALEY: It is in the witness statements.
 15 PROFESSOR JOHN BEATH: Is it Dr Niels'? There is a table --
 16 MR JUSTICE BARLING: I had a feeling it was. Don't take
 17 time up now.
 18 MR BREALEY: I think it is less than five.
 19 MR JUSTICE BARLING: I can't remember if this is
 20 confidential or not.
 21 PROFESSOR JOHN BEATH: It is a relatively small number.
 22 MR BREALEY: Yes. I think actually it is in the Visa
 23 decision.
 24 MR JUSTICE BARLING: Don't get out of your way now,
 25 Mr Brealey, it was just because we paused for

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1 a question. I think I had seen it somewhere, but I just
 2 couldn't remember.
 3 MR BREALEY: Just to pick up on the point. If one goes back
 4 to the Visa decision, or I can just give you the --
 5 MR JUSTICE BARLING: Yes.
 6 MR BREALEY: It is recital 101 and footnote -- I think it is
 7 45. The printing is very bad. But in recital 101 --
 8 and this is why this is an evidential point, but
 9 recital 101, the Commission is looking at Visa's EEA MIF
 10 and saying "When you come to the EEA, you are looking at
 11 quite a few banks" and the figure there is with more
 12 than 5,000 banks in the Visa EU region.
 13 Then they say in the footnote:
 14 "This conclusion is not necessarily valid. In
 15 a domestic context, where the number of banks may well
 16 be far fewer and the efficiency gains of a multilateral
 17 arrangement, vis-a-vis bilateral agreements, may not
 18 outweigh the disadvantage of the creation of
 19 a restriction of competition."
 20 So one immediately sees that it is not just the case
 21 that as a matter of evidence these bilaterals are going
 22 to increase costs, but certainly even if they do, does
 23 it outweigh the inefficiencies of a MIF? And that there
 24 you are in 101(3) territory because you are balancing --
 25 the whole point, and we will have to come onto this, but

1 the whole point of 101.3 is you are balancing the pro--
 2 So this is in Dr Niels' report figure 3.4 at 252 of
 3 the bundle. There may be more. Certainly in the
 4 witnesses of fact, I thought they gave -- that is
 5 paragraph 39.
 6 MR JUSTICE BARLING: Yes, well, you have answered my
 7 question.
 8 MR BREALEY: Our case is that a system of bilaterals --
 9 again just to recap on this, ignore the honour all cards
 10 rule. A system of bilaterals will lead to lower prices
 11 because the merchants can negotiate with the acquirers.
 12 We fully endorse what was said in footnote 360, and to
 13 the extent that there are any greater transactional
 14 costs, there's certainly less, a lower interchange fee
 15 than you would get with an MIF.
 16 MR SMITH: You said there, Mr Brealey, "ignore the honour
 17 all cards rule". Does that pertain if you have the
 18 honour all cards rule, but you have the prohibition
 19 against ex-post prices?
 20 MR BREALEY: Once you insert the honour all cards rule, then
 21 according to Mastercard, and Mr von Hinten-Reed accepts,
 22 so Mastercard submits, which we have just seen, and
 23 Mr von Hinten-Reed accepts that if you don't ignore the
 24 honour all cards rule and you put that into the mix,
 25 then the MIF is liable to go sky high to the point of

1 the scheme shrinking and collapsing because of the
 2 scheme now being at the mercy of the issuers.
 3 And that's why Mastercard and the intervening banks
 4 are submitting that the scheme would collapse without
 5 the MIF to the European Court, and the European Court
 6 upheld what the Commission ruled at 554, that you can
 7 have a default system -- so if you are going to have the
 8 honour all cards rule and a system of bilaterals, it is
 9 basically accepted that you need some sort of default
 10 system so that the issuers don't abuse their power.
 11 The question is -- you have two that have been put
 12 forward. One is the MIF, but that kind of takes up the
 13 interchange fee, and one is this prohibition on ex-post
 14 pricing which now brings it down, and the interchange
 15 fee is lower than it would be --
 16 MR JUSTICE BARLING: It brings it to zero as a default?
 17 MR BREALEY: Yes.
 18 MR JUSTICE BARLING: You can only get it now through
 19 a bilateral.
 20 MR BREALEY: You can only get it now through bilateral.
 21 Now, the issuers have got to negotiate with the
 22 acquirers.
 23 MR JUSTICE BARLING: There has to be an agreement in place.
 24 MR BREALEY: There has to be an agreement in place.
 25 MR JUSTICE BARLING: If you want to have the honour all

1 cards rule.
 2 MR BREALEY: But I don't want this to get -- I have to deal
 3 with this because this is part of the counterfactual
 4 that is made against us. But one cannot get away from
 5 the simple fact that at the beginning the analysis is
 6 that this is a collective price arrangement. And the
 7 big question is: is this collective price -- so you have
 8 competing banks. Is this collective price arrangement,
 9 does it look as if it should fall within 101? And then
 10 you argue about whether it should be exempted
 11 under 101(3).
 12 It is very difficult to understand why, and this is
 13 why the Commission says it basically would negate 101(1)
 14 completely. We will see this in a moment. I can't
 15 think of any other area where such a price fixing
 16 mechanism would escape 101(1) altogether. That's why in
 17 the opening submission I asked the Tribunal just to step
 18 back, all the kind of arguments about ex post facto, all
 19 this sort of thing, just to take a step back and realise
 20 this is a collective price mechanism to which all the
 21 major UK banks adhere in the UK, setting a common price,
 22 which is paid by merchants. And the notion that that
 23 somehow falls out of article 101(1), so you don't even
 24 get to weighing the pro and anti-competitive effects in
 25 101(3) --

1 MR JUSTICE BARLING: You don't even get to restriction of
2 competition.
3 MR BREALEY: No, that is right.
4 MR JUSTICE BARLING: Because you are on objective necessity
5 now.
6 MR BREALEY: I'm on objective necessity.
7 You can see what the restrictive effects are. You
8 can see that it creates a floor. You can see that it
9 creates an inflated floor and you can see that
10 competition between the banks is restricted, it doesn't
11 exist. So all those vices, those restrictive effects,
12 don't constitute, on Mastercard's view, a restriction of
13 competition.
14 MR JUSTICE BARLING: Because without them you can't have the
15 thing which is good, namely, a four-party payment of
16 cards.
17 MR BREALEY: That's what they say. To which the European
18 Court says: yes, you can, you can have the honour all
19 cards rule. You don't need the default mechanism, which
20 is the MIF. There is, to use the words "a less
21 restrictive of competition default mechanism" and that
22 is you can have a system of bilaterals with the
23 prohibition on ex-post pricing.
24 MR SMITH: Or could you equally have a default MIF of zero
25 and financial pricing? Could that have worked equally

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1 well?
2 MR BREALEY: I don't see why not. I will put that to the
3 witnesses. I'm not the commercial -- yes, I mean, as
4 a European -- as the Commission and the European General
5 Court say, you don't need a MIF at all. The issuing
6 banks can get the money from the cardholders. Schemes
7 do operate without MIFs, they don't go bust. So you
8 don't actually have to have a system of bilaterals, is
9 what I'm saying.
10 So if you had a rule saying no bilaterals -- let me
11 put it this way, if you said to Visa and Mastercard: you
12 can't have any interchange fee at all, will the system
13 collapse? The answer is no because in the decision,
14 the Commission refers to instances of open payment card
15 schemes without a MIF. It just means you don't take the
16 money from the merchant, you take it from the
17 cardholder, or you realise you are making so much money
18 in interest that you don't even have to go to the
19 cardholder.
20 So the MIF is not absolutely essential for
21 a four-part payment card scheme anyway.
22 MR SMITH: No, I see that. I mean, what you have got is
23 a situation where issuing banks are providing services
24 to acquiring banks and vice versa.
25 MR BREALEY: Yes.

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1 MR SMITH: And the scheme rules provide for what exactly has
2 been provided each way.
3 MR BREALEY: Correct.
4 MR SMITH: And then one can argue about whether there should
5 be a price paid one way or the other, or whether there
6 should be no price at all. That's all that needs to be
7 laid down. It can be zero, in which case, yes, you may
8 say there is no MIF, but what you are saying is there is
9 no compensating price going either way for the services
10 that had been provided by the banks on each side.
11 MR BREALEY: Yes. The acquirers charge the merchants for
12 the service they are providing and the issuers charge
13 the cardholders for the services they are providing.
14 MR JUSTICE BARLING: There isn't any real distinction, is
15 there, between a zero MIF and a no ex-post pricing?
16 MR BREALEY: I think the difference is that you can agree
17 a fee under bilateral, but if you don't agree, then the
18 issuer can't say, "Aha, we haven't agreed and this price
19 is going to be x times 100".
20 MR JUSTICE BARLING: I'm struggling. You can have
21 bilaterals in both cases, but is there any distinction
22 in reality between a zero MIF and a no ex-post pricing?
23 MR BREALEY: I think to be fair, Dr Niels says it is
24 basically a zero MIF. As I understand it, if you had
25 a rule which said zero MIF, it would be zero.

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1 MR JUSTICE BARLING: There would be no payment. There would
2 be no deduction by the acquiring bank which would be the
3 same as --
4 MR BREALEY: But in a system of bilaterals ex-post pricing,
5 you at least have the ability to agree something. But
6 if you don't agree --
7 MR JUSTICE BARLING: Yes, of course. If you are assuming
8 one has a bilateral possibility and the other doesn't,
9 I agree there is a difference. I thought that the
10 bilateral option was open to -- no one was suggesting
11 you get rid of that in any of these counterfactuals.
12 MR BREALEY: I think the point and the thing that's put to
13 me is I think, and we don't quite work out where
14 Mastercard are coming from in their skeleton, or for
15 that matter Dr Niels, because he seems to kind of
16 slightly pooh pooh bilaterals in his first report. But
17 when it comes to his second report they seem to be more
18 accepted, and that leads him into further arguments
19 about the prices going up.
20 Even when you read Dr Niels' report, we are not
21 quite sure the extent to which you can't have
22 bilaterals. Certainly when you read his first report he
23 doesn't like bilaterals. You read Mastercard's skeleton
24 and it seems to be premised on bilaterals. Again, this
25 is just me opening. We are going to have to find out

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1 actually what their view is on bilaterals.
 2 MR JUSTICE BARLING: This question of objection, while we
 3 are on objective necessity, I think there is a bit of
 4 a debate about to what extent you look at the
 5 counterfactual to see whether something is objectively
 6 necessary, and you look at it in a world that, as it
 7 were, might be said to exist now, a real world, or you
 8 look at it feeding into a certain more theoretical
 9 approach, lawful, which involves looking at the
 10 legalities.

11 In other words, what is objectively necessary?
 12 Let's assume that payment card X is the target of the
 13 Commission investigation and they have evidence to say
 14 that if they abolish the MIF or there was no payment by
 15 the acquiring bank to the issuing bank, then they would
 16 lose 100% market share in about two years and,
 17 therefore, for them it was objectively necessary. And
 18 the answer to that is the Commission might say, or the
 19 Authority might say, you can't, you have got to assume
 20 that is applied to everyone, the law is the law, and if
 21 it is not objectively necessary for you, then it is not
 22 objectively necessary for anybody and that's the
 23 assumption you have got to make. No one needs that. So
 24 you will all be in the same boat.

25 That is the controversy, isn't it, that to some

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1 extent it is visible on your openings on this and on
 2 restriction of competition?
 3 MR BREALEY: Yes. So this, as I said, in the skeleton, they
 4 don't deal with decision of association on takings, they
 5 don't deal with market definition, they don't really
 6 deal with the three vices: the floor, the upward
 7 pressure and the non-compete between the banks. The
 8 whole thrust of the case on distortion of competition
 9 really is the two counterfactuals.

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

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

20 Before I actually -- I will deal with it because
 21 I might as well just raise it. I might as well deal
 22 with it and come onto it again tomorrow, but where does
 23 it fit into the legal analysis? Let's just take a step
 24 back. They are saying 0%, 0.9. Is that an objective
 25 necessity? I don't think it is because even on

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1 Dr Niels' point, they are saying -- so we are not on the
 2 ex post facto now, on collapse, we are on restriction or
 3 distortion of competition.

4 Again, it is not that clear, but let's try and tease
 5 it out. What are they actually saying? That I am
 6 Mastercard, I have a competitor that has 0.9% MIF, but
 7 I need a collective price agreement in order to raise
 8 money from the merchants in order to compete with Visa?
 9 That's essentially what they are saying. I start off
 10 from the premise of a zero MIF, I have been told that it
 11 acts as a floor, a minimum price, it is an inflated
 12 minimum price. I'm told that it does restrict the
 13 ability of independent banks to compete, but my
 14 competitor over there has 0.9% and unless I can have
 15 that price agreement, that collective price agreement,
 16 I cannot compete with Visa.

17 That's essentially, in a nutshell, what we are
 18 talking about.

19 MR JUSTICE BARLING: Because all the issuing banks will get
 20 rid of you and they will start issuing Visa?

21 MR BREALEY: That is the issue. To a certain extent that is
 22 a fact, but let's assume there is an element of truth in
 23 that. What is the legal analysis? Why is that
 24 relevant?

25 My responses to that are several, but first, we say

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1 in our skeleton it is a very, very unattractive
 2 argument. Why is it unattractive? Because Mastercard
 3 are arguing that on a Monday, and on Tuesday Visa argue
 4 the same thing.

5 Visa say: if Mastercard are at 0.9 and me, Visa, I'm
 6 at zero, I will bleed market share to Mastercard.
 7 Therefore, article 101 doesn't apply. So you have
 8 essentially a duopoly of card systems, both arguing the
 9 same thing. And if successful, they both escape the
 10 rigours of the application of article 101.

11 Just intuitively, is that how it is all going to pan
 12 out? Does the argument, for example, depend on the
 13 timing? I mean, everyone knows that Sainsbury's is
 14 suing Visa coming up for trial in autumn this year.

15 Now, let's assume that they were jointly -- and I'm
 16 still on the unattractive nature -- let's assume they
 17 were sued jointly, does Mr Hoskins' argument still hold
 18 if they are both defendants? Is it really the case that
 19 you would have both Mastercard and Visa both arguing the
 20 same thing when you are saying you have been applying
 21 this MIF, the two of you, at the same time and they can
 22 escape this minimum floor, the three vices, just by some
 23 sort of counterfactual?

24 MR JUSTICE BARLING: So legally we should assume that
 25 everyone is potentially in the frame. We should assume

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1 that you are all equally vulnerable to having your
 2 conduct pronounced unlawful, and therefore it would be
 3 wrong to take any account of what could happen, might
 4 happen?
 5 Let's say the evidence said it was likely to be the
 6 case that for one reason or another, the Visa or Amex is
 7 not going to be pursued at the moment. Then I may have
 8 a window of opportunity and you just happen to be in the
 9 dock at the moment.
 10 MR BREALEY: Correct. That is one argument that I make.
 11 I have a few, and --
 12 MR JUSTICE BARLING: Yes.
 13 MR BREALEY: But absolutely, my Lord. So the first is just
 14 intuitively, and I don't think it is my worse argument,
 15 it is a John McEnroe "you can't be serious" type. Is
 16 this really the interpretation you are going to put on
 17 article 101, that you can have a duopoly, just come and
 18 say "We are both going to"? Kind of that's my -- the
 19 second one is as my Lord has just said: Why are you
 20 saying that Visa is lawful when I spent most of this
 21 morning showing the Tribunal that Visa was the first one
 22 to be fingered in 2002 and was told in 2006 that its
 23 exemption would not be renewed, but the MIF would be at
 24 zero and all the sort of things we saw in the Visa
 25 exemption decision.

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1 So is the Tribunal going to ignore -- we were always
 2 looking at -- we are looking at realistic
 3 counterfactuals. The European Court has referred to
 4 realistic counterfactuals. So in a realistic
 5 counterfactual world, are you going to ignore the Visa
 6 investigation, the fact that it didn't get its exemption
 7 renewed, the implications for that, that its MIF was
 8 unlawful?
 9 Then there is a further argument, which is that, as
 10 I tried to impress on the Tribunal this morning, this
 11 argument is about competition. It is about Mastercard
 12 saying "I need this money to compete with Visa".
 13 I showed the Tribunal this morning that that argument is
 14 a 101(3) argument. That's why in the Visa decision at
 15 paragraph 59, where Visa said:
 16 "Visa only says that without the MIF ..."
 17 So it was making the same point.
 18 So Visa says that without the MIF, the scale of
 19 Visa's operations would be greatly reduced and so would
 20 its competitive impact. So that was Visa saying almost
 21 the same thing as Mastercard is saying: Without the
 22 MIF, I will be less competitive.
 23 And the Commission said such argument must be
 24 considered under article 101(3), not 101(1), because it
 25 is an efficiency. So you are talking about

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1 efficiencies, you are talking about -- sorry, my Lord --
 2 MR SMITH: Do carry on. I won't interrupt, I will come in
 3 after you have finished.
 4 MR BREALEY: Okay. So that is why we also say that it is
 5 wrong in law to say all this happens in 101(1) and you
 6 don't even get to 101(3) because of course when you get
 7 to 101(3), you are talking about a level of MIF. You
 8 are not talking about a zero MIF, you are talking about
 9 a level of MIF, and then you are not into the zero
 10 counterfactual anymore. And I will answer any
 11 questions.
 12 So that is a further point. Then the last point
 13 really is, again, it is realistic. Is it realistic to
 14 suppose that the banks that are subject to the
 15 Mastercard scheme, that have just been -- I think this
 16 is more or less the first point that my Lord was putting
 17 to me, but it is a factual inquiry because I think the
 18 factual inquiry that you are saying to me is that they
 19 will all just migrate because Visa has the bigger MIF.
 20 The factual inquiry, how realistic is it that they
 21 will migrate to Visa knowing that Mastercard has just
 22 been told that it constitutes a floor, an inflated
 23 floor, and we come to this, again, the infringement
 24 point, really. So it is not just a question of
 25 a counterfactual in the commercial world. What would

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1 Mr Perez have done in the commercial world? This is
 2 a counterfactual.
 3 You can't ignore that we are in the Tribunal and
 4 someone is arguing that it is anti-competitive. You
 5 don't have to go to the stage -- Mr Hoskins says this is
 6 all crazy because you have to find that the Visa system
 7 is unlawful. You don't. You can say both are
 8 four-party systems, they have been treated exactly the
 9 same by the Commission, exactly the same considerations
 10 apply. Is it realistic that the banks, knowing that the
 11 Mastercard scheme is being attacked and underwater, that
 12 they are just simply going to cross Mastercard off and
 13 go to the same almost identical scheme, but it is called
 14 Visa, with impunity? Particularly if Visa are being
 15 sued in October?
 16 How likely is it that knowing that there is
 17 a problem with Mastercard, they are going to migrate?
 18 MR SMITH: If I understand you correctly, you are saying
 19 that the one-size legal regime fits all extends to all
 20 four-party schemes? Does it extend to three-party
 21 schemes where one has the scheme operator acting both as
 22 the issuing and the acquiring bank as well as the scheme
 23 operator?
 24 MR BREALEY: So Amex?
 25 MR SMITH: Amex, for example.

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1 MR BREALEY: The old-fashioned Amex.
 2 MR SMITH: Then as the follow-on to that, does it extend to
 3 the -- I'm not sure what to call it -- the three and
 4 a half party system where one has Amex operating as the
 5 scheme operator and the acquirer bank, but licensing
 6 issuers?
 7 MR BREALEY: The answer to that is when it comes to the Duo,
 8 in my submission, you can treat the Duo in the same way
 9 as -- so the new Amex, which hasn't been that
 10 successful. Again, this is evidence to a certain
 11 extent -- but the Duo hasn't been that successful
 12 because customers are confused.
 13 But if you are saying "I am going to treat
 14 Mastercard and Visa the same", which is exactly what's
 15 happened, you can treat the Duo, because there is the
 16 beginnings of a relationship now between Amex and the
 17 issuer. That's the first point. The second point is it
 18 doesn't really matter, it does not matter about Amex
 19 because, again, what is -- again, it is very important
 20 to focus on the legal relevance of what is being
 21 submitted. It is not being submitted that Mastercard
 22 will go bust or will lose significant market shares not
 23 to be the sort of Mastercard scheme if it can't issue
 24 premium cards.
 25 Amex is only about its premium card market, and the

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1 witnesses are not saying that the Mastercard scheme will
 2 bleed market share and hit whatever -- what that
 3 ultimately lands on, 5, 10% of whatever, they will lose
 4 just on, for the sake of argument, their premium card
 5 business. To which one says, well, so what? If you are
 6 only gaining that competing with Amex by a price fixing
 7 agreement, well, the competition law doesn't come to
 8 your assistance.
 9 Let's take it back. I want to have a price fixing
 10 agreement in order to compete with somebody. So as
 11 a matter of legal analysis, we say "So what?" But it is
 12 not at all clear as a matter of fact, and certainly we
 13 take issue with it, the premise that if Mastercard were
 14 to reduce its premium card to zero, or 0.3, or whatever,
 15 it would lose all its premium card business to Amex.
 16 Why? Because we see in this decision, and we shall see
 17 elsewhere, that Amex, when it sees Visa and Mastercard
 18 lowering its fees, doesn't keep its fee up here, it
 19 lowers it and keeps the differential as a matter of
 20 fact.
 21 So the nuances are quite (inaudible) and there's a
 22 factual analysis here and it is just too glib to say,
 23 well, if we are at zero or 0.3, we are going to lose
 24 everything to Amex because the experience that Amex can
 25 see that merchants can vote with their feet comes down

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1 and the differential stays the same.
 2 So this Amex thing is, we would say, legally
 3 irrelevant and factually highly suspect. Their big
 4 point is Visa.
 5 MR JUSTICE BARLING: Returning to Visa for one second,
 6 I want to be quite clear what we have to decide, and
 7 just to repeat or paraphrase what you said, how likely
 8 is it -- this is one of your points -- that Mastercard's
 9 bank would migrate to Visa in the present context
 10 knowing what they know, and all the rest of it.
 11 That is a pure question of fact, is it? And in
 12 order to resolve that we have to assess evidence and
 13 judge whether, on the evidence we have, how likely or
 14 otherwise it is, and that would feed into our decision
 15 on objective necessity?
 16 Supposing we found that it was likely that they
 17 would migrate if we or any other court found that
 18 Mastercard had to have a zero, or was only exempt to
 19 whatever the decision was. If we found it was likely as
 20 a matter of fact that there would be, do we have to look
 21 over what period of time and how long would it take to
 22 reduce, how long would they want before -- they would
 23 want to have a good look at the situation first and try
 24 and predict. I'm just wondering how elaborate the
 25 fact-finding that seems to be implicit --

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1 MR BREALEY: We are not raising this point. Obviously it is
 2 Mr Hoskins raising the point.
 3 Yes, to a certain extent. Before I answer that can
 4 I emphasise a key point, which is this is not a proper
 5 101 counterfactual analysis. This is a 101(3) analysis.
 6 Why? Because when you have someone -- we can take
 7 a cartel coming to court and the cartel saying
 8 "I need to have a cartel to compete otherwise I'm going
 9 to not gain market share" or "I'm going to lose market
 10 share", that is not a counterfactual 101 analysis.
 11 It is a 101(3) analysis. I need the money in order
 12 to compete allegedly to be more efficient, whatever they
 13 want to say. The reason why I say that is important is
 14 because when it comes to the exemption, this doesn't
 15 raise its head at all. This "I need it to compete",
 16 when one looks at the chapters in Dr Niels' report, this
 17 doesn't really figure at all in exemption. It is purely
 18 a clever argument, but flawed in my submission, to get
 19 rid of the whole thing in 101.
 20 MR JUSTICE BARLING: And this objective necessity before you
 21 get to 101.
 22 MR BREALEY: And objective necessity. Just to be crystal
 23 clear, I don't believe it is an objective necessity
 24 point, it is a counterfactual relating to restriction of
 25 competition point, just to add to the complexity of it.

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1 So when one is looking at a counterfactual for
2 objective necessity, we are looking to see whether the
3 system would collapse, whether the system is viable,
4 whether without the MIF it would collapse. And in my
5 submission, they don't go to the point of collapse, they
6 just say "We will lose market share". They don't use
7 this competitive counterfactual in objective necessity,
8 the mission impossible point.

9 There is a greater restriction of competition. If
10 they do, then they will have to come to -- in the
11 evidence, they will have to say it will collapse.

12 As I understand it, they are still in business with
13 a lot less market share, true, as in paragraph 59 of the
14 Visa submission. They don't actually say that
15 Mastercard will not be around; indeed, the evidence in
16 the witness statements say we will do something about
17 it, we will not let the system collapse. So this is not
18 an objective necessity point. They are not saying the
19 scheme will disappear; they are saying we need it to
20 compete with Visa.

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

23 MR BREALEY: Under exemption. If you apply paragraph 59 of
24 the Visa decision, where Visa was making exactly the
25 same point, without the MIF we will become less

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1 competitive.
2 MR JUSTICE BARLING: Am I right in thinking that you don't
3 say there is a legal bar? Leave aside objective
4 necessity and leave aside whether it is in 101(1) or
5 101(3), one or the other of those, you don't say that
6 there is a legal bar to looking at this, you say it is
7 a factual question rather than it being inadmissible
8 somehow?

9 I don't know, I'm groping a bit as to what the
10 interrelationship between the legal --

11 MR BREALEY: My legal bit is don't confuse 101(1)
12 with 101(3).

13 MR JUSTICE BARLING: Right. That I follow.

14 MR BREALEY: That's why I say the legal analysis. When
15 Mr Hoskins comes in and says "This is all terrible,
16 I rely on Dr Niels' report, market shares are going to
17 go down", you have to look at this in the counterfactual
18 world to determine whether there is a distortion of
19 competition. I say legally you have to take a step
20 back, what actually are we arguing about here as a
21 matter of law? I say it is a 101(3).

22 MR JUSTICE BARLING: But other than that, you say it is
23 a question of how realistic, or otherwise?

24 MR BREALEY: Correct. So the European Court has said that
25 any counterfactual, whether it is a counterfactual under

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1 objective necessity or a counterfactual to determine
2 whether there is a restriction of competition. And
3 there you are looking at two restrictions of
4 competition. In the restriction of competition
5 counterfactual, like the ex-post pricing, you are
6 looking at two restrictions of competition. One is the
7 restriction with the MIF and one is the restriction of
8 competition bilaterals in the honour all cards rule.
9 And it is said the honour all cards rule is a greater
10 restriction of competition, whereas the European Court
11 says actually not, if you have the other default
12 mechanism which is the ex-post pricing.

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

15 All they are saying is without the money, I can't
16 compete with the Visa. They are not arguing about
17 lesser restrictions of competition. If they are saying
18 that, then they are confusing 101(1) and 101(3).

19 Again, I come back to the Tribunal has to take
20 a fairly pragmatic view on this. That's one of the
21 reasons I wanted to emphasise this morning how
22 intertwined Visa and Mastercard have been; each making
23 submissions on each other's statements of objections,
24 intervening. One gives undertakings to reduce to 0.3,
25 the other follows, given the commitments to reduce

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1 to 0.3. The EU regulating them both, 0.3, not making
2 any distinction about them at all. And then you get
3 this rather absurd situation where both companies are
4 arguing "Without the MIF, we can't compete, or we find
5 it more difficult to compete, and therefore 101 doesn't
6 apply".

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

8 MR BREALEY: They must do.

9 MR JUSTICE BARLING: -- effectively.

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

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

17 MR BREALEY: Yes, I'm sorry.

18 MR JUSTICE BARLING: We will take 10 minutes, thank you.
19 (3.32 pm)

(A short break)

(3.40 pm)

22 MR JUSTICE BARLING: Mr Brealey, I volunteered to show
23 myself ignorant now.

24 One merchant typically would have one acquiring
25 bank, who dealt with it, say, in relation to all card

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1 transactions of any payment system, or would merchants
 2 typically tend to have a different acquiring bank,
 3 a single merchant have a different acquiring bank for
 4 each payment system's cards, or is there nothing typical
 5 at all?
 6 MR BREALEY: I know that some merchants can have two. Can
 7 I just --
 8 MR JUSTICE BARLING: Or, indeed, you could give us the
 9 answer any time. But don't interrupt, if you like.
 10 MR BREALEY: I will get the answer. I don't know about the
 11 typical merchant. Sainsbury's, as I understand it, for
 12 Visa has Barclaycard, and Mastercard has Worldpay and
 13 another bank, HSBC maybe. So you can --
 14 MR JUSTICE BARLING: So you can --
 15 MR BREALEY: -- you can play them off.
 16 MR JUSTICE BARLING: But you could have just one acquiring
 17 bank?
 18 MR BREALEY: Absolutely.
 19 MR JUSTICE BARLING: There's nothing in the rules that
 20 prevents that?
 21 MR BREALEY: No. I imagine the little corner shop in
 22 Essex Street would just have one acquirer.
 23 MR JUSTICE BARLING: Thank you very much.
 24 MR BREALEY: We will probably come back to what we say is
 25 the unrealistic counterfactual of one of the major

1 21

1 schemes having 0.9 and the other major scheme being
 2 zero. I'm probably going to come back to it time and
 3 time again, but if I can move on.
 4 MR JUSTICE BARLING: Yes.
 5 MR BREALEY: Certainly we are talking about Visa. Shall
 6 I just show the Tribunal paragraph 620 of the decision?
 7 And again, this is 620 essentially to 648 where
 8 Mastercard were arguing that without the MIF it could
 9 not compete with Amex. So at least this is passages in
 10 the decision -- again, it is referring to facts prior to
 11 2007, but it shows the same argument being used.
 12 So 620:
 13 "Mastercard argues that closed payment card systems
 14 such as American Express have a number of distinct
 15 advantages."
 16 621:
 17 "Mastercard concludes that a MIF was objectively
 18 necessary for Mastercard to compete with American
 19 Express."
 20 And then what the Commission does is it rejects it
 21 on the facts. It refers to the Australian -- again,
 22 I won't go through it all, but it goes through the
 23 Australian evidence, for example, at 634.
 24 "In 2001, Mastercard argued towards the Reserve Bank
 25 of Australia that the regulation of the scheme's

1 22

1 interchange fees lead to a death spiral," that is the
 2 phrase we see repeatedly "death spiral", "of its scheme
 3 in Australia if interchange fees were reduced and set
 4 too low as Mastercard's member bank would be motivated
 5 to evolve towards three-party systems. That argument is
 6 not dissimilar to key elements of Mastercard's defence
 7 in this case."
 8 We have been through this sort of thing before:
 9 "As the Reserve Bank of Australia set out in
 10 a public document, Mastercard's death spiral argument
 11 was proven wrong by events following the regulation of
 12 interchange fees."
 13 That is 636. Why?
 14 "The decrease of interchange fees for Mastercard and
 15 Visa credit cards in Australia was followed by a sharp
 16 decrease of the merchant fees in both schemes. The fees
 17 of the closed schemes, American Express and Diners, were
 18 not regulated, but their merchant fees also decreased
 19 even though in a less pronounced manner."
 20 We will see some documents on this a bit later on.
 21 But what the Commission is referring to -- and this
 22 is 2007 and some of it has been updated, as I said
 23 earlier on -- is just not a given fact that if
 24 Mastercard is forced to reduce its interchange fees,
 25 American Express will say, "Ha, ha, fantastic, I'm going

1 23

1 to take all their business". Why? American Express has
 2 acceptance issues. Merchants have a choice whether to
 3 take the American Express. They are not bound like the
 4 honour all cards rule. They can choose. If they see
 5 a Mastercard premium card being used at a lower rate and
 6 they see an American Express card three times, four
 7 times the rate of the Mastercard, American Express gets
 8 extremely nervous about acceptability. And that is the
 9 reason why in Australia -- and, again, this is not the
 10 complete picture -- American Express reduced its fees
 11 when it saw Mastercard and Visa reducing its fees.
 12 Then I think if I could go to the exemption. So
 13 just so that the Tribunal know. I think, I'm at
 14 paragraph 23(d) of the opening submissions. I shall
 15 speed up tomorrow, but I have gone through, as you would
 16 expect, some of the arguments.
 17 MR JUSTICE BARLING: Well, we have slowed you down.
 18 MR BREALEY: Not at all.
 19 (d):
 20 "How did the Commission look at exemption?"
 21 Points to note. I go to paragraph 679. I won't go
 22 through all the things on exemption because I shall do
 23 that when I deal with the exemption. That is very a
 24 important point; it is only three lines, but we see it
 25 in the Commission's decision, we see it in the

1 24

1 General Court and we see it in the ECJ, the CJEU.
2 Mastercard have repeatedly argued that it should get
3 an exemption because its scheme is efficient, is
4 a brilliant scheme and benefits consumers, the scheme
5 does this and the scheme does that.

6 The Commission said, yes, it is. The scheme does
7 lead to efficiencies. But that is not the question.
8 The question is whether the restriction, ie the MIF,
9 leads to efficiencies, and you will have seen that we
10 repeat this time and time again in our section in our
11 opening submission on exemption. There is a big
12 difference between saying the scheme creates
13 efficiencies and the MIF.

14 So we haven't seen, but the Commissioner has shown,
15 that you can have a four-party payment scheme without
16 a MIF, and it still allows people to use credit cards,
17 it uses them in the shops etc.

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

24 PROFESSOR JOHN BEATH: Presumably we should be talking about
25 it in relation to the additional efficiencies, because

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1 the scheme creates a set of efficiencies. Is that set
2 enhanced by any one of them? It's that marshalled
3 effect that we should be thinking about.

4 MR BREALEY: Absolutely. I have not put it quite right. It
5 is the additional efficiencies created by the MIF.

6 Those efficiencies that would not otherwise be there.

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

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

20 So Sainsbury's saves money if I use a card as
21 opposed to cash. It means that the person at the till
22 doesn't have to take the money, give the change, the
23 money doesn't have to go to the back office, you don't
24 have the swag bags taking it to Group 4, going to the
25 bank. There are savings in costs by using a card over

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1 cash. This is the MIT MIF. And when you calculate
2 those, and it is not just a transaction cost, you may
3 have an element of the fraud costs which are saved over
4 and above the cash. That factors in, but those are the
5 efficiencies; it is said that the MIF creates those
6 efficiencies.

7 Now, Mr von Hinten-Reed, he will say, well, actually
8 that is quite conservative. The application of the MIF
9 test is actually quite a conservative test in the card
10 system's favour. But we have settled on the application
11 of the MIT MIF test, recognising that merchants do save
12 money, there are efficiencies. Therefore, we have come
13 out at 0.15. We have seen earlier on that if you strip
14 out the funding cost, even Dr Niels on the cost
15 methodology, which is the cost to the issuers, not the
16 savings to the merchants, comes out roughly the same,
17 0.2. It is only when you load on the funding costs,
18 this cost of the free funding, do you then rocket up.

19 So we accept that there is, in this case, a lawful
20 level of MIF that can be accepted. So 679 is extremely
21 important, but we will see that this paragraph is
22 endorsed by the General Court and endorsed by the CJEU.

23 Mastercard are told to focus on the MIF, not the
24 scheme. Having said looking at funding costs, could
25 I just finish, I think I will finish the decision by

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1 reference to the funding costs. So if I can go to 684.
2 We saw this morning about Visa and the funding costs.
3 This is the funding of credit. For the sake of
4 argument, it is a 28-day period.

5 Visa allowing it for EEA, saying it is unlikely, or
6 it is maybe not going to be permitted for domestic.
7 Then the parties finding out the exemption is unsound,
8 and now we see the Commission's view on EEA free
9 funding.

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

13 So 684:

14 "One of the crucial assumptions underlying the
15 Mastercard MIF is a perceived imbalance between the
16 issuing and the acquiring business in the scheme.
17 Mastercard derives that imbalance from the fact that the
18 average issuer will incur the vast majority of the
19 scheme costs, because in the UK market 95% of the costs
20 are skewed towards the issuing side."

21 I just add here that when it comes to a read across
22 from this decision to the present case, it is quite
23 illustrative to note that a lot of the evidence in
24 the Commission's decision relates to the UK. So
25 Mastercard are referring essentially to the UK in saying

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1 that there should be free funding.
 2 So over the page, 685:
 3 "The argument that a MIF was required because
 4 issuing banks incurred 95% of the total cost in the UK
 5 is a circular reason because it is precisely due to the
 6 MIF that issuing banks incur certain costs they would
 7 not incur in the absence of a MIF. To the extent a MIF
 8 provides a situation to issuing banks to issue cards,
 9 they may incur all kinds of marketing costs to push card
 10 usage and these costs then determine ex-post the
 11 objective necessity for MasterCard to cover these costs.
 12 In economic terms, Mastercard's argument suffers from
 13 endogeneity."
 14 Also:
 15 "An imbalance between issuing and acquiring cannot
 16 be assumed on the basis of cost considerations only, but
 17 has to comprise analysis of revenues as well. A cost
 18 imbalance is as such no sufficient evidence to explain
 19 why Mastercard's MIF is always paid by the acquirer to
 20 the issuer irrespective of the concrete market
 21 situation. If we seek interest money, exchange fees,
 22 penalty fees or other monetary benefits, cost
 23 savings etc from payment card issuing provides
 24 sufficient commercial incentives for banks to invest in
 25 incremental card issuing, a transfer from acquiring to

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1 issuing may be superfluous and even counterproductive as
 2 the revenue transfer dampens card acceptance due to the
 3 increasing costs on the merchant's side."
 4 I rely in particular on the first sentence of 686,
 5 because Mastercard is being told that if you are going
 6 to base it on cost, you have to look at the revenues.
 7 And one sees at footnote 829:
 8 "In the UK, for instance, issuing banks generated
 9 90% of their revenues with income from cardholders,
 10 mainly interests, and only 10% from interchange fees.
 11 The magnitude of issuer revenues from cardholders in the
 12 UK show that not only the costs, but also the revenues
 13 of credit cards must be skewed to the issuing side in
 14 the UK market. Mastercard neglects this in assuming
 15 an imbalance. Moreover, it should be clarified in this
 16 context that at the Visa 2 decision, the Commission
 17 accepted a cost benchmark for exempting MIF for a
 18 five-year period until 2000."
 19 Then they refer it expires.
 20 "I know Visa have proposed this cost benchmark in
 21 order to meet the Commission's concern that Visa's board
 22 had unlimited discretion for setting interchange fee
 23 rates."
 24 I wanted to emphasise that, because the
 25 General Court endorses this and says that if you are

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1 going to start arguing about an imbalance and you are
 2 going to start arguing about merchants paying for the
 3 cost of free funding, you can't just look at that
 4 imbalance and say, well, I'm going to look at the costs.
 5 You have got to look at the interest that issuing banks
 6 get which, on these figures, constitutes 90% of the
 7 revenue from credit cards.
 8 Clearly, that is a fact that is relevant to the
 9 death spiral that, again, Mastercard submit in the
 10 present proceedings about losing business to Visa.
 11 But we will come onto that.
 12 PROFESSOR JOHN BEATH: Really I wondered if you wanted to
 13 draw our attention to the closing sentence of
 14 paragraph 686 about robust and empirical evidence and
 15 underlining the word robust?
 16 MR BREALEY: You are absolutely right, sir and it is
 17 something that I will touch on:
 18 "Robust empirical evidence is therefore required to
 19 establish the necessity for and the direction of
 20 a fallback interchange fee."
 21 I shall pick up at this point --
 22 PROFESSOR JOHN BEATH: That's fine if we are going to --
 23 MR BREALEY: No, you are absolutely -- because, again, it is
 24 something that the Commission say in its decision. We
 25 haven't seen robust evidence, and when we come to

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1 annex 6, again, the Commission says that the evidence is
 2 not robust. But I am obliged.
 3 Again, I'm on the free funding period. If I could
 4 go to paragraph 742.
 5 Having said at the last sentence of 741:
 6 "The Commission's concerns under the second
 7 condition of 81(3) relate to the customer group which
 8 bears the cost of the MIF, that is the merchants."
 9 At 742.1:
 10 "While merchants may benefit through enhanced
 11 network effects ...
 12 (Pause)
 13 "While merchants may benefit through enhanced
 14 network effects from the issuing side, this does not
 15 necessarily offset their losses which result from paying
 16 inflated merchant fees. The Commission has therefore
 17 reviewed how Mastercard sets an upper limit to its
 18 interchange fee. MasterCard in practice ..."
 19 Then the rest is a business secret, I won't read it
 20 out:
 21 "As set out in detail in the supplementary statement
 22 of objections, this benchmark includes cost elements
 23 that are not related to services which sufficiently
 24 benefits merchants. It remains unproven that merchants
 25 benefit from bearing the financial burden of issuers for

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1 the provision by issuers to cardholders of a so-called
 2 free funding period. Moreover, the Commission doubts
 3 that merchants sufficiently benefit from bearing the
 4 financial cost of issuers writing off bad debts and
 5 collecting debts from cardholders."
 6 Again, these are the sort of costs being offloaded
 7 onto merchants.
 8 We see from the witnesses of fact that with the
 9 monoline banks, Capital One -- this is their own
 10 evidence -- that there was more competition in the UK,
 11 more people coming into the market, more banks,
 12 financial institutions lending money to people, taking
 13 risks, lending money to customers who could not pay and
 14 yet this is being offloaded onto the merchants. It is
 15 something we will have to explore in the evidence, but
 16 this is why the Commission is so against it.
 17 744, 745, 746, I ask the Tribunal to note, but 746
 18 finally:
 19 "A bank in the UK submitted on 22nd September to
 20 a study conducted by ..."
 21 That is blanked out, but the name of the consultant
 22 one can see from the report of Dr Niels:
 23 "... evidence on the benefits to merchants form the
 24 extension of credit. In the Commission's view, that
 25 study does not establish that merchants sufficiently

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1 benefit from a cost benchmark, which includes the cost
 2 of a free funding period, that is a period during which
 3 a cardholder makes use of free credit. For details,"
 4 and then we see annex 6.
 5 Annex 6 is at page 1242.
 6 So Mastercard submitted a study apparently which
 7 said that merchants do benefit from the free funding.
 8 It was rejected, and I just ask the Tribunal to note
 9 paragraphs 8 and 9:
 10 "In particular, the study does not distinguish
 11 between the timing of consumer spending and net changes
 12 to total consumer spending. If consumers respond to
 13 an increase in the credit limit by borrowing more and
 14 spending more in the current period, they must repay
 15 their debt thereafter. Everything else equal,
 16 cardholders must reduce their spending in the future.
 17 If credit card holders cannot generate incremental
 18 income to finance their incremental purchasing, their
 19 capacity to spend will stagnate. A euro spent today
 20 cannot be spent tomorrow."
 21 David Copperfield, Mr Micawber.
 22 "The study, moreover, does not even distinguish the
 23 provision of interest-free period and the extension of
 24 credit more generally. Issuing banks finance the
 25 extension of credit to cardholders for interest. At no

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1 point this study considers why a MIF [this is the robust
 2 evidence for the link between the MIF] would be
 3 necessary for the extension of credit through credit
 4 cards. Rather, the study limits itself exclusively to
 5 analysing the effects of extending credit as such. It
 6 does not establish a causal link between the issuing
 7 bank's capacity to extend credit to cardholders and
 8 a MIF."
 9 Again, this is something that we make complaint of
 10 to Dr Niels in his report.
 11 With the greatest of respect to him, but we do not
 12 see the requisite link between the MIF and the free
 13 funding period to justify that jump from 0.2 to 0.75.
 14 Again, I'm almost at the end of going through the
 15 regulatory context. I will speed up tomorrow. So I'm
 16 finished with the decision now. I'm at paragraph 24 of
 17 the opening submissions.
 18 We know that after the infringement decision there
 19 was a discussion between Mastercard and the Commission.
 20 We shall see tomorrow the nature of some of those
 21 discussions. We will see tomorrow the introduction of
 22 the MIT MIF test, this merchant indifference test,
 23 Mastercard calculating a MIF on the basis of the test
 24 and that ultimately led to the undertakings in 2009 to
 25 reduce the credit card MIF from the level it was, the

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1 high level, to the 0.3.
 2 But that was only on the EEA. It did not reduce the
 3 credit card MIF on domestic, nor did Visa, and that's
 4 why we are in court today. But I shall deal with that
 5 when I get to exemption.
 6 Similarly, paragraphs 26, 27, 28 just set out that
 7 Mastercard having given the undertakings, Visa gave
 8 commitments along the same lines, reducing its EEA MIF
 9 for credit cards to 0.3%.
 10 In the meantime, Mastercard appealed to the
 11 General Court, and that is at E1, tab 15. So
 12 paragraph 29:
 13 "Mastercard, supported by several UK retail banks,
 14 appealed to the General Court on the following grounds.
 15 The Commission was wrong to find the MIF to be
 16 a decision of association by undertakings ... wrong to
 17 find the MIF had the effect of restricting competition,
 18 and it was in any event objectively necessary.
 19 The Commission's analysis of the exemption
 20 conditions 101(3) was wrong.
 21 "In May 2012, the General Court dismissed
 22 Mastercard's appeal."
 23 Then in the opening we have tried to set out under
 24 various headings where -- because actually it is
 25 a fairly tricky read, the General Court's. You get lost

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1 as to under what headings they are talking about.
 2 So paragraph 31 and 32 is the objective necessity,
 3 and I can just pick this up at 106 to 121.
 4 106:
 5 "Insofar as the MIF constitutes a mechanism for the
 6 transfer of funds to issuing banks, its objective
 7 necessity for the operation of the Mastercard system
 8 must be examined in the wider context of the resources
 9 and economic advantage, which the banks derive from
 10 their card issuing business."
 11 Now, 107 is a reference to the interest point which
 12 it picks up later and we shall see this tomorrow:
 13 "... but it must be noted that credit cards generate
 14 significant revenues for issuing banks consistent, in
 15 particular, with the interest charged to cardholders.
 16 It is thus clear from recital 346 to the SSO, to which
 17 reference is made in 162 of the decision, therefore
 18 issuing banks' importance of lending money via credit
 19 cards may be high, especially in markets where credit
 20 cards are widely used, such as in the UK, the country
 21 with the highest number of MasterCards with a credit
 22 facility. This assessment also appears in footnote 829
 23 to the contested decision in which it is pointed out
 24 that in the UK the issuing banks generate 90% of their
 25 revenue from interest and only 10% from interchange

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1 fees."
 2 Then they deal with debit cards. 109:
 3 "It must be observed that the existence of such
 4 revenues and benefits make it unlikely that without
 5 a MIF an appreciable proportion of banks would cease or
 6 significantly reduce their MasterCard issuing business."
 7 Again, MasterCard seems to have been arguing these
 8 points before the General Court:
 9 "... unlikely that without a MIF an appreciable
 10 proportion of banks would cease or significantly reduce
 11 their MasterCard business or would change the terms of
 12 issue in holders of their cards or favouring other forms
 13 of payment ...[this is for the transcript 109] Or
 14 turning to cards issued under three-party schemes which
 15 might effect the viability... In other words, while a
 16 reduction in the benefit conferred on cardholders and
 17 the profitability of the card... issuing business might
 18 be expected in a system without operating a MIF. It is
 19 reasonable to conclude that such a reduction would not
 20 be sufficient to effect the viability of the MasterCard
 21 system."
 22 Then 111 refers to the Australian evidence. That
 23 conclusion is reinforced by the Australian example to
 24 which the Commission referred. It is clear from that
 25 example that a substantial reduction in the MasterCard's

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1 system that was imposed by the Reserve Bank of Australia
 2 had no notable impact on the system's viability and in
 3 particular did not lead to a move towards three-party
 4 schemes even though such schemes were not affected by
 5 the regulations.
 6 We can go on but 114:
 7 "The fact remains that if such a mechanism were
 8 objectively necessary as claimed by the applicants, the
 9 significant reduction in interchange fees imposed in
 10 Australia could reasonably be expected to have
 11 an adverse impact on the operation of the MasterCard
 12 system. No such impact was produced."
 13 It goes through some of the facts. So we don't know
 14 precisely the sort of arguments that were being advanced
 15 to the General Court, but, clearly, similar sort of
 16 arguments that we have been debating before the break
 17 about the migration of business to others was raised and
 18 the General Courts are saying well you have got all this
 19 interest --
 20 MR JUSTICE BARLING: In 110 they seem to be drawing
 21 a distinction between the reduction in profitability and
 22 an absence of viableness.
 23 MR BREALEY: Correct. That is the mission impossible test
 24 and we will see this becomes -- it is not mission
 25 difficult under whatever, it is mission impossible, and

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1 the ECJ clearly stated that the fact that -- so when one
 2 is coming to objective necessity, the fact that the
 3 scheme is more difficult to operate, or it is less
 4 profitable is not the test for objective necessity. It
 5 is impossibility. So it is a very, very high hurdle.
 6 The policy reasons for it being a high hurdle are
 7 obvious because if every time you had a price fixing
 8 agreement, for example, which you said was necessary to
 9 compete in order to make more money and that was
 10 sufficient to get you outside 101(1), every restrictive
 11 agreement would fall outside 101(1). If you are going
 12 to say it is necessary, the test is mission impossible.
 13 The effects on competition; again we will see this
 14 in more detail but they start at -- they refer to it in
 15 part at paragraph 172. I just mention this again
 16 because 172/173, the acquiring market is endorsed by the
 17 General Courts. It says there is no manifest error:
 18 "The Commission took the view that the four party
 19 bank card systems operated in three separate markets."
 20 There's no distinction between Visa and MasterCard
 21 that four party bank card systems operated in three
 22 separate markets and relied on the restrictive effects
 23 of the MIF on the acquirer market.
 24 Again, to a certain extent all this, until 182, is
 25 relevant and I mention it because Dr Niels says, you

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1 shouldn't be looking at this sort of thing under 101,
 2 this is a two sided market, let the market decide, he
 3 says. But you look at 181 and 182 to how the
 4 General Court view this:
 5 "In the second place, with regard to the criticism
 6 concerning the failure to take the two sided nature of
 7 the market into consideration, it must be pointed out in
 8 that regard that the applicants highlight the economic
 9 advantages that flow to the MIF...[comes back to
 10 Mr Hoskins VISA counterfactual] allows me to compete.
 11 That in essence the applicant states that the MIF
 12 ...(Reading to the words)...to be optimised by financing
 13 expenditure intended to encourage cardholder acceptance
 14 and use. They deduce from this that it is not in the
 15 interests of banks to set the MIF at an excessive rate,
 16 moreover that merchants benefit from the MIF. The
 17 applicants also complain that the commission overlooked
 18 the impact of its decision on cardholders. In that
 19 regard a number of interveners add [that is the banks]
 20 in a system operating without the MIF they would be
 21 compelled to limit the advantages conferred on
 22 cardholders or reduce such activities."
 23 This comes back to the point I have been trying to
 24 emphasise on 101(1) and 101(3):
 25 "Such criticisms have no relevance in the context of

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1 a plea relating to the infringement of article 101(1) in
 2 that they entail a weighing up of the restrictive
 3 effects of the MIF on competition, legitimately
 4 established by the Commission with any economic
 5 advantages that may ensue. However it is only within
 6 the specific framework of article 81(3), 101(3), that
 7 the pro and anti-competitive aspects of a restriction
 8 may be weighed."
 9 MR JUSTICE BARLING: That's the same point again.
 10 MR BREALEY: It is the same point. Again, and I can only
 11 repeat it so many times, if MasterCard are coming to
 12 this Tribunal saying: I want this price fixing
 13 agreement, which I acknowledge creates this inflated
 14 floor, I acknowledge that it restricts competition
 15 between the banks, but I need this in order to better
 16 compete with Visa, that is not a 101(1)
 17 counterfactual --
 18 MR JUSTICE BARLING: It is an exemption point you say.
 19 Look, we have read this at some point or other, but you
 20 have presumably got other bits and pieces in there that
 21 you want to take us to. Would it help, I expect people
 22 might be winding down, if you gave us a few passages to
 23 read overnight and then you could make your points on
 24 them if you wanted rather than take time now? Where
 25 were you going to go to next? 172 to 182?

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1 MR BREALEY: At paragraph 34 I was going to emphasise the
 2 point that Professor Beath made which is paragraph 196,
 3 the burden of proof is on MasterCard to show by means of
 4 convincing arguments and evidence. That is the robust
 5 point. You have to show robustness.
 6 At (b), paragraph 207, is where the General Court
 7 emphasises that you have to look at the efficiencies
 8 created by the MIF alone. That's paragraph 207.
 9 Paragraph 233 picks up on the nature of you have got to
 10 look at the free funding and the interest payments.
 11 That's paragraph 233. Paragraph 221 again is a point on
 12 exemption. It is not benefits to MasterCard for
 13 exemption, it has to be objective benefits.
 14 That's more or less all I wanted to emphasise on the
 15 General Court. Then I'm almost finished then, if I go
 16 to paragraph 36 of the opening submissions and the ECJ,
 17 the CJEU, which is E1, tab 19. I was going to refer to
 18 paragraph 76, where the court endorses the decision of
 19 association of undertakings. I was going to go to
 20 paragraph 91, the mission impossible objective
 21 necessity. Paragraphs 171 to 173 is where the
 22 General Court states that the ex-post pricing
 23 prohibition counterfactual is the likely one, it uses
 24 the word "likely".
 25 MR JUSTICE BARLING: Sorry the CJEU?

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1 MR BREALEY: This is the CJEU and paragraph 232 referring
 2 to: you have got to look at the efficiencies created by
 3 the MIF not the scheme.
 4 MR JUSTICE BARLING: If we --
 5 MR BREALEY: Then I can almost --
 6 MR JUSTICE BARLING: If we read those...
 7 MR BREALEY: If my Lord has questions on that, I can then
 8 just go straight onto the next section, which is
 9 infringement. I have covered a lot of the ground in
 10 infringement because of the discussion we have been
 11 having today.
 12 MR JUSTICE BARLING: Right, is that a convenient moment?
 13 MR BREALEY: Yes.
 14 MR JUSTICE BARLING: Then we will see you again at 10.30 am.
 15 Thank you.
 16 (4.30 pm)
 17 (The court adjourned until 10.30 am
 18 on Tuesday, 26th January 2016)

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