

# OPUS 2

## INTERNATIONAL

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

Day 21

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1 Monday, 14th March 2016  
 2 (9.30 am)  
 3 Closing submissions by MR BREALEY (continued)  
 4 MR BREALEY: Good morning.  
 5 MR JUSTICE BARLING: Good morning, Mr Brealey.  
 6 MR BREALEY: I have got three topics to do and then Mr Spitz  
 7 will take over.  
 8 If I could just start where I finished, which was at  
 9 section 8 of our closing, page 205. That's where  
 10 we are.  
 11 MR JUSTICE BARLING: Yes.  
 12 MR BREALEY: I won't go through the suspicions bits again.  
 13 I was just going to emphasise the Maestro and the Amex  
 14 story. A lot of this now is in blue, so the Maestro  
 15 story starts at 210. We set out what we regard as the  
 16 evidence relating to Maestro and then the Amex  
 17 counterfactual is at 659.  
 18 MR JUSTICE BARLING: Yes.  
 19 MR BREALEY: As I say, a lot of it is in blue, so I won't  
 20 ask the Tribunal to go into camera so I will just  
 21 highlight what I think I can because it is all set out  
 22 here.  
 23 MR JUSTICE BARLING: Yes.  
 24 MR BREALEY: I will just double check -- it isn't really  
 25 what I thought. (Pause)

1

1 So, as I say, the Maestro story starts at  
 2 paragraph 627. We have split the Maestro story into  
 3 three chapters just so that the Tribunal can see the  
 4 relevant chapters. The first is just above 630, which  
 5 is the timeline.  
 6 MR JUSTICE BARLING: Yes.  
 7 MR BREALEY: The second is above 636, which is the  
 8 functionality problems with Maestro. And then the  
 9 third, the reasons for the portfolio flips, which is  
 10 above 643, and I probably should also -- there is  
 11 a fourth which is just above 649, which is the damages  
 12 modelling. As you know, they take the steep decline and  
 13 actually, if you actually look at the facts, it should  
 14 not be as steep even on their case.  
 15 Just quickly going back to the Maestro story. What  
 16 I want to emphasise at 630, which is the timeline, is  
 17 although there was a differential between the rates,  
 18 Maestro and Visa, in the early 2000s the market shares  
 19 were relatively stable.  
 20 So it would be incorrect just to look at the two big  
 21 banks and their flips. You can actually take a step  
 22 back in time a bit and see that, notwithstanding the  
 23 differentials, the market shares were relatively stable.  
 24 That's what I wanted to emphasise on the timeline.  
 25 And obviously at 631 we have got what Mr Douglas

2

1 accepted in his oral evidence:  
 2 "The important point to note is that the UK debit  
 3 card market reduced to such a level because MasterCard  
 4 lost two of its main customers, HSBC and Royal Bank of  
 5 Scotland, who represented 90% of the Maestro market."  
 6 And that is correct.  
 7 So that is the reason that it plummeted. That is  
 8 the timeline.  
 9 The second point we pray in aid obviously, and it  
 10 took a lot of cross-examination, this is at 636:  
 11 functionality. We do say there is a wealth of  
 12 internal -- this is internal -- MasterCard  
 13 documentation, attesting to the fact that the Maestro  
 14 was an inferior product in terms of functionality.  
 15 If one could just keep a finger there but then just  
 16 go to 658, which I won't -- I want to go back to this  
 17 page. I think that the evidence from Mr Douglas at 658,  
 18 which is blued out, is important and we do submit that  
 19 on any view the Maestro was an inferior product to the  
 20 Visa Debit and it was at the start at a competitive  
 21 disadvantage.  
 22 So going back to paragraph 636, again we say there  
 23 is a wealth of documentation. It did have limited more  
 24 international acceptance, it had relatively stringent  
 25 security requirements more than the others, it was

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1 limited for online transactions, it could not be used to  
 2 make recurring payments, that's payments two or three  
 3 times over, and the Maestro cards could not readily be  
 4 changed when they were lost.  
 5 Why does that matter? Well, clearly, we say it  
 6 makes it an inferior product, so when the bank is  
 7 looking at it and they are trying to sell it to their  
 8 customers, it is a big point and why should their  
 9 customers get an inferior product? But it is also  
 10 important for the economics, which essentially leads me  
 11 to the third reason: the reason for the portfolio flips.  
 12 That is on the top of 217, which again is not blued  
 13 out so I can refer to it. So the functionality is  
 14 relevant to the economics. So the question is: are the  
 15 banks going to issue inferior cards to their customers?  
 16 But does this functionality, the ability to use it  
 17 in America, for example, matter from the economic point  
 18 of view? And we say yes, it would have done. So when  
 19 the banks were looking at the revenue earning  
 20 opportunities, the inferior nature of the Maestro would  
 21 have been a relevant consideration, and indeed it was  
 22 because we saw that from the contemporaneous internal  
 23 documentation.  
 24 It was an important consideration for those two  
 25 banks. That is really Maestro. Obviously there is

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1 a lot in the Maestro story. A lot of it was subject to  
2 cross-examination of Mr Douglas, so one hopefully will  
3 go back to the transcript of Mr Douglas on that. But  
4 that is the story.

5 The last one is the damages modelling and we say it  
6 is not such a steep decline even on MasterCard's view.  
7 But I think one has to just take a step back, and what  
8 is the Maestro story being used for? It is being used  
9 as a reason for saying that the credit card would have  
10 gone down to 3%. And really, we are looking at cutting  
11 Sainsbury's damages down. And we would say it is  
12 a wholly imperfect analogy to take this Maestro story  
13 with all its problems and just to transport that on the  
14 credit card and say, well, it would have been the same  
15 decline.

16 You have got two banks who accounted for 90%. You  
17 have got functionality problems. You have got quite  
18 a lot in there that's not necessarily applicable to  
19 credit cards.

20 That is Maestro. If I can go to Amex -- unless the  
21 Tribunal has any questions? Amex. Now, again, you will  
22 have seen that the witness is saying lower interchange  
23 environment, we would have lost our premium business.

24 We give six reasons in this section why not, but  
25 I would like to just highlight -- if we can just

5

1 highlight them -- so 663. First of all, we say that the  
2 proposed mechanism is implausible. That is the  
3 complexity of the Duo. That's the first reason. We  
4 give six reasons, and at 663 we give the first one, that  
5 we say it was implausible. This is the Duo.

6 The second is at 669. Is it realistic -- I'm not  
7 sure there was any evidence adduced on this -- that all  
8 of MasterCard's premium cardholders are just going to be  
9 taken up by Amex? You actually have to apply.

10 Third, we have the issue of acceptability, the  
11 acceptance. So, again, MasterCard have really played  
12 the card that MasterCard has a significant acceptance  
13 advantage over Amex, yet then seems to ignore that in  
14 the damages counterfactual.

15 Fourth is Australia. That's at 673. Fifth, I want  
16 to emphasise in a moment the fifth one, which is the  
17 actual counterfactual. This fifth is at 680. I just  
18 want to emphasise this little bit more.

19 This is essentially: we are looking at damages here,  
20 we are trying to work out what would have happened and  
21 we actually have an actual. We have an actual  
22 counterfactual. So when the Tribunal is trying to work  
23 out what would have happened, it is actually quite  
24 illustrative to see what actually did happen. And  
25 I just want to emphasise the fifth reason here.

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1 Then the sixth is at 686, which is again -- we are  
2 looking at damages, and clearly Amex is -- we are  
3 looking at damages here. But the point that was being  
4 made to von Hinten-Reed is that how much is going to be  
5 used for groceries?

6 So MasterCard were putting to Mr von Hinten-Reed on  
7 the basis of the factual evidence that really if you are  
8 going to have an Amex you use it for travel, hotels, you  
9 don't tend to use it for groceries. So I'm using what  
10 they say is the case, and I'm saying if you are going to  
11 take that, are you really going to have this increase in  
12 Amex for your sliced bread, basically? That was what  
13 was being put to Mr von Hinten-Reed.

14 Those are the six points. Can I just bring some of  
15 these six points together and emphasise three factors.  
16 So this is in the context of them saying "We are going  
17 to lose all our premium business because of lower  
18 interchange fees".

19 The first point I want to emphasise is that they  
20 have cried wolf at least twice before. This is not the  
21 first time they have made this argument. We have seen  
22 from the evidence that they cried wolf in Australia.  
23 They said "If you reduce our fees and you don't do  
24 anything about Amex, we will have 'a death spiral'".  
25 That death spiral never materialised. For whatever

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1 reason, whether it was surcharging, acceptance, it did  
2 not happen.

3 The second time they cried wolf was before the  
4 European Commission, and on Friday I took the  
5 Tribunal -- I referred to the bit in the decision, and  
6 the Commission deals with it for about six or seven  
7 pages and refers to this death spiral.

8 I just want to urge caution here because MasterCard  
9 repeatedly make this argument and it never materialises.  
10 That's the first thing I want to highlight.

11 The second thing I want to highlight is essentially  
12 what I said a moment ago is the fifth reason, which is  
13 at paragraph 680. We do have a real-life actual to base  
14 the counterfactual and you will see here in these  
15 paragraphs we know that MasterCard announced a reduction  
16 of its premium rates in autumn 2014. So it announced it  
17 in 2014 taking effect in April 2015. Therefore, we have  
18 a year's worth of experience to test this total loss of  
19 premium argument. It simply has not materialised.

20 If I could just -- again, I'm not going to go to too  
21 many documents this morning, but I would like to just  
22 remind the Tribunal. They are in yellow, but I would  
23 like to highlight them. If one could get E3.13 and  
24 E3.12.

25 MR JUSTICE BARLING: Are these the negotiations, are they?

8

1 MR BREALEY: Yes. I won't obviously go through it, but  
 2 I just want to ... (Pause)  
 3 MR JUSTICE BARLING: 5023, is it?  
 4 MR BREALEY: I was just going to go to 5388, tab 255.  
 5 Again, I will do this very quickly.  
 6 MR JUSTICE BARLING: Tab 255?  
 7 MR BREALEY: Tab 255. My note is ... (Pause)  
 8 I know the Tribunal has all this in mind, but I just  
 9 want to emphasise a couple of documents --  
 10 MR JUSTICE BARLING: Yes.  
 11 MR BREALEY: -- just to refresh the memory.  
 12 So this is at 4th December 2014 from Holly Hulett.  
 13 This is after MasterCard have announced the reduction of  
 14 their premium rates to widen the gap between its premium  
 15 card and Amex. And what do we get? We get Holly  
 16 saying, after Amex's first salvo:  
 17 "As you would expect, we have told them to go back  
 18 and sharpen their pencil."  
 19 There are other obviously emails there.  
 20 That is the start. You can put E3.13 away. If you  
 21 remember the story was slightly truncated. And E12,  
 22 tab 232, there is a series of emails here if the  
 23 Tribunal remembers, if one goes to 5051 and 5050.  
 24 So this has now got to a very high level between  
 25 Amex and Sainsbury's. It doesn't get much higher. At

9

1 5051 you see the last paragraph, and I would ask the  
 2 Tribunal to note "materiality". That is the last  
 3 paragraph, first line. What Amex are saying to  
 4 Sainsbury's, and then again at 5050, the paragraph  
 5 regarding the length, I would ask the Tribunal to note  
 6 the word "colossal".  
 7 Now, this is real world. This is not Dr Niels  
 8 speculating as to what will happen based on some wishy  
 9 washy Maestro analogy. This is real world stuff. You  
 10 see the merchants in the wake of MasterCard reducing  
 11 their interchange fees, telling Amex to do exactly the  
 12 same thing.  
 13 That is the second point I want to highlight, which  
 14 is that the Tribunal does have more than a year's worth  
 15 of actual fact in order to test this complete loss of  
 16 premium business.  
 17 The third thing I want --  
 18 MR JUSTICE BARLING: Just before you leave that. Mr Hoskins  
 19 says this is a different real world because Sainsbury's  
 20 has got them over a barrel now because they know that  
 21 within a year or so Amex are likely to be regulated, and  
 22 therefore this is not really comparable to  
 23 a counterfactual back in 2007.  
 24 MR BREALEY: Again, that is complete and utter speculation.  
 25 Where does one see in any of this email exchange Amex

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1 saying: we are going to have to do this because we are  
 2 going to get regulated?  
 3 The whole story, the whole Amex story here is about  
 4 economics. We had a certain differential before and we  
 5 are not -- there is a risk of -- we are going to get rid  
 6 of them. That's what the documents say. We are going  
 7 to get rid, unless you come down. It is about  
 8 economics, it is not about being regulated. And I would  
 9 also say that this is, again -- we will have to ask  
 10 Mr Hoskins -- how are they going to be regulated and how  
 11 are they being regulated now? Is it just the 3.5, the  
 12 Duo system? It is not the whole thing. It is not the  
 13 normal Green card.  
 14 MR JUSTICE BARLING: Forgive me, it is probably my fault,  
 15 but this is a negotiation that's taking place in the  
 16 context of a new agreement that's being proposed.  
 17 MR BREALEY: Yes.  
 18 MR JUSTICE BARLING: I think you did tell us, or we did see,  
 19 have evidence about it, but I don't know whether you  
 20 know off the top of your head how long that previous  
 21 agreement lasted?  
 22 MR BREALEY: There was agreement because it was signed by  
 23 Mr Scott Abrahams when he was at Amex. I can find out  
 24 how long that was. We do know --  
 25 MR JUSTICE BARLING: It may be that my colleagues have

11

1 a better memory than I do about how long it was.  
 2 MR BREALEY: As you say, this was coming up for  
 3 renegotiation. They put it off for a while to see what  
 4 MasterCard were going to do.  
 5 MR JUSTICE BARLING: Yes.  
 6 MR BREALEY: In my submission, Mr Hoskins can speculate on  
 7 Amex's reasons about being regulated and how they are  
 8 being regulated, because he has to be quite clear as to  
 9 how they are going to be regulated.  
 10 For me, what I get out of this is that this is about  
 11 hard economics. It is about a retailer now seeing too  
 12 big a differential between MasterCard and Amex and  
 13 telling Amex it's got to do something about it.  
 14 MR JUSTICE BARLING: Am I right, we haven't got any  
 15 documents relating to the negotiation of any earlier  
 16 agreement? These are the only ones we have got?  
 17 MR BREALEY: No. The UK example is consistent with  
 18 Australia. It may well be there is an element of  
 19 regulation, I don't know, it is just speculation. But  
 20 what I can say is that it looks as if the merchants in  
 21 Australia reacted, whether by surcharging or whatever,  
 22 or non-acceptance. And the whole thing can't just be  
 23 explained away by surcharging, otherwise the rates would  
 24 have not come down because the Amex rates did come down  
 25 in Australia.

12

1 So I can't just explain that by surcharges. So you  
2 actually look -- you have two real-life stories of what  
3 happened when MasterCard was forced to bring down its  
4 interchange fee, and the two real-life stories are  
5 Australia and the UK.

6 What do we know happened? First, we know that Amex  
7 brought its rates down, and secondly, we know that  
8 MasterCard has not lost its premium business. I think  
9 in the market shares, in one of the bundles that is  
10 provided, we did ask for 2015, I'm not sure we got 2015.

11 Ms Love knows all the documents. The previous  
12 contract is at E3.13 at 245. It was signed by  
13 Scott Abrahams and it was for three years.

14 MR JUSTICE BARLING: Thank you very much. Thank you,  
15 Ms Love.

16 MR BREALEY: Again, I just repeat, the Tribunal has got  
17 a report from Dr Niels saying "We will lose all our  
18 premium card business". Based on what? Based on the  
19 Maestro story. So it candidly accepts that the loss of  
20 the premium business is based on Maestro. That is in  
21 his report.

22 You compare that with two real-life world examples,  
23 Australia and the UK. The first is, as a result of the  
24 reduction Amex came down, and secondly, MasterCard did  
25 not lose its premium business.

13

1 The third thing I wanted to emphasise is that -- and  
2 this goes to the quantum of damages, not to the  
3 migration -- even if you conclude there was some  
4 migration, that is to say from MasterCard to Amex, that  
5 doesn't impact on the quantum. The reason for that is  
6 because if the Tribunal concludes that Amex would have  
7 come down in its rates, so if you take the two real-life  
8 examples I have just given and you conclude that it is  
9 possible, likely, whatever, that in the light of  
10 MasterCard coming down that Amex would have come down,  
11 Sainsbury's doesn't actually lose its quantum claim.  
12 There may have been a migration, but they still paid  
13 a far higher rate for the last six years.

14 So if in the counterfactual there was migration but  
15 the Tribunal concludes that generally Amex would have  
16 come down in response, Sainsbury's would have actually  
17 saved money on the other Amex charges. A bit like the  
18 umbrella damages.

19 So that is in Dr Niels' new damages calculation. He  
20 has said there could be a 5% migration. Whether the  
21 Tribunal accepts that or not, it is up to the Tribunal  
22 clearly. But even if there is a 5% migration it doesn't  
23 impact on the damages because on his view, and we say in  
24 the light of the evidence, the Amex rates would have  
25 come down as a response to the MasterCard rates.

14

1 I don't know if that makes sense? (Pause)

2 MR JUSTICE BARLING: Yes.

3 MR BREALEY: So Sainsbury's were paying a higher rate for  
4 Amex. If MasterCard had reduced its rates to a lawful  
5 level, to which we say they should have done, that would  
6 have dragged Amex down and it would not have paid the  
7 same high fees to Amex.

8 Therefore, when it says there would have been  
9 a migration of business to Amex and therefore you  
10 haven't suffered any loss, actually we have suffered  
11 a loss because --

12 MR JUSTICE BARLING: Because you would have paid a lower  
13 Amex charge as well.

14 MR BREALEY: That's all I wanted to say on -- just to finish  
15 off on the damages counterfactual. Obviously it is all  
16 in there. I was going to move to exemption if you  
17 permitted.

18 So exemption starts at paragraph 197 of our  
19 skeleton. As I said on Friday, I will try and deal with  
20 some points made by MasterCard. So it is 197 of our  
21 skeleton, page 78. It is paragraph 192 of MasterCard's  
22 skeleton, page 62.

23 At 197 obviously we set out the conditions and the  
24 standard -- this is 197B -- needed to demonstrate that  
25 a restrictive agreement satisfies these conditions.

15

1 That to a certain extent picks up on the broad axe we  
2 were talking about on Friday, that if there is  
3 an unlawful overcharge then it has to be exempted, and  
4 MasterCard have accepted before the Commission that this  
5 is the standard that they have to meet.

6 So in respect of the first condition, "the  
7 efficiency claims must be substantiated; the nature of  
8 the claimed efficiencies, the link between the agreement  
9 and the efficiencies, the likelihood and magnitude."

10 The second condition:  
11 "No worse off."

12 That is paragraphs 85 and 87 of the guidelines.  
13 MasterCard actually refer to these guidelines in their  
14 closing.

15 Then this is the third condition:

16 "It must be reasonably necessary to achieve the  
17 efficiencies. So would the efficiency have occurred in  
18 the absence of a restriction?"

19 I put all these to Dr Niels. He accepted them all,  
20 but in our respectful submission he has not applied  
21 them.

22 That is the test and, again, I do not want to go  
23 back over old ground, but in my respectful submission  
24 that test cannot be ignored simply because we are  
25 claiming damages.

16

1 What we have tried to do from paragraph 200 onwards  
2 is mention five misconceptions that we believe  
3 MasterCard are under as regards exemption. And I will  
4 summarise these five misconceptions, and then I will  
5 try -- over the weekend we just delivered a three-page  
6 handout which is called "Free funding", and I will try  
7 and put it all in context of kind of an actual example  
8 just to see because sometimes it gets a bit lost.

9 Now, obviously, these misconceptions are here and  
10 I will just summarise them, but the first misconception,  
11 we say, is it is not good enough merely to say there is  
12 an exemptible level of MIF out there, which is what they  
13 appear to say and Mr Hoskins, candidly in opening,  
14 essentially said.

15 So at 200, the very last of that quote, he says:  
16 "We are not necessarily putting our case saying you  
17 have to tick all the 103s. We are saying if the proxy  
18 is good enough for the Commission it is good enough for  
19 the Tribunal."

20 Well, what actually does that mean?

21 The Commission, it used the word "proxy" but it has  
22 never said you can't satisfy the four conditions and it  
23 has never said "You are excused from adducing robust  
24 evidence". If proxy is being used as some wishy washy  
25 finger in the air, I don't have to adduce robust

17

1 evidence, then in my submission it is an error.

2 Again, Dr Niels in the quote that we set at 201:

3 "I think the approach, but also the European  
4 Commission ... there is an exemptible level of MIF and  
5 now let's try to come up with a sensible method that  
6 would approximate that exemptible level."

7 We say that is simply not the approach. You don't  
8 say there is an exemptible level of MIF out there and  
9 let's just try and work it out. You are in 101(3)  
10 territory and you have got to, first of all, identify  
11 an efficiency. You have got to identify the link  
12 between the MIF and the efficiency, which, I hesitate to  
13 add, seemed to be accepted in the opening.

14 So 205 is the crunch point. We say the starting  
15 point for the Tribunal is therefore not what level,  
16 paragraph 205, but what efficiencies. It is only after  
17 any efficiencies attributable specifically to the UK MIF  
18 have been identified and verified that you then go on to  
19 look at the second condition.

20 At 206, this is a point that the Commission made  
21 repeatedly to MasterCard throughout the investigation.  
22 We have seen in the evidence that the letter -- which is  
23 blued out -- I would ask the Tribunal to note it -- it  
24 is at the top of page 82.

25 So what Mr Perez was told and, as I understand,

18

1 Mr Koboldt accepted:

2 "The Commission is telling MasterCard I would like  
3 first to recall in coherence with our previous  
4 correspondence ..."

5 (Pause)

6 I thought it probably was ... (Pause)

7 MR JUSTICE BARLING: Do you want us to just read it?

8 MR BREALEY: Yes, please. I don't believe that one can  
9 really seriously challenge that. That has been the  
10 practice for the last 40-odd years, whenever it started,  
11 that you have a restriction of competition, you want to  
12 prove an exemption, you have got to show by reference to  
13 robust and convincing arguments and evidence that the  
14 four conditions are satisfied.

15 The second misconception, and this is actually quite  
16 an important -- they are all important, but this is  
17 really goes to the interpretation of 101(3). We pick  
18 this up at 209. A constant refrain from MasterCard  
19 during these proceedings has been that the MIT-MIF, such  
20 as that calculated by Mr von Hinten-Reed, is too low  
21 because it does not maximise social welfare.

22 I want to emphasise the social welfare. Footnote,  
23 it is total welfare, total surplus.

24 Particular emphasis has been placed by MasterCard on  
25 a comment by the economists Rochet and Tirole.

19

1 Then 210, I'm going to come on to MasterCard's skeleton  
2 in a moment, but it is quite clear that they are  
3 adopting a social welfare test in article 101(3).

4 Paragraph 2, 2.12:

5 "Again, MasterCard seeks to circumvent the  
6 difficulty by arguing that 101(3) is concerned primarily  
7 with social welfare."

8 Just so that we can see, rather than us citing it,  
9 if one goes to MasterCard's closing at paragraph 275.

10 MR JUSTICE BARLING: Yes.

11 MR BREALEY: The key point here is we are not concerned with  
12 social welfare. The academics might be interested in  
13 social welfare, a regulator, not having regard  
14 to 101(3), may be concerned with social welfare, but  
15 101(3) is not concerned with social welfare.

16 So just three paragraphs. It is littered with  
17 references to social welfare, but 275:

18 "As indicated above, the MIT methodology previously  
19 applied ... would suggest suboptimal results from the  
20 point of view of social welfare."

21 Then at 277, over the page:

22 "Social welfare or total welfare is the sum of  
23 consumer welfare and producer welfare, wherein producer  
24 welfare or surplus is understood to be the sum of all  
25 profits made by producers in an industry. Under Rochet

20

1 and Tirole's framework, the social or total welfare  
 2 would refer to the aggregate surplus of all the players  
 3 involved in the four-party scheme."  
 4 I emphasise that because we are going to come on to  
 5 see why that's wrong in a moment:  
 6 "The aggregate surplus of all the players involved  
 7 in a four-party scheme, merchants, cardholders, issuing  
 8 and acquiring banks. It may be great from an academic  
 9 point of view, but it is not great for a 101(3)."  
 10 278:  
 11 "Article 101(3) and EU competition law in general is  
 12 not limited to promoting consumer welfare. The aim of  
 13 EU competition rules is to protect competition on the  
 14 market as a means of enhancing consumer welfare and of  
 15 ensuring an efficient allocation of resources ..."  
 16 It goes on:  
 17 "... in order to maximise social welfare."  
 18 They are clearly pinning their colours to a social  
 19 welfare mast.  
 20 If one goes back to our closing at paragraph 214, it  
 21 is clear from the jurisprudence of the court and the  
 22 interpretation of 101(3) that that simply cannot be  
 23 right for at least two reasons.  
 24 The first is at paragraph 215, when we look at the  
 25 aim of the second condition:

21

1 "The aim is to ensure that those consumers on the  
 2 relevant market that are affected by the restriction  
 3 must be compensated for the negative impact of the  
 4 restriction."  
 5 So MasterCard actually refer to paragraph 85 in  
 6 their closing. And the second condition is not about  
 7 total social welfare, it is designed to ensure that  
 8 those people that are affected by the restriction of  
 9 competition are no worse off. That is what the second  
 10 condition says: fair share to consumers. And  
 11 "consumers" in paragraph 85 refers to those that are  
 12 affected by the restriction of competition.  
 13 MR SMITH: You say that is only the merchants?  
 14 MR BREALEY: That has been the consistent approach of the  
 15 Commission and the court, and it is the evidence of  
 16 Mr von Hinten-Reed and it is correct as a matter of law.  
 17 So we have heard nothing really from MasterCard  
 18 about the acquiring market, nothing in opening hardly,  
 19 nothing really in their closing. There are various  
 20 markets out there, but the market that is affected by  
 21 this MIF is the acquiring market. That is the  
 22 merchants. And you have got to -- in the first  
 23 condition you can have all sorts of benefits. That is  
 24 clear. You can look at all sorts of benefits:  
 25 cardholders, merchants, whatever. But when it comes to

22

1 ensuring that consumers get a fair share of the  
 2 resulting benefit, of the resulting efficiency, you  
 3 can't penalise those who are directly affected by the  
 4 restriction of competition. That is embedded in the  
 5 guidelines, in the jurisprudence.  
 6 I can't say very much more. It is an interpretation  
 7 of 101(3) that has been around for many, many, many  
 8 years.  
 9 The second reason why this social welfare argument  
 10 simply does not work -- and, again, I emphasise  
 11 paragraph 277 of MasterCard's closing, where it says:  
 12 "The aggregate surplus of all the players involved  
 13 ..."  
 14 The second reason at paragraph 217 of our closing,  
 15 again, this comes clearly from MasterCard's own  
 16 judgment. You ignore the profits that are being made by  
 17 the parties to the unlawful agreement. That has been  
 18 the jurisprudence and interpretation of 101(3) since it  
 19 began.  
 20 You have a cartel, you have a restrictive agreement.  
 21 It impacts on some customers over there. It has never  
 22 ever been the correct interpretation of 101(3) to say it  
 23 has been good for us, we made some profit. You  
 24 ignore -- this is what the European Court says -- it  
 25 goes back to the infringement decision:

23

1 "The increase of sales volumes in MasterCard's  
 2 scheme is clearly to the advantage of MasterCard's  
 3 member banks."  
 4 This is 217(a):  
 5 "An increase of system output only contributes to  
 6 appreciable objective advantages if parties other than  
 7 the organisation member's banks benefit from it. The  
 8 analysis of the first condition is therefore linked to  
 9 the second condition."  
 10 They must have appealed this. Again, we never saw  
 11 this, but they must have appealed this. And the General  
 12 Court says:  
 13 "It must be observed that the primary beneficiaries  
 14 of an increase in MasterCard system output are the  
 15 MasterCard payment organisation and banks. However, as  
 16 the case law cited in paragraph 206 above shows, the  
 17 improvement within the meaning of the first condition  
 18 of 81.3 cannot be identified with all the advantages  
 19 which the parties obtained from the agreement in their  
 20 production of distribution activities."  
 21 Then --  
 22 MR JUSTICE BARLING: So does that mean that if the merchants  
 23 benefit to some extent from an increase in output, does  
 24 that get you over that hurdle?  
 25 MR BREALEY: You would have to highlight the benefit to the

24

1 merchant from the MIF. I will come on to this free  
 2 fund -- my little example in a moment.  
 3 MR SMITH: Mr Brealey, isn't the problem though that when  
 4 one is talking about the default interchange fee, whilst  
 5 when one looks at it as a merchant it is a floor, if one  
 6 looks at it from the point of view of the issuing bank  
 7 it is a ceiling because you can't detach one side of the  
 8 price from the two-sided market in which it appears?  
 9 In other words --  
 10 MR BREALEY: With respect, that's not what the European  
 11 courts have said. It is not the approach that you  
 12 adopt. But I will take the --  
 13 MR SMITH: The point that Mr Baxter makes in his article is  
 14 that without co-operation between the cardholder's bank,  
 15 the issuing bank, and the merchant's bank, the acquiring  
 16 bank, you are not going to effect a sale through a debit  
 17 or credit card. You need to have the chain intact by  
 18 way of a series of agreements. And between the two  
 19 banks, in that chain, one has got a price for the  
 20 provision of the services, if you want to call them  
 21 that, by way of which a card is accepted and payment  
 22 moves to the merchant via the acquiring bank.  
 23 For better or worse we have here a price that is  
 24 a default price, and you say, well, the problem with  
 25 that default price is that it is passed on from the

25

1 acquiring bank to the merchant and it constitutes  
 2 a floor.  
 3 MR BREALEY: Yes, well, it is fixed. It constitutes  
 4 a floor.  
 5 MR SMITH: It is fixed. If we call it fixed we don't need  
 6 to say floor.  
 7 MR BREALEY: You can, but it's both, yes.  
 8 MR SMITH: But my point is it is both fixed and a ceiling on  
 9 the other side of the market.  
 10 MR BREALEY: Well, it is not really a ceiling because, as we  
 11 see in the evidence, they will do whatever increase that  
 12 they feel. It's never a ceiling. MasterCard will  
 13 continually increase it if they feel that it is  
 14 necessary.  
 15 MR SMITH: Well, that requires you to say that without  
 16 question MasterCard will simply heed the siren calls of  
 17 the issuing bank market and do everything at their beck  
 18 and call. So, in effect, it is, on that basis, a  
 19 unilaterally imposed price.  
 20 MR BREALEY: That essentially is their evidence, which is  
 21 they do do that because MasterCard needs to throw money  
 22 at the issuing banks in order to keep them sweet,  
 23 because if they don't throw money at the issuing banks,  
 24 they don't keep them sweet and they will go to Visa.  
 25 That's their whole argument.

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1 MR SMITH: My recollection of Mr Willeart's evidence was it  
 2 was a little bit more nuanced than that.  
 3 MR BREALEY: I'm just putting it in a forensic way. But  
 4 essentially that's what it's about. You can call it  
 5 "I want to be competitive", but take the Maestro story.  
 6 That's what they say there. They say "I want to  
 7 increase the fees in order to retain my business". It  
 8 is not a ceiling on the issuing --  
 9 MR SMITH: Let's park this notion of upward movement of the  
 10 MIF because of competition between issuers. So I take  
 11 your point.  
 12 But let's suppose one simply has got a MIF that is  
 13 being set by MasterCard on what it attempts to create as  
 14 an objective standard, what it thinks is the right price  
 15 as between these two markets.  
 16 MR BREALEY: Correct, and --  
 17 MR SMITH: Let's just assume that.  
 18 MR BREALEY: Yes.  
 19 MR SMITH: I know one can argue --  
 20 MR BREALEY: No, no --  
 21 MR SMITH: -- whether that is right or not. On that  
 22 assumption the default is equally, on both sides of the  
 23 market, a constraint.  
 24 MR BREALEY: A constraint on who?  
 25 MR SMITH: On both sets of banks, in the sense that the

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1 acquiring banks have to pay X MIF and the issuing banks  
 2 only receive X MIF.  
 3 MR BREALEY: Well, that's true, but they are party to the  
 4 agreement --  
 5 MR SMITH: They are all party to the agreement.  
 6 MR BREALEY: Pardon?  
 7 MR SMITH: They are all party to the agreement.  
 8 MR BREALEY: Except the merchants, and the merchants are the  
 9 ones who end up paying it.  
 10 MR SMITH: But surely it must be right that there is going  
 11 to be some sort of interplay between the cardholder and  
 12 the issuing bank, and the issuing bank is going to be  
 13 looking at what it receives and, therefore, for  
 14 instance, what rewards it could pass on to cardholders?  
 15 So we have seen frequently in the course of this  
 16 trial the nexus between rewards and what issuing banks  
 17 choose to give to their cardholders.  
 18 MR BREALEY: Can I just answer -- two points, really.  
 19 First, you refer to Baxter. And as you will gather,  
 20 the Commission in its infringement decision rejected  
 21 Baxter. The OFT in its decision rejected Baxter, and  
 22 the General Court didn't like Baxter very much. And one  
 23 of the reasons that Baxter has never found favour is  
 24 because it assumes too much of a willingness of  
 25 merchants to pay.

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1 The evidence is that the market is skewed, and  
 2 essentially what has happened, and what's more  
 3 the Commission didn't like it, the people who are  
 4 setting the fees, ie MasterCard and Visa, skew it too  
 5 much to the detriment of the merchants on the basis that  
 6 the merchants are willing to pay and this is a necessary  
 7 fee in order to make the two-sided markets work.  
 8 Again, it is a question of how you perceive it to  
 9 operate. MasterCard have been making this argument now  
 10 for the best part of 15 years: We need this MIF to make  
 11 the scheme work. And the question is whether they are  
 12 allowed to get away with it, which results in ever,  
 13 potentially, ever-increasing fees for merchants.  
 14 That's the -- at the end of the day it is a simple  
 15 decision.  
 16 MR SMITH: Forgive me, all I was getting from Baxter, and it  
 17 seemed to me quite an obvious point, was that you needed  
 18 to have in order for the whole scheme to work  
 19 an agreement between issuing and acquiring banks as to  
 20 the price for which the services that constitutes --  
 21 MR BREALEY: Well, now the question -- sorry, sir -- is  
 22 whether it is on a bilateral or multilateral basis.  
 23 MR SMITH: Sure, and if it is bilateral we don't have  
 24 a problem because it is agreed. We are talking about  
 25 the significance of the MIF, and I quite understand your

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1 points that the MIF is a restriction because it is not  
 2 a negotiated price in the acquiring market.  
 3 Now, what I'm asking is: why isn't exactly the same  
 4 true in the issuing market? As I understand it, your  
 5 answer to that is to say: well, it isn't true in the  
 6 issuing market because it is the issuing market that  
 7 calls the shots.  
 8 MR BREALEY: Correct.  
 9 MR SMITH: Now, okay, I understand that.  
 10 MR BREALEY: And calls the shots with the acquiring banks.  
 11 But they are neutral because they just pass on that  
 12 cost. They are not going to absorb it, it gets passed  
 13 on to --  
 14 MR SMITH: It gets passed on.  
 15 MR BREALEY: And everyone knows it.  
 16 MR SMITH: So you have a much clearer costs line on the  
 17 acquiring side as you do on the issuing side because it  
 18 is simply passed on.  
 19 Now, what I'm asking is whether the reason you are  
 20 saying that there's no constraint on the issuing side is  
 21 because it is the issuing banks that are calling the  
 22 shots.  
 23 MR BREALEY: In a sense there is a constraint on the issuing  
 24 banks because they have collectively agreed that they  
 25 will not act independently. So I take that. That's why

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1 there's a distortion on the issuing side and the  
 2 acquiring side, but the analysis of the exemption and  
 3 the Commission, you are looking at the merchants because  
 4 they are the ones who are paying. But clearly, there is  
 5 a constraint between the issuing banks because that is  
 6 the collective agreement.  
 7 MR SMITH: So it is a constraint but one they are happy  
 8 with, you might say.  
 9 MR BREALEY: It is like cartelists should not cheat and they  
 10 constrain each other's behaviour. But that is the  
 11 reason that article 101 gets involved.  
 12 MR SMITH: Okay.  
 13 MR BREALEY: It is the constraint between the issuers and  
 14 the acquirers to a certain extent which is impacting on  
 15 the acquiring market, the merchants.  
 16 MR SMITH: So if we have a MIF that is perhaps skewed the  
 17 other way, a MIT-MIF, where the rate is much, much  
 18 lower. Why isn't that a constraint and not one they are  
 19 happy with on the issuing ---  
 20 MR BREALEY: One has to look at it in stages. You ask  
 21 yourself the question: is this an agreement which  
 22 restricts competition? If yes, you go to the next  
 23 stage, exemption.  
 24 As we have just seen, the first thing you are  
 25 supposed to do is ask whether this MIF creates any

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1 efficiencies. If it doesn't create any efficiencies,  
 2 that's the end of the story, you walk away and you have  
 3 got your restriction of competition.  
 4 So when you say to me, well, the MIT-MIF skews it  
 5 the other way, that is essentially the Commission has  
 6 said that there is an efficiency gain if you apply the  
 7 MIF, because that's the transactional benefit to the  
 8 merchant. So the merchant is paying a fixed fee, but it  
 9 is said that that does create efficiencies under the  
 10 MIT-MIF.  
 11 I'm going to come on to free funding in a moment  
 12 because I think it is important to look at how the MIF  
 13 creates an efficiency.  
 14 We saw on Friday that if the Tribunal concludes that  
 15 a MIF is absolutely essential for the MasterCard scheme  
 16 and without it it will collapse, then they win on  
 17 objective necessity.  
 18 MR SMITH: We are beyond that. I suppose what I'm  
 19 struggling with, or what I am wanting more clarity on is  
 20 that at a very early stage you jettison the issuing  
 21 market altogether and look only, on 101(3), at the  
 22 acquiring market.  
 23 MR BREALEY: That's not quite true because the first  
 24 condition of 101(3), I do look at both.  
 25 MR SMITH: All right. If you are talking about who is

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1 a consumer, the only segment of persons you look at are  
 2 merchants.  
 3 MR BREALEY: Under the second condition?  
 4 MR SMITH: Correct. Consumer benefit.  
 5 MR BREALEY: All I am doing is applying the guidelines in  
 6 the jurisprudence. You ask yourself the question under  
 7 the first condition: is this promoting economic and  
 8 technical progress? Yes.  
 9 MR JUSTICE BARLING: That's where the efficiencies come in,  
 10 isn't it?  
 11 MR BREALEY: Yes.  
 12 MR JUSTICE BARLING: And we haven't had much argument about  
 13 that. You say it is a great thing, or you did in  
 14 opening, that payments -- and are we still to assume  
 15 that there are no efficiencies?  
 16 MR BREALEY: We have to be extremely careful, and this is  
 17 essentially the third misconception at 220, that we  
 18 don't confuse the scheme with MIF.  
 19 MR JUSTICE BARLING: Okay.  
 20 MR BREALEY: That is something that comes again and again  
 21 and again.  
 22 MR SMITH: I entirely accept that, but I'm going back to the  
 23 question which we raised on Friday, which was: given the  
 24 fact that the MIF is a price in two markets, it has to  
 25 be, why isn't it a constraint in both? The answer you

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1 gave me on Friday was that, ah, the difference between  
 2 the issuing market and the acquiring market is that in  
 3 the acquiring market the constraint, or the price that  
 4 reflects that constraint is 100% passed on to the  
 5 merchants.  
 6 MR BREALEY: Yes, we are talking about a distortion of  
 7 competition.  
 8 MR SMITH: Sure.  
 9 MR BREALEY: And merchants no longer have the ability to  
 10 negotiate with anybody. They are faced with a common  
 11 price.  
 12 MR SMITH: But my point is that although one hasn't got --  
 13 and we haven't had nearly as much evidence in terms of  
 14 the interrelationship between the price that is a given  
 15 price in the issuing market and what cardholders receive  
 16 and are charged --  
 17 MR BREALEY: Correct, absolutely --  
 18 MR SMITH: Nevertheless -- I'm just trying to get my theory  
 19 out here -- nevertheless there is a constraint here too  
 20 because the price is fixed.  
 21 Now, you may say it is not right because it is the  
 22 issuing banks that actually call the shots with  
 23 MasterCard, and we can look at what Mr Willcart and the  
 24 other witnesses have said about that.  
 25 So moving away from that factual debate, what I'm

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1 putting to you is: let's suppose MasterCard are creating  
 2 a MIF, attempting to hold the ring between two sides of  
 3 the market, and they are paying or attempting to pay  
 4 equal weights to both and they reach a conclusion  
 5 saying, right, here you are, this is the MIF for both  
 6 sides of the market. My question is, first, why isn't  
 7 that A constraint on both sides? And secondly, if it  
 8 is, why don't you take both sides into account when  
 9 conducting your article 101(3) analysis?  
 10 MR BREALEY: Because I'm having difficulty finding where the  
 11 impact is on the -- you say the issuing, are you talking  
 12 about the cardholders or the issuing banks?  
 13 If one is talking about the issuing banks -- let's  
 14 just leave the cardholders out for the moment, and  
 15 I agree with you, we haven't really seen that much  
 16 evidence about the MIF going into the coffers of the  
 17 issuing banks where it then goes out to the cardholders.  
 18 As the European Commission said, that could just lead to  
 19 rents to the banks.  
 20 So let's just leave the cardholders to one side for  
 21 moment. And you have got a situation where you have  
 22 an issuing bank that has certain costs and that issuing  
 23 bank has the costs of providing the free funding, the  
 24 28-day period, and it is now going to get together with  
 25 its competitors and it says "I'm now going to now charge

35

1 that to the merchant". That's eventually what happens.  
 2 So that is a distortion of competition on the  
 3 merchant -- I will call it the merchant market -- the  
 4 acquiring market.  
 5 So the issuers have these costs, they have their own  
 6 business models. We are not looking at cardholders at  
 7 the moment. We have these banks, they have their  
 8 business models, I want to offer credit, in order to  
 9 offer credit I'm going to incur these costs. So what  
 10 happens? The issuers, who have these costs, individual  
 11 costs, they now say, on a common basis, "We are going to  
 12 club together and we are going to make sure that the  
 13 merchant pays a fixed percentage on it".  
 14 Whilst I can see there is a constraint between the  
 15 issuers, the effect of that collective agreement is  
 16 being felt on the acquiring market. It is not being  
 17 felt on the cardholder market, because as the Commission  
 18 would say, if you actually absent the MIF, either the  
 19 issuing banks have got to do something different or they  
 20 will take some of the rewards away from the cardholders.  
 21 But -- and this is where the Commission says it all  
 22 becomes very circular, because the issuers say, well,  
 23 the MIF is great because we can give the cardholders  
 24 rewards, but that is a circular argument. They only  
 25 give the cardholder rewards because they are charging

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1 the merchant the MIF. So it becomes a self-serving  
 2 argument.  
 3 MR SMITH: I'm glad you ended on that because it does seem  
 4 to have been a theme that one of the reasons for higher  
 5 MIFs, or pressure towards higher MIFs was a competition  
 6 in terms of wanting to reward cardholders so as to  
 7 attract them from one brand to another.  
 8 MR BREALEY: Absolutely. Just pausing there, issuers are  
 9 supposed to be competing with one another in order to  
 10 attract cardholders. They, in a normal world, would be  
 11 trying to entice them with their own money. And yet  
 12 rather do that, they say, well, it would be a good idea  
 13 if we have a fixed price, the merchants will pay, that  
 14 will go to the issuers and we can use that in order to  
 15 compete, in order to attract the cardholders.  
 16 MR SMITH: Sticking with my assumption that MasterCard is  
 17 not, as it were, putty in the issuing bank's hands but  
 18 is reaching an attempt to balance two markets, it must  
 19 be the case then that MasterCard could reach a MIF that  
 20 is from the side of the issuing banks too low, and on  
 21 that basis the issuing banks are subject to a constraint  
 22 because they can't fund through the MIF the sort of  
 23 rewards that they would wish to operate or give to the  
 24 cardholders.  
 25 MR BREALEY: I'm sorry, one has to come back -- again, the

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1 Tribunal is not regulating this industry. The Tribunal  
 2 is having to apply 101(3), and when it comes to 101(3)  
 3 we have identified the consumers who are affected by  
 4 this restriction of competition.  
 5 It is not the cardholders; they are not affected by  
 6 the restriction of competition. They are being  
 7 benefited, if anything. They are not being affected  
 8 by it. It is the merchants who are paying.  
 9 The notion that somehow the cardholders are losing  
 10 out because absent the collective price agreement the  
 11 merchants wouldn't pay so much, again, either the  
 12 Tribunal accepts it or not. But the Commission has said  
 13 that is a completely circular argument. The more you  
 14 have the collective price agreement and the higher it  
 15 goes, because of this upward pressure, then there is not  
 16 much evidence on it about how much it goes to the  
 17 cardholders, but let's assume it does go to the  
 18 cardholders, it just becomes a self-fulfilling prophecy.  
 19 MR JUSTICE BARLING: But if you forget cardholders and just  
 20 look at the costs incurred on some basics that the  
 21 merchants themselves benefit from and like and want,  
 22 such as the fraud and the default, so they get -- so  
 23 they like that. Forget the rewards to cardholders. It  
 24 must be right, mustn't it, that you could have a MIF  
 25 that didn't cover the issuer's costs of those benefits?

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1 If it was very low or zero, then if things remained as  
 2 they are, the MIF would not actually cover the costs  
 3 incurred that the issuers incur partly for the benefit  
 4 of the merchants.  
 5 Then you could say that the pendulum, as it were,  
 6 had swung the other way and the constraint that I think  
 7 you accept exists on all sides of the market would  
 8 operate to the detriment of the issuers. So it would be  
 9 a sort of mirror image in a way.  
 10 MR BREALEY: I tell you what, can I hand this up, this free  
 11 funding thing? It was something that was mentioned to  
 12 me on Friday (handed).  
 13 So the question was put to me on Friday, I think,  
 14 about the free funding. I started off with the credit  
 15 right-offs, then I've got free funding in my head. So,  
 16 again, this is in the context of article 101(3).  
 17 What I'm trying to do here is analyse the benefit to  
 18 the merchant of the free funding, the 28-day period.  
 19 I don't know whether the Tribunal wants to just kind of  
 20 look at it and then we can go through it, or --  
 21 MR JUSTICE BARLING: I suppose one thing we could do would  
 22 be to have a short break and read it, if that would  
 23 shorten things a bit?  
 24 MR BREALEY: I would like to go through it because I think  
 25 actually it does kind of tease out some of these

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1 problems, which is again, is it the scheme, is it the  
 2 MIF?  
 3 MR JUSTICE BARLING: Shall we do that? If we take a short  
 4 break we will read it.  
 5 (10.45 am)  
 6 (A short break)  
 7 (11.00 am)  
 8 MR BREALEY: So could I go through this little paper and  
 9 explain, obviously the Tribunal has read it now, but  
 10 explain where we are coming from on this.  
 11 MR JUSTICE BARLING: Yes.  
 12 MR BREALEY: I shall try, as I go through it, to pick up  
 13 some of the points, Mr Smith, that you have been putting  
 14 to me over the last 10/15 minutes.  
 15 Before I get to the question and the analysis, I do  
 16 want to just emphasise some passages of law in principle  
 17 which I think are relevant to the analysis.  
 18 Could we go first of all to E1, tab 15. That is the  
 19 General Court. I'm looking at the legal parameters here  
 20 on this little note. So we start at paragraph 209 of  
 21 the General Court. That's at 345. I just want to spend  
 22 five or six minutes on the law on principle before we  
 23 get to the analysis.  
 24 This is something that we have seen before. This is  
 25 the paragraph 209, and it relates to the interest point.

40

1 Now, the punchline is at 211, but it is important to see  
2 what is being said at 209.

3 So:  
4 "The line of argument presupposes that issuing bank  
5 and acquiring banks provide a joint service involving  
6 joint costs ..."

7 That gets rejection, the first assumption:  
8 "... and that the issuing banks bear the majority of  
9 the costs of the system."

10 Second assumption. And it is the second assumption  
11 which relates to the interest payment.

12 At 210 we see the rejection of the joint costs, and  
13 at 211 -- again this is so important to the analysis at  
14 101(3):

15 "With regard to the second assumption, as  
16 the Commission has pointed out in essence in recital 686  
17 [I'd like to go to that in a moment], it is sufficient  
18 to note that it is based on a partial presentation of  
19 the issuing and acquiring business taking into account  
20 only the costs borne by the issuing banks and omitting  
21 the revenues of other economic advantages,  
22 notwithstanding the latter's importance referred to in  
23 paragraphs 106 and 108."

24 We know the principle, we are supposed to be looking  
25 at other revenues, but I emphasise, if one goes back to

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1 the paragraph 106 this argument was made specifically --  
2 it is 332 -- in the context of the UK market:

3 "Credit cards generate significant revenues for  
4 issuing banks consisting in particular of the interest  
5 charged to cardholders".

6 You can read that.

7 I will answer any questions, but it is very, very  
8 important to -- in the analysis of 101(3) and the  
9 question that Mr Smith puts to me about: what are all  
10 these costs? It is very important to work out, is the  
11 issuing bank actually incurring a cost?

12 That's the first point I just want to highlight.  
13 This leads into the little analysis on free funding.  
14 While we are in the General Court, if one goes to  
15 page 340 and 168, and I don't want to go over product  
16 market again, but the questions that were being put to  
17 me before the short adjournment, with the greatest  
18 respect, suffer from the flaw which is that you have got  
19 to take it in stages, 101(1), you have got to define  
20 a market.

21 Now, we know that there is evidence about defining  
22 the market, that there is an acquiring market that is  
23 being defined. And you look at the snip test, you look  
24 at the competitive constraints, and it has been decided  
25 that an acquiring market is distinct from the issuing

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1 market.

2 Merchants are distinct from cardholders. They may  
3 be related, and you get this in spades from the  
4 judgments, but the starting point is the acquiring  
5 market. If you accept that the market for the purposes  
6 of 101(1) is the acquiring market, you can't then just  
7 abandon that analysis when you get to 101(3). Clearly  
8 you can have a look at other markets in 101(3), but you  
9 can't jettison that 101(1) market. Why? Because you  
10 know under the second condition of 101(3) the consumers  
11 who are being affected in that market should be no  
12 worse off.

13 So the analysis of 101(3) is dependent on the  
14 conclusion that you have made on 101(1).

15 MR JUSTICE BARLING: You equate no worse off -- just pausing  
16 there -- with a fair share of the benefit, do you?

17 MR BREALEY: Yes, and that's --

18 MR JUSTICE BARLING: I have seen that in the case law.

19 MR BREALEY: Yes.

20 MR JUSTICE BARLING: Don't worry about it, Mr Brealey, but  
21 I know we have seen it.

22 MR BREALEY: That is the third bit in these legal  
23 parameters. Merchants as aggregate must not be worse  
24 off. Paragraphs 85 to 87, cited in MasterCard's  
25 skeleton.

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1 MR JUSTICE BARLING: Quite a low threshold when put in that  
2 way, quite a low threshold, isn't it? No worse off  
3 than, fair share of the benefit might -- sounds like  
4 a slightly different animal.

5 MR BREALEY: You have a pricing fixing agreement which is  
6 affecting one group of consumers. You are supposed to  
7 work out whether under 101(3) it creates efficiencies  
8 and those consumers are no worse off. Why are you doing  
9 that? Because they are the ones who are the subject of  
10 the anti-competitive conduct.

11 MR JUSTICE BARLING: What I meant was -- I agree with all  
12 that -- the paraphrase "no worse off" seems a rather  
13 lower threshold than "fair share of the benefit".

14 MR BREALEY: I'm with you. As we see from this note under  
15 the MIT-MIF, you work out that the merchants have  
16 suffered and you basically have 0.3 under the  
17 regulations or under the undertakings, which basically  
18 just means they are no worse off.

19 MR JUSTICE BARLING: Yes. It sounds wrong but anyway, here  
20 we are.

21 MR BREALEY: Legal parameters, it is very -- because I want  
22 to come on to the -- so I have looked at interest  
23 payments, I have looked at product market and it is  
24 very, very important to remember that by the time you  
25 get to 101(3) you have gone through an analysis of

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1 competitive constraints, you have gone through all the  
 2 market definition tools that are available to you to  
 3 work out whether it is the acquiring market that's being  
 4 distorted or a joint market.

5 And I can only repeat it one more time: Throughout  
 6 the whole last 15 years, this notion of joint market has  
 7 been rejected and you are looking at the acquiring  
 8 market.

9 I want to come on to the Commission decision because  
 10 it is relevant to something Mr Smith said. So that is  
 11 the interest. Again, we don't have to pick it up, but  
 12 number 2 on these legal parameters, you have to have  
 13 appreciable objective advantages arising specifically  
 14 from MIF.

15 Again, we didn't have access to the arguments made,  
 16 but the argument that was being made in the European  
 17 Courts was that the scheme has benefits. Both the  
 18 General Court and the CJEU said you have to be very  
 19 careful that you don't confuse the two. That's one of  
 20 our misconceptions that we have referred to.

21 MR JUSTICE BARLING: Yes.

22 MR BREALEY: I have done 1, 2 and 3. Could I just quickly  
 23 go to the Commission decision, which is at E2.2. This  
 24 is almost like a fourth point on those legal parameters.  
 25 There are two paragraphs I just wanted to refer to.

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1 The first paragraph is 453, which in E2.2 is at  
 2 bundle 1131. This to a certain extent goes to the  
 3 exchange I had with Mr Smith, so this is paragraph 453  
 4 at 1131.

5 So here is MasterCard arguing that the MIF does not  
 6 constitute a restriction because it reduces charges to  
 7 cardholders:

8 "MasterCard argues that the analysis of the  
 9 Commission was wrongly asymmetrical because  
 10 the Commission only focused on MSCs, not on cardholder  
 11 fees. MasterCard sets out that if the interchange fees  
 12 viewed as a de facto floor for MSCs, then it is just as  
 13 much a de facto floor for cardholders' fees. In this  
 14 context, MasterCard refers to the following statement  
 15 whether it is positive or zero or negative, always forms  
 16 a price floor."

17 I don't know who that was.

18 Then the argument at 454 is rejected:

19 "That argument cannot be accepted. Under  
 20 article 101 there is legally no reason why the negative  
 21 effect of the MIF on prices in the acquiring market to  
 22 the detriment of merchants and subsequent purchasers  
 23 should not constitute a restriction of competition  
 24 because of potential benefits which a MIF may create for  
 25 cardholders."

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1 So, again, that is emphasising the point that if you  
 2 are going to have a market definition of joint market,  
 3 and you look at merchants and cardholders, then so be  
 4 it. But if you are defining the market as an acquiring  
 5 market, and we know there are three separate markets,  
 6 that's in all the decisions, you can't say, well, it is  
 7 not a restriction of competition because cardholders get  
 8 benefits. You have to look at the effect on the  
 9 merchants.

10 Then just on the circularity point, that is, as you  
 11 probably know but I will just emphasise this at  
 12 paragraph 685 of the decision -- we can maybe go to 684  
 13 because it does pick up the interest bit as well.

14 684 -- I think we have seen this before -- 1190:

15 "One of the crucial assumptions underlying the  
 16 MasterCard MIF is a perceived imbalance between the  
 17 issuing and the acquiring business in the scheme.  
 18 MasterCard derives that imbalance from the fact that the  
 19 average issuer will incur the vast majority of the  
 20 scheme's costs, because in the UK market 95% of the  
 21 costs are skewed ...(Reading to the words)... the  
 22 issuing side."

23 So we have two arguments: 685 is the circularity  
 24 argument; 686 is the revenue.

25 685:

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1 "The argument that a MIF was required because  
 2 issuing banks incurred 95% of the total costs is a  
 3 circular reasoning because it is precisely due to the  
 4 MIF that issuing banks incur certain costs that they  
 5 would not incur in the absence of the MIF."

6 So it is all very well to say you get these rewards,  
 7 but you wouldn't be providing them if you --

8 MR JUSTICE BARLING: If you didn't have the money from MIF  
 9 to do it.

10 MR BREALEY: That is right.

11 MR JUSTICE BARLING: But that doesn't apply to fraud costs  
 12 or default.

13 MR BREALEY: No, we will come on to that.

14 So that is the kind of the circularity. Then 686 is  
 15 again:

16 "The imbalance between issuer and acquirer cannot be  
 17 assumed on the basis of cost considerations only, but to  
 18 comprise an analysis of revenues as well.

19 "Cost imbalances ...(Reading to the words)... no  
 20 sufficient evidence to explain why MasterCard is always  
 21 paid by the acquirer to the issuer irrespective of the  
 22 concrete market situation."

23 I just want to mention these points because then we  
 24 come to this little paper on free funding. We can put  
 25 the General Court away.

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1 MR JUSTICE BARLING: So they end up by saying:  
 2 "Robust empirical evidence is therefore required to  
 3 establish a necessity for the direction of a fallback  
 4 interchange fee."  
 5 MR BREALEY: Yes.  
 6 MR JUSTICE BARLING: That's sort of reflecting the question  
 7 that Mr Smith was putting, that the constraint could be  
 8 seen as -- the detriment of the constraint could be seen  
 9 as falling on one or other side of the market depending  
 10 on the level of the interchange fee.  
 11 I mean, that seems to me to be what the last  
 12 sentence in 686 is talking about.  
 13 MR BREALEY: Sorry, I put it away.  
 14 MR JUSTICE BARLING: Doesn't matter. All it says is:  
 15 "Robust empirical evidence is therefore required to  
 16 establish the necessity for and the direction of a  
 17 fallback interchange fee."  
 18 MR BREALEY: Yes. Essentially, that picks up a line of  
 19 questioning I put to Mr Willeart, which is why is it  
 20 that it is always the case that the interchange fee goes  
 21 from issuer to acquirer? And there is -- if you are  
 22 going to adopt a cost-based approach, and if, as I say,  
 23 it is required because I think this is a question of law  
 24 and principle which has been adopted by the court, you  
 25 take revenues into account, there is a case for saying

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1 if merchants are making all this money for issuing  
 2 banks, why is it that it always goes the other way?  
 3 MR JUSTICE BARLING: Because the interest revenue, which is  
 4 the bulk of it, is incurred by the issuers.  
 5 MR BREALEY: So if I go to the question --  
 6 MR JUSTICE BARLING: The cost of it.  
 7 MR BREALEY: So:  
 8 "Does the 28-day free funding period give merchants  
 9 the benefit within the meaning of 101(3)?"  
 10 MR JUSTICE BARLING: Sorry, I was talking about "more than  
 11 wider", not the 28 days which could be said to be  
 12 a different compartment because there is no revenue  
 13 derived from that particular chunk.  
 14 MR BREALEY: That's what I want to come to.  
 15 MR JUSTICE BARLING: By the issuer.  
 16 MR BREALEY: Because we say it does. It is a business  
 17 model. So the question is: does the 28-day free funding  
 18 period give merchants the benefit within the meaning  
 19 within 101.(3)?  
 20 The way this is analysed is the question is in the  
 21 context of the issuing bank saying: first, the free  
 22 funding period costs me money, and secondly, the free  
 23 funding period creates a benefit for the merchants. So  
 24 the efficiency.  
 25 MR JUSTICE BARLING: Do you agree with the first point? It

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1 obviously costs them money.  
 2 MR BREALEY: Yes.  
 3 MR JUSTICE BARLING: So no issue on that.  
 4 MR BREALEY: But with the proviso I'm going to come on to on  
 5 the interest payment, but yes, it does.  
 6 MR JUSTICE BARLING: They have to fund it.  
 7 MR BREALEY: They have to fund it.  
 8 MR JUSTICE BARLING: Yes.  
 9 MR BREALEY: But then the question is also does it create  
 10 a benefit to the merchant --  
 11 MR JUSTICE BARLING: Yes.  
 12 MR BREALEY: Why don't we try to do costs and then the  
 13 benefits. Let's look at costs first.  
 14 So the issuing bank's business model is to offer  
 15 a free funding period because they believe that  
 16 a sufficient number of people will not pay the money  
 17 back in full within 28 days. That is a business model.  
 18 We all know that banks are not a charity, they are there  
 19 to make money and they would not be offering 28 days'  
 20 free credit if there wasn't something in it for them.  
 21 There must be a business rationale, inextricably linked  
 22 to this 28-day period. It is just common sense.  
 23 The business model is that you will get revolvers.  
 24 So if you accept that you are going revolvers, you would  
 25 also accept that the merchant accepting the card is

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1 likely to be generating profit for the issuing bank. So  
 2 the point here is that if an interchange fee is to be  
 3 based on the cost of credit, which so far MasterCard  
 4 have been arguing for the last 15 years, interest must  
 5 be taken into account. To do otherwise, you have only  
 6 to look at part of the issuer's business model.  
 7 Then:  
 8 "If interest is not taken into account it cannot be  
 9 assumed that the 28-day period is actually costing the  
 10 issuing bank anything, because the interest that we have  
 11 seen from the evidence, paid by cardholders more than  
 12 compensates the issuer for the original cost of the  
 13 28-day period. That is why the Commission, with regard  
 14 to the UK market --  
 15 MR JUSTICE BARLING: Does that read "if interest is taken  
 16 into account"?  
 17 MR BREALEY: I think Ms Love did tell me it was unclear.  
 18 MR JUSTICE BARLING: I don't know.  
 19 MR BREALEY: "If interest is not taken into account".  
 20 MR JUSTICE BARLING: It is the double negative that's  
 21 fooling me. Surely you want it to be taken into  
 22 account, and if it is taken into account, it can't then  
 23 be assumed that the 28-day period costs anything?  
 24 I think we get rid of the first "not".  
 25 MR BREALEY: Yes. We are not making this up. This is

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1 something that has been emphasised by the European  
 2 Commission and emphasised by the court and, as I repeat  
 3 it one more time, by reference to the UK credit card  
 4 market.  
 5 Just as a little postscript to that, and we know  
 6 that the free funding is a separate category of cost  
 7 that is put on to the merchant, Dr Niels, if one  
 8 remembers, adopted the 2007 data from the Edgar Dunn  
 9 cost study, which gives an interchange fee of that  
 10 amount, which is in blue because I think that is the  
 11 confidential, to reflect the free funding period and  
 12 charges 25% to 50% of that on to the merchant.  
 13 So they calculate that the free funding period is  
 14 that percentage. And then Dr Niels, in that one  
 15 paragraph, says: The merchant can pay a quarter to half  
 16 of that and, it's common knowledge, LIBOR rates have  
 17 dropped from 6% to 0.6% during the claim period.  
 18 So if one just takes -- I mean, just for the sake of  
 19 this argument, I have taken 0.1% as being reflective of  
 20 between his 25 and 50%, but it actually could be a lot  
 21 lower than that because of the drop in LIBOR.  
 22 So that 0.1% is on the basis of his figures, but  
 23 they are based on 2007 data which, as we know, are  
 24 completely out of date. So it could actually be a lot  
 25 lower than that.

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1 So that is the cost to the merchant and that's why  
 2 it is important -- almost, the free funding period, is  
 3 it a cost to the issuer?  
 4 Now, let's have a look to see whether it is  
 5 a benefit to the merchant because it kind of sounds kind  
 6 of logical that the 28-day free period would be of  
 7 benefit to the merchant. It is of benefit to the  
 8 cardholder. But actually, when one drills into the  
 9 analysis, is there a link between the MIF and any  
 10 efficiency gain? And that is the test that we have got  
 11 to apply.  
 12 So now we are going to look at the benefit to the  
 13 merchant. So the MIF of 0.1%, and I take this on the  
 14 basis of the 25/50% and just taking the 2007 data, so we  
 15 know it is a fixed cost that merchants cannot negotiate.  
 16 It is a cost common to all merchants who accept credit  
 17 cards.  
 18 Now, I'm taking a market of two restaurants in  
 19 Tottenham because Dr Niels actually does refer to  
 20 Tottenham. So take a market of two restaurants in  
 21 Tottenham. So that is the market. They are next door  
 22 to each other.  
 23 Now, accepting a MasterCard credit card for a meal  
 24 costing £100 leads to a fee of 10 pence. What benefit  
 25 does a restaurant obtain for that 10 pence? Now,

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1 MasterCard looks at increased spending to individual  
 2 merchants and increased aggregate spending to all  
 3 merchants. So this is how MasterCard articulates the  
 4 efficiency gain to the merchant. It says that you will  
 5 get additional sales, essentially.

6 Now, let's have a look at the two situations: where  
 7 both restaurants accept cards; where one restaurant  
 8 accepts credit cards and the other does not.

9 I would say that just going out in London today you  
 10 are pretty hard put to see that one restaurant does  
 11 accept a card and one doesn't, but let's just take those  
 12 two situations.

13 Both accept cards and then only one does. So how  
 14 does MasterCard articulate the benefit to the merchant  
 15 individually? He comes up with two ways: the merchant  
 16 individually and merchants in aggregate.

17 So, first of all, Dr Niels says:

18 "The restaurant in Tottenham gets an extra business  
 19 and that is at the expense of another restaurant.  
 20 I think that is still a relevant benefit to merchants."

21 If you remember he gave evidence -- he wanted to  
 22 give an answer right at the end of his evidence. This  
 23 is where it is taken from because he wanted to have the  
 24 opportunity to say why he thought the free funding led  
 25 to additional sales.

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1 So that was what he said.

2 Now:

3 "The customer goes into one restaurant and pays by  
 4 credit card. MasterCard --."

5 This is where both restaurants accept MasterCard:  
 6 "MasterCard argues that the free funding period  
 7 benefits a successful merchant to the detriment of the  
 8 other."

9 So the "however" is quite important:

10 "However, although the use of the card may have  
 11 facilitated payment as would a cheque, cash or debit  
 12 card, and the merchant has paid a MIF based on the  
 13 convenience of using a card ..."

14 So let's assume that is 0.2, 20 pence. So on our  
 15 view the merchant is paying something for the  
 16 convenience of accepting the card:

17 "... now we are looking at the extra 0.1% fee, the  
 18 10 pence, and we have got to ask ourselves the question  
 19 whether that has promoted any additional sale of the  
 20 meal which benefits the individual merchant or merchant  
 21 as a group."

22 Because we know from the guidelines you are looking  
 23 at merchants as a group.

24 "So the first point, the 0.1% has not promoted any  
 25 business stealing. Both restaurants accept cards. The

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1 customer has chosen one and not the other for other  
 2 reasons. One might be an Italian, one might be Chinese,  
 3 I don't know, but the 0.1% has not promoted anything.  
 4 In any event [this is where the Commission is coming  
 5 from] merchants as a whole have not benefited."  
 6 MR JUSTICE BARLING: How can you say the first point,  
 7 because it might have been the clinching factor that --  
 8 you have to look at --  
 9 MR BREALEY: But both --  
 10 MR JUSTICE BARLING: Yes, but both. But they may not have  
 11 chosen that restaurant had they not accepted credit  
 12 cards.  
 13 MR BREALEY: This is my next -- this is my next --  
 14 MR JUSTICE BARLING: Yes, but I'm not sure whether,  
 15 really --  
 16 MR BREALEY: This is a market of two.  
 17 MR JUSTICE BARLING: I'm not sure they are different points,  
 18 they are mirror images.  
 19 MR BREALEY: All I'm doing is looking at a market of  
 20 restaurants. As we see in the 2015 cost of cash study  
 21 where you have a mature market, different considerations  
 22 might apply.  
 23 All I'm doing at the moment is looking at the UK  
 24 market which we know is mature, and I'm defining the  
 25 market where everyone is accepting MasterCard. Everyone

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1 is accepting MasterCard. And you have got to ask  
 2 yourself the question whether that 0.1%, that 10 pence,  
 3 is leading to an additional sale.  
 4 MR JUSTICE BARLING: But it might be because even though  
 5 they both accept MasterCard, both restaurants, it may be  
 6 the case that the consumer would not wish to go into  
 7 a restaurant that didn't accept MasterCard and therefore  
 8 because it accepts MasterCard it goes into that  
 9 restaurant.  
 10 MR BREALEY: Then does MasterCard then take that 10 pence  
 11 forever?  
 12 MR JUSTICE BARLING: Well, that's another matter.  
 13 MR BREALEY: So now we know the market is mature, we know  
 14 that people have one, two, three credit cards, or  
 15 whatever. So now you can go into Costa Coffee,  
 16 Pret a Manger, whatever it is, and use your card.  
 17 Forever more they are going to take 0.1% even though the  
 18 market is now --  
 19 MR JUSTICE BARLING: Sorry.  
 20 MR SMITH: Don't you define the benefit by asking what would  
 21 happen to the merchant if it then exited the scheme?  
 22 MR BREALEY: If you are going to join the two up, because  
 23 I do come on to -- the next example is where one does  
 24 and one doesn't.  
 25 Can I just emphasise, even if on the basis you are

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1 putting the two together and even if you say, ah, then  
 2 the second restaurant has benefited because it takes  
 3 MasterCard, merchants as a group have not benefited.  
 4 There has not been an extra meal sold. All that has  
 5 happened is it has gone into one restaurant and not the  
 6 other.  
 7 So when you are looking at the merchants as a group,  
 8 not one extra meal has been sold.  
 9 MR JUSTICE BARLING: It might be depending upon how you  
 10 define the group. If you define the group as  
 11 restaurants, you know, then it may be that that would  
 12 then eventually lead to a shift for people eating at  
 13 home or self catering, or all sorts of things. It  
 14 depends how you define the merchants, doesn't it?  
 15 We know that, for example, greater availability and  
 16 cheapness and so on of alcohol in supermarkets has led  
 17 to a decline in on licence, or is said to have led to  
 18 a decline in on licence. It depends how you define  
 19 these groups, doesn't it?  
 20 MR BREALEY: Having defined the acquiring market you have to  
 21 define the merchant as a group.  
 22 MR SMITH: You have answered my questions, I think, but you  
 23 are leaving entirely out of account the benefit that the  
 24 cardholder might have, or perceive to have in interest  
 25 from being able to pay by card, that's simply

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1 an irrelevant consideration for the purpose of this  
 2 exercise because the relevant consumer is the two  
 3 restaurants in Tottenham.  
 4 MR BREALEY: Mmm hmm, and the relationship between the  
 5 issuer and the cardholder is one thing. It is not  
 6 relevant to determine whether the merchant is gaining  
 7 a benefit as a result of the MIF.  
 8 MR JUSTICE BARLING: Not relevant?  
 9 MR BREALEY: Not relevant on the second condition.  
 10 MR JUSTICE BARLING: Do you mean the individual merchant or  
 11 the merchants as a whole?  
 12 MR BREALEY: I have made the submission that if you have  
 13 a market which is saturated with people using  
 14 MasterCards, there is no business stealing. If the  
 15 Tribunal doesn't like that, I fall back onto it doesn't  
 16 increase any additional spend.  
 17 MR JUSTICE BARLING: It is just this restaurant rather than  
 18 another?  
 19 MR BREALEY: It's just taken one from the other.  
 20 MR JUSTICE BARLING: Yes.  
 21 MR BREALEY: The notion that -- clearly the cardholder may  
 22 benefit from the 28 days, but as we just saw from the  
 23 European Commission's decision, the fact that the  
 24 cardholder may benefit doesn't alter the fact that there  
 25 is a restriction of competition on the merchant.

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1 If one looks at page 3, so we are now in only one  
 2 restaurant accepts cards, which I think is -- so we have  
 3 got here, if the customer would have chosen that  
 4 restaurant anyway, how has that 0.1% contributed to it?  
 5 Looking at robust evidence, it is like general  
 6 terms, but one has got to ask how that 0.1% has promoted  
 7 business stealing? Two, if the 28 period was a key  
 8 factor but the meal would have been consumed anyway the  
 9 MIF still has not led to an individual sale to the  
 10 merchant group as a whole. This is the factor  
 11 considered determinative by the Commission: there has  
 12 still only been one meal consumed. As we say, the  
 13 beneficiary is the cardholder, not the merchant as  
 14 a group.  
 15 Then three is still very, very important because as  
 16 we know from the standard required of MasterCard, it has  
 17 got to put some value on this. And all that Dr Niels  
 18 does is say, right, well, this is the cost and I'm going  
 19 to say it is 25% to 50%. But at 3, I say:  
 20 "How does the level of the MIF contribute to this  
 21 business stealing or increased competition?"  
 22 You can test it. There has been absolutely no  
 23 evidence put before the Tribunal that there has been any  
 24 decline in sales, less competition as a result of the  
 25 MIF going from 0.9 to 0.3. So when the Tribunal is

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1 asking itself the question, what are the appreciable  
 2 objective advantages arising specifically from the MIF,  
 3 which is paragraph 232 of the main court, how has the  
 4 MIF contributed to this increased competition? Then ask  
 5 yourself the question, well, what has happened since it  
 6 went from 0.9 to 0.3? Is there any evidence that they  
 7 have adduced to say, well, the meals have gone down,  
 8 sale of meals has gone down, the sale of anything has  
 9 gone down? Indeed, on the contrary, we have not been  
 10 given the figures of 2015.  
 11 MR HOSKINS: The regulation bit in December 2015.  
 12 MR JUSTICE BARLING: I know MasterCard phased it in, but it  
 13 might be a bit early to expect --  
 14 MR BREALEY: But maybe, maybe not, but they still reduced it  
 15 in 2015.  
 16 MR JUSTICE BARLING: We don't know what the counterfactual  
 17 is. It might have gone up or down. There isn't any  
 18 evidence, that's true.  
 19 MR BREALEY: Precisely. My point is there is a lot of  
 20 assumption being done and not much detail.  
 21 MR JUSTICE BARLING: But this question about benefit from  
 22 the MIF can be looked at in various ways. You don't  
 23 accept -- or do you -- that if there were benefits in  
 24 the way that you say there aren't benefits to merchants  
 25 from this element, the free funding element, but

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1 assuming there were benefits to merchants as a whole or  
 2 whatever, would that justify some element of --  
 3 MR BREALEY: Yes.  
 4 MR JUSTICE BARLING: Yes.  
 5 MR BREALEY: Mr von Hinten-Reed says that. I think  
 6 the Commission would accept that. But if it is accepted  
 7 that the 28-day -- I say no because of the interest, so  
 8 the interest --  
 9 MR JUSTICE BARLING: So you say that even if there were  
 10 a benefit to merchants from the 28-day period, it  
 11 shouldn't increase the MIF in any way because of the  
 12 interest that they get overall.  
 13 MR BREALEY: Correct. But if we park that, then it would be  
 14 accepted that if the 28-day period increased sales to  
 15 merchants, because one has -- if those sales would have  
 16 occurred anyway, if I would have gone into A restaurant  
 17 and bought that meal anyway, what is the -- the third  
 18 condition of 101(3), it has to be necessary, if the sale  
 19 would have occurred anyway, there is no efficiency gain  
 20 because it would have occurred anyway.  
 21 MR JUSTICE BARLING: If all the meals that were bought on  
 22 credit cards or a substantial proportion were bought  
 23 a month earlier than they would otherwise have been,  
 24 there would be a benefit there, wouldn't there? Even  
 25 though there wouldn't necessarily be more because

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1 earlier funding is a benefit generally in the economy.  
 2 MR BREALEY: Well, then you have to look at Dr Niels' second  
 3 point, which is the Commission then would disagree with  
 4 that because although technically you can see that there  
 5 is a benefit of getting something earlier, if you end up  
 6 paying interest, you have got less money to spend in the  
 7 future. And as we know from the guidelines at 101(3),  
 8 not only do you have to put a value on it, you have to  
 9 give some sort of timescale. And we all know, and if we  
 10 pay £100 on credit today for a meal, and let's assume  
 11 I have got £100 a month budget to buy myself a meal and  
 12 I buy the first one on credit and then don't pay it off  
 13 and I start paying interest, I won't have £100 for the  
 14 second meal.  
 15 That's why the Commission in annex 6 rejecting  
 16 Dr Niels and Oxera's report said actually, it is just  
 17 too simplistic to say that the fact you are going to get  
 18 something today rather than tomorrow excuses you from  
 19 paying for it.  
 20 It is the David Copperfield scenario. Mr Micawber.  
 21 Obviously, you can go and buy a bottle of champagne if  
 22 you haven't got the money and buy it on credit, but is  
 23 that actually leading to an additional sale of the  
 24 bottle of champagne? Because you have only got so much  
 25 income. The credit card doesn't increase your income,

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1 and if you don't pay it off you will have less of your  
 2 income to spend in the future.  
 3 MR JUSTICE BARLING: I suppose it might make you go out to  
 4 dinner, whereas you might have just gone and bought some  
 5 sausages and cooked them yourselves.  
 6 Might you not spend -- these are arguments that are  
 7 explored in the expert material, but the 28-day period  
 8 appears to be, and I think you accept this, one of the  
 9 attractions of taking a credit card and using it, you  
 10 know. People -- consume, like it and --  
 11 MR BREALEY: Absolutely, and that's our third misconception.  
 12 I quote it now all the time now saying the scheme is  
 13 fantastic, and it is, credit people love credit cards.  
 14 MR JUSTICE BARLING: But not the MIF, you say.  
 15 MR BREALEY: So MasterCard argue this point time and time  
 16 again. The scheme produced the benefits, and the court  
 17 says the scheme is not the restriction, the MIF is the  
 18 restriction and you have got to identify the benefit  
 19 that the restriction of competition gives you.  
 20 As I say, one way of testing that is have the  
 21 benefits changed? MasterCard say all these benefits --  
 22 you get all these benefits. Have they changed since the  
 23 MIF went down? The 0.9 to 0.3. You would have expected  
 24 something, you can maybe say it is all too early, it  
 25 might be said, well, let's have a look at Australia, or

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1 whatever.  
 2 There is a lot of assumptions based on assumptions  
 3 and general statements made in Dr Niels' report, which  
 4 in our submission doesn't satisfy the rigours of 101(3).  
 5 That is one of the reasons that MasterCard didn't  
 6 get any exemption in 2007.  
 7 MR SMITH: I have three groups of questions, but can I start  
 8 with the interest-free period?  
 9 MR BREALEY: Yes.  
 10 MR SMITH: Clearly there it is uncontroversial that the  
 11 cardholder gets a benefit.  
 12 MR BREALEY: Yes.  
 13 MR SMITH: Assuming the cardholder is a transactor, he or  
 14 she doesn't pay for 28 days.  
 15 MR BREALEY: Yes.  
 16 MR SMITH: And in terms of who bears the cost of that, it  
 17 rather depends on how one construes the interest that is  
 18 charged by the issuing card to the cardholder.  
 19 On one level, you can say "If I extend credit to  
 20 a cardholder, the price for that credit is the  
 21 interest".  
 22 If I then offer a 28-day free period, providing  
 23 certain conditions are made you can say that is  
 24 unequivocally a cost to the issuing bank. I think what  
 25 you are saying is that that cost is compensated for in

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1 a higher rate of interest, or could be compensated for  
 2 in a higher rate of interest that is charged to the  
 3 cardholders who do pay interest.  
 4 MR BREALEY: Or any rate of interest, or it could be  
 5 a cardholder fee. The banks come up with all sorts of  
 6 ways to charge money.  
 7 MR SMITH: But in short, what you are saying is that the  
 8 issuing bank is not uncompensated for because somewhere  
 9 in the charging structure the issuing bank gets repaid  
 10 for its interest-free period, and we obviously haven't  
 11 had any evidence in terms of how the interest is  
 12 calculated but I understand the argument.  
 13 MR BREALEY: Yes, there is APR and whatever.  
 14 MR SMITH: You are saying that although the cardholder gets  
 15 a benefit, the merchant gets no clearly definable  
 16 benefit from this 28-day period?  
 17 MR BREALEY: Correct. Both the merchant individually and in  
 18 aggregate.  
 19 MR SMITH: You discount any general benefit to the scheme as  
 20 a whole, and let me just unpack that a little bit, the  
 21 idea that a 28-day free period will attract more  
 22 cardholders, will involve more transactions using that  
 23 card, will increase the scheme acceptability to the  
 24 benefit of all concerned.  
 25 MR BREALEY: With respect, we haven't, because we come to

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1 court saying there should be a 0.15, 0.2 MIF which does  
 2 reflect the benefits of the scheme or the benefits of  
 3 accepting the card, it is the benefit to the merchant,  
 4 ease, you don't have to accept the cash. So we don't  
 5 ignore the scheme or whatever completely. We --  
 6 MR SMITH: You attribute some value to it?  
 7 MR BREALEY: Absolutely.  
 8 MR SMITH: Can I now suppose a cost rather different from  
 9 the 28-day period. Let's say a case where the merchant  
 10 receives payment from the issuing bank via the acquiring  
 11 bank but the cardholder doesn't pay.  
 12 MR BREALEY: Can I go through that again?  
 13 MR SMITH: Sure, I will repeat it. So the merchant receives  
 14 payment for a sale from the issuing bank, but for  
 15 whatever reason the cardholder doesn't pay the issuing  
 16 bank. It's maybe a forged card. It may be that the  
 17 cardholder can't pay and the money can't be recovered,  
 18 but whatever happens there is a shortfall.  
 19 MR BREALEY: That is factored into --  
 20 MR SMITH: I am sure it is, and I just want to get my  
 21 parameters clear. You do accept, because you say it is  
 22 factored in, it is an unequivocal benefit to merchants,  
 23 that payment?  
 24 MR BREALEY: Unequivocal, it is a -- we have accepted that  
 25 there is an element of payment guarantee in the MIT-MIF.

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1 MR SMITH: What I'm trying to get clear is I'm trying to  
 2 identify costs which don't have this sort of penumbral  
 3 'who is benefiting' question. I'm trying to identify  
 4 a cost and a benefit that unequivocally benefits one  
 5 side and is unequivocally a cost to the other before we  
 6 talk about MIFs.  
 7 If one has a case where I pay in a shop with a card,  
 8 the shop gets payment but the money can't be recovered  
 9 from me via the issuing bank, then someone has clearly  
 10 benefited because there has been a sale and a payment.  
 11 MR BREALEY: I understand the point that's being made, and  
 12 in simple terms the answer is yes, it is a benefit. Can  
 13 I just give the proviso, which is, again, merchants all  
 14 the time take out insurance for fraudulent transactions.  
 15 What you are putting to me is that all the issuers  
 16 have got together to put forward a common cost, so it is  
 17 a fixed cost on a payment guarantee. So just before you  
 18 say it is an unequivocal benefit to the merchant, one  
 19 has to factor in -- one has to be careful because,  
 20 again, who is saying that the issuers are not going to  
 21 kind of raise that and it does become inefficient  
 22 because the merchant -- had it been done on  
 23 an individual basis, the merchants may equally have  
 24 taken out insurance to cover that, which they do on  
 25 cash.

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1 So, yes, we do factor it into the MIF, but I would  
 2 not want it to be on record that it is just an absolute  
 3 given that it is a -- something which unequivocally  
 4 benefits merchants.  
 5 MR SMITH: I forget whichever witness it was, but all other  
 6 things being equal.  
 7 MR BREALEY: There have been a few of those. Mr Rogers,  
 8 I think, said that.  
 9 MR SMITH: Let's add to the list. If one is simply looking  
 10 at a case where the payment is made by the issuing bank  
 11 to the merchant via the acquiring bank, leaving all  
 12 other things out of account, that would be regarded as  
 13 a benefit? Perhaps unequivocal is making it too strong.  
 14 MR BREALEY: All things being equal.  
 15 MR SMITH: All things being equal. Ceteris Paribus and on  
 16 the same basis that would be a cost to the issuing  
 17 bank/cardholders.  
 18 MR BREALEY: Yes.  
 19 MR SMITH: It must follow.  
 20 MR BREALEY: Yes, but again, as we examined with Mr Douglas,  
 21 one has to be slightly careful because if you go down  
 22 that road and you say, right, I'm going to be -- I, the  
 23 issuing bank, am going to be indemnified every time  
 24 there is a fraudulent transaction, the merchant is going  
 25 to pick up 50% of the cost, for example, one has to work

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1 out how that impacts on the lending market, for example.  
 2 And as Mr von Hinten-Reed says, does that start creating  
 3 inefficient lending?  
 4 So you will start loaning money to anybody and you  
 5 become a bit reckless about doing it, with the monolines  
 6 and stuff, but you know that somebody else is going to  
 7 pick up with it.  
 8 So this is why I think one has to say it is  
 9 a restriction of competition and then you work out the  
 10 exemption criteria. But I will stay with you --  
 11 MR SMITH: Thank you. I appreciate there is a broader  
 12 picture, but let's simply focus on this benefit to  
 13 merchants cost to issuing banks with all the provisos  
 14 you have put on the record. But let us suppose that  
 15 a MIF is then set that is below these costs.  
 16 MR BREALEY: Yes, so the merchant is paying half and the  
 17 issuer is paying half.  
 18 MR SMITH: Yes, for example. Now, would that be  
 19 a constraint in the issuing market? Would that be  
 20 anti-competitive in the issuing market?  
 21 MR BREALEY: Well, as I said before the short adjournment,  
 22 there is a constraint between issuers. They are  
 23 supposed to be picking up a cost. They have lent money.  
 24 And there's -- and the person has defaulted. And they  
 25 have agreed to impose 50% on the acquirers. So I'm not

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1 quite sure what the question is.  
 2 If the question is: is that not a restriction of  
 3 competition? I say clearly it still is a restriction of  
 4 competition in the acquiring market. I can't at the  
 5 moment see -- it is clearly a restriction on the issuing  
 6 market in the sense of it is a restriction of  
 7 competition between those who are party to the agreement  
 8 because they are no longer doing it on a bilateral  
 9 basis.  
 10 I don't see it on the cardholder market or anything.  
 11 The collective agreement is having an impact on the  
 12 acquiring market, which is a separate market. So I'm  
 13 slightly confused continually about this distortion of  
 14 competition on the issuing market. Yes, it is  
 15 a distortion on the issuing market because the  
 16 independent players in that market have clubbed  
 17 together, but the effects of that clubbing together is  
 18 being felt squarely in the acquiring market, let's call  
 19 it the merchants, because it is the nature of that  
 20 agreement which is saying: we will bear half and we will  
 21 put half onto the merchants.  
 22 MR SMITH: But by parity of reasoning, can't you say in the  
 23 issuing market that the 50%, let's say there is a split  
 24 of the costs, that is borne by the issuing banks gets  
 25 passed on to the cardholders who are good for the money

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1 in the shape of interest or fees?  
 2 MR BREALEY: Well, they benefit from it. Whether they  
 3 actually -- that is distorted is another matter, they  
 4 benefit from it.  
 5 I come back to the guts of article 101. Which  
 6 market have we defined in this debate in 101? So are  
 7 we -- is one talking about a restriction of competition  
 8 under 101(1) or are we talking about benefits under  
 9 101(3)? Because we have got to work out whether there  
 10 is a restriction of competition in 101(1).  
 11 Now, let's assume for the sake of argument that we  
 12 have highlighted it is the acquiring market that is  
 13 a distinct market that has been affected because of the  
 14 snip, because of the tools, the market definition, the  
 15 competitive restraints, merchants cannot bargain away  
 16 this common cost. So let's assume that we have  
 17 identified the acquiring market as the distorted market.  
 18 Now, where is the analysis going? We are looking  
 19 at 101(3). Yes, you could say cardholders might benefit  
 20 under 101(3), under the first condition. Now you have  
 21 still got to come back to paragraph 85, the guidelines,  
 22 and ask yourself the question whether the merchants who  
 23 are in that acquiring market that has been distorted,  
 24 you have identified at first go are any worse off.  
 25 MR JUSTICE BARLING: I mean, sorry, just to pick up on this

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1 point while Mr Smith is thinking about that answer.  
 2 Coming back to paragraph 686 of the Commission  
 3 decision, if the MasterCard in its wisdom said: we think  
 4 to make this payment card system work better, I know  
 5 that the fraud payment, and the guarantee and the  
 6 default guarantee works in favour of the merchants  
 7 really, but we think it would work better if the MIF  
 8 works the other way and we make a default, multilateral  
 9 default, where actually it goes in the other direction.  
 10 Although they get those benefits, they get a lot of  
 11 interest, ongoing credit, and so we are going to make  
 12 the issuing banks pay a MIF in the other direction.  
 13 MR BREALEY: Yes.  
 14 MR JUSTICE BARLING: So there would be a payment to the  
 15 acquirers from them.  
 16 Now, why would you only look at the acquiring market  
 17 in that situation? Why wouldn't you say --  
 18 MR BREALEY: Now you have got an agreement which is going to  
 19 impose a common cost on a cardholder, now all the banks  
 20 on the MasterCard scheme wake up one morning and see the  
 21 error of their ways and say actually, we should be  
 22 fixing the fees for the cardholders. So actually, we  
 23 reckon that the cardholders get rewards on this, they  
 24 benefit from the 28-day period, let's all of us club  
 25 together and charge the cardholder £25 a year.

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1 Now, the same argument could apply. It is  
 2 a two-sided market. We know best cardholders benefit  
 3 from this scheme. I don't think -- again, you just have  
 4 to say it to realise that if they all club together to  
 5 impose a common annual £25 fee to cardholders, there  
 6 must be something wrong with them.  
 7 MR JUSTICE BARLING: That is a different point. You were  
 8 just saying you are going to charge the issuing bank;  
 9 the acquirer's going to pay something to the issuing  
 10 bank.  
 11 MR BREALEY: The acquirers are going to pay.  
 12 MR JUSTICE BARLING: They will be paying £101 for the £100  
 13 transaction, for example. But isn't it slightly  
 14 artificial just to look at that one thing, because what  
 15 you are really saying is depending on where the pendulum  
 16 swings in relation to these costs and benefits, there  
 17 comes a point where you try and find the right fair  
 18 balance, and that's what MasterCard --  
 19 MR BREALEY: That's what I argue, yes.  
 20 MR JUSTICE BARLING: -- and in a sense your argument, by  
 21 implication, at any rate, is that we know that it is  
 22 fair, or we accept it is fair at a certain level of MIF,  
 23 but --  
 24 MR BREALEY: What we say, and I think this is clearly how  
 25 the Commission and the court have looked at it, is you

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1 have this -- let's assume -- take the two-sided market,  
 2 and you take Dr Niels' radical approach and MasterCard  
 3 know best and they will know how to make it work in the  
 4 most perfect way.  
 5 You are still faced with an agreement between  
 6 competitors in imposing a cost on a certain category of  
 7 person. If you accept that is a restriction of  
 8 competition on a particular market, then you are in  
 9 article 101(3) territory. And the question the Tribunal  
 10 has to decide is whether, when you are looking at  
 11 101(3), you just allow MasterCard to say "We can do what  
 12 we want because we know best", which was rejected even  
 13 in 2002 by the European Commission, we saw that on  
 14 Friday, that the card schemes cannot just have a free  
 15 range, or you try and calculate the efficiencies by  
 16 reference to certain objective criteria.  
 17 The question is, what are these objective criteria?  
 18 MR SMITH: Can we get away from the contention, I know it is  
 19 your contention, that it is the issuing market that  
 20 drives the MIF. Let's suppose instead we have a MIF  
 21 that is set by MasterCard, we don't need to trouble  
 22 ourselves with what criteria at the moment, but it is  
 23 set by MasterCard and the acquiring and issuing banks  
 24 are in exactly the same boat. They have the MIF imposed  
 25 on them. It is a default MIF, but that's the MIF and

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1 they are, in terms of their market power quoad  
2 MasterCard, their ability to influence, they are  
3 exactly equal.  
4 Let us suppose that instead of a MIF as it was set,  
5 the MIF that MasterCard sets is below the costs of, let  
6 us say, the fraudulent transactions incurred by the  
7 issuing banks. The cost we have just been discussing.  
8 Let's suppose there is 10 million a year of payments by  
9 issuing banks to acquiring banks which are not recovered  
10 from cardholders. So 10 million.  
11 But the MIF only enables recovery of half of these.  
12 Presumably that cost would in some way be passed on by  
13 the issuing bank to cardholders, either through interest  
14 fees or through card payments?  
15 MR BREALEY: Probably.  
16 MR SMITH: Given that it is a MIF to which the acquiring  
17 banks and the issuing banks are party, albeit the  
18 passive side of it, you would agree then that this is  
19 a constraint on the issuing market, where the cardholder  
20 suffers?  
21 MR BREALEY: So the cardholder has defaulted?  
22 MR SMITH: Yes. Let us say to the tune of 10 million a  
23 year, cardholders in the aggregate default and one can't  
24 recover from it. They are either fraudsters who have  
25 duplicated cards or they don't have the money and can't

1 pay. So this is a cost which in the first instance is  
2 borne to 50% because the MIF is so low, borne to 50% by  
3 the issuing banks and that cost is passed on to those  
4 who have money, those cardholders who can pay through  
5 high interest or card charges or the methods you have  
6 discussed.  
7 My question to you is: isn't this a constraint in  
8 the issuing market where the costs of the default are  
9 being passed on to the cardholders through, let us say,  
10 interest charges?  
11 MR BREALEY: I don't believe so. So we have a situation now  
12 where you have got -- again, so it is issuers don't --  
13 it is non-agreement between issuers. It is just  
14 MasterCard setting --  
15 MR SMITH: They are all party to this network of agreement,  
16 they have all signed up to the licence, both acquirers  
17 and issuers. But MasterCard debates the appropriate  
18 MIF, reaches a conclusion and says: this is the MIF.  
19 MR BREALEY: But again, I mean, I don't want to be difficult  
20 about this because we keep on coming back to the  
21 constraint on the issuing market. You are still faced  
22 with a situation where the issuers have lent money and  
23 ordinarily they would be recovering the cost of that  
24 offering credit, which is --  
25 MR SMITH: But I am not talking about credit here. Park

1 credit, because I can understand that that's a slightly  
2 Janus-faced cost. So I'm talking about card fraud here  
3 which we discussed earlier and Ceteris Paribus --  
4 MR BREALEY: So you now have a situation where, again I'm  
5 just trying to work it through, you have a situation  
6 where are you have a card scheme, it licences an issuing  
7 bank to issue the cards, merchants don't have any  
8 visibility about these people at all. So ordinarily you  
9 will start off, I would suggest, that if the bank has  
10 licensed a fraudster, that would be a matter between the  
11 bank and the fraudster.  
12 Now, what I think you are saying to me is that if  
13 the bank is guaranteeing some sort of payment to the  
14 merchant because the bank is having to pay, I am  
15 struggling with why there is a distortion of competition  
16 in the fraudster's market.  
17 There is a fixed common cost that is being charged  
18 to the acquirers. We say that's a restriction of  
19 competition. It could be benefited from an exemption.  
20 We see that. But I am still struggling why there is --  
21 beyond the restriction of competition between the  
22 issuers, where is the distortion in the fraudster's  
23 market?  
24 MR SMITH: We are really talking about cardholders as  
25 a whole. I thought on Friday you distinguished between

1 the issuing side and the acquiring side by saying that  
2 the difference was that on the acquiring side the MIF  
3 was passed on to the merchants?  
4 What I am suggesting here is certainly a MIF that is  
5 still going the issuer's way --  
6 MR BREALEY: It is not a MIF, is it?  
7 MR SMITH: No, it is a MIF. It is a default interchange fee  
8 set by MasterCard. All I'm requiring you to suppose is  
9 that it is set by MasterCard without significant input  
10 from either the issuing market or the acquiring market.  
11 So I'm certainly presupposing a default.  
12 MR BREALEY: It is a default on my logic. It is  
13 a restriction, and now we have to work out whether --  
14 again, what market have we identified? This is where  
15 I kind of -- is the question that's being put to me  
16 a situation where, whatever decision we have got now, is  
17 there are two markets, there is one market for the  
18 acquirers and one market on the issuing side, or have we  
19 just identified the acquiring market?  
20 MR SMITH: Well, we are looking at two markets and what I'm  
21 suggesting to you is that the same MIF is a restriction  
22 in both.  
23 MR BREALEY: That's where I would -- I don't see where it is  
24 a restriction in the cardholder market. I see it is  
25 a restriction of competition between issuers.

1 MR JUSTICE BARLING: Isn't the issuing market what we think  
 2 of loosely as being the issuers/cardholders? Isn't that  
 3 what the Commission said?  
 4 MR BREALEY: Let's try and work it through then. You have  
 5 MasterCard saying to everybody "I have woken up, I have  
 6 come up with a rule which says that fraudulent  
 7 transactions cardholders will pay half and merchants  
 8 will pay half".  
 9 MR SMITH: For the sake of argument. That would work, yes.  
 10 MR BREALEY: Well, then again --  
 11 MR SMITH: Or to be absolutely precise, what MasterCard  
 12 would be saying is the acquiring banks pay half and the  
 13 issuing banks pay half. But you are quite right, the  
 14 inference of a well-informed MasterCard would be that it  
 15 will get passed down the line.  
 16 MR BREALEY: It may not be the same because it may well be  
 17 that it is passed down on the acquirers and it is not  
 18 passed down to the issuers. But let's assume it is.  
 19 Then you would ask yourself the question: what markets  
 20 are being distorted here? And you would do your market  
 21 analysis.  
 22 Mr von Hinten-Reed, he was saying there are three  
 23 markets. There's a payment system market, there's a  
 24 cardholder market, there's a merchant market.  
 25 MR SMITH: Wouldn't a cardholder say -- just like

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1 a merchant, a cardholder would say: there is a ceiling  
 2 being imposed? In other words, my issuing bank can't  
 3 recover more than this 50% from the acquiring side in  
 4 just the same way as you have been saying that there is  
 5 a floor imposed by virtue of the MIF in the acquiring  
 6 market?  
 7 MR BREALEY: It may well be that you would say: I have to  
 8 think about this. If you have gone down an analysis of  
 9 two markets, you might say, right, it is undoubtedly  
 10 a restriction of competition in both, because you have  
 11 imposed this rule 50/50. Now I am going to look at the  
 12 efficiency gains in both markets.  
 13 I will turn first to the acquirers and then I will  
 14 turn to the issuing market. Let's call it the  
 15 cardholder market. The cardholder, because it gets  
 16 confused. And you would have to go through the separate  
 17 analysis. You would say -- you may say, well, the 50%  
 18 split is completely and utterly arbitrary because the  
 19 cardholder market should be paying more. It may well be  
 20 you would say the acquiring market should be paying  
 21 more, but you would have to have that debate and  
 22 analysis.  
 23 MR SMITH: I understand. We are moving now from 101(1)  
 24 to 101(3).  
 25 MR BREALEY: Again, subject to this market knows best point,

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1 if you had a MasterCard rule saying this group of people  
 2 are going to pay 50%, this group of people is going to  
 3 pay 50% where actually it should be being done on  
 4 a bilateral independent basis, you have a restriction of  
 5 competition, now you can look at the efficiencies.  
 6 MR SMITH: The question is how does one compute these. And  
 7 what I want to ask you is how does one work out what the  
 8 "exemptible" level of the MIF ought to be? Can I just  
 9 suggest a test and ask your comments on it.  
 10 Stage one is that one identifies the legitimate  
 11 costs of the party receiving the payment. So let us  
 12 assume one has a MIF going in one direction and let's  
 13 stick with the direction that is fact movement from the  
 14 acquiring market to the cardholder or issuing market.  
 15 So you ask yourself what are the legitimate costs of  
 16 the issuing banks receiving the payment? Legitimate  
 17 covers a multitude of sins. I know it is a vague term.  
 18 You ask yourself what are the costs of the issuing bank  
 19 in relation to the card scheme, and then before you say  
 20 no --  
 21 MR BREALEY: Sorry.  
 22 MR SMITH: -- you ask yourself to what extent should the  
 23 paying party, here the acquiring banks, to what extent  
 24 should they pay these costs, in what proportion? The  
 25 reason I'm articulating the approach that way is because

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1 if one is trying to work out what is fair between two  
 2 markets, doesn't one have to take into account both  
 3 sides?  
 4 MR BREALEY: There is many, many things on that. The first  
 5 point to note is it is not what is fair on both.  
 6 You have got to look at what is fair on the group of  
 7 consumers that is affected by the restriction of  
 8 competition.  
 9 MR SMITH: Here, I'm saying that both the cardholders and  
 10 the merchants are affected.  
 11 MR BREALEY: To bring it back to this case, the joint  
 12 service has been rejected, and what is fair to both is  
 13 not the correct analysis.  
 14 But I would take issue with the very first thing you  
 15 asked which is: what is the cost? My first -- I think  
 16 how it should be is that you have to look at the  
 17 efficiency because that is the first condition of  
 18 article 101(3).  
 19 If, for example -- let's assume you do identify the  
 20 cost, but someone said, well, those costs -- even if  
 21 you -- you then say: to what extent should you pay? And  
 22 you say, well, even if you didn't pay anything these  
 23 costs would still be incurred and this service would  
 24 still be provided.  
 25 So to put it back, which is the kind of the third

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1 condition of 101(3), let's assume that the transaction  
 2 would have happened anyway. So, MasterCard is saying  
 3 I have got these costs and it is fair that you should  
 4 pay this. But then, except when told it has to reduce  
 5 the amount it is charging, I will continue to provide  
 6 this service anyway, I will get the money back somehow,  
 7 from schemes fees, or whatever it is.  
 8 Then your third point is the transaction would have  
 9 happened anyway. Then there is no efficiency gain  
 10 within the meaning of 101(3). I don't believe one  
 11 should start off with identifying a cost because  
 12 although obviously that is not an irrelevant  
 13 consideration, I do believe the very first question you  
 14 should ask is: what is the efficiency that's being  
 15 generated and would it happen anyway.  
 16 MR SMITH: I think we are ending up where we ended up with  
 17 Mr von Hinten-Reed when I asked him about the cinemas  
 18 and the reclining chairs, and the advantage to cinema  
 19 goers. Doesn't one on that analysis of the very narrow  
 20 assessment of what is the efficiency to the two sides,  
 21 both markets, lose the general benefit, the general  
 22 welfare benefit of the fact that these card schemes are,  
 23 to use your words yet again, a jolly good thing?  
 24 Somehow that falls out of the equation, doesn't it?  
 25 MR BREALEY: All I can do is come back to 101(3) first

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1 condition and 101(3) second condition.  
 2 We certainly accept that when you are looking at the  
 3 first condition, you look at advantages to the merchants  
 4 and cardholders, so your general punters who go to the  
 5 cinema. If you have identified the acquiring market as  
 6 your market that is being distorted, you have to, if you  
 7 are going to apply paragraph 85 of the guidelines, at  
 8 least determine whether, as a result of the MIF and the  
 9 efficiency gains, that group is not worse off.  
 10 Let's just take that example where you say the only  
 11 efficiency gains that are generated to merchants is  
 12 the 0.2%, the transactional savings.  
 13 Let's, for the sake of argument, assume that. So we  
 14 have got the acquiring market, we see that there are  
 15 advantages to cardholders and merchants, but then you  
 16 conclude that actually, when I'm looking at efficiency  
 17 gains, the only efficiency gains I can see that the  
 18 merchants get are the transactional -- and with a bit of  
 19 fraud -- say on Mr von Hinten-Reed's. So you get  
 20 to 0.2.  
 21 Now, you say, well, but you know, the cardholders  
 22 have benefited massively from this scheme and if we were  
 23 then to raise it from 0.2 to 0.7, the cardholders would  
 24 get lots more rewards and they would benefit. It is  
 25 a two-sided market at the end of the day, they will

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1 benefit.  
 2 Now the merchants are paying not 0.2, they are not  
 3 being worse off, they are actually worse off because  
 4 they are paying 0.7. And that's where we say you fall  
 5 down, because you have identified a restriction of  
 6 competition in the acquirer market -- don't forget if  
 7 merchants are paying 0.2 they are no worse off, but  
 8 there is still a 0.2 pot of money going to issuers which  
 9 issuers can give to cardholders.  
 10 Sorry, if you are saying that the efficiencies to  
 11 merchants are 0.2, but I, because I like the  
 12 cardholders, am going to charge then 0.7, 0.9, those  
 13 merchants are worse off.  
 14 MR SMITH: Doesn't one then, to balance the two sides, need  
 15 to have a cardholder indifference test, where one  
 16 measures the benefit that the cardholder gets of having  
 17 a card over and above holding cash?  
 18 MR BREALEY: But we come back to this circular argument.  
 19 I'm a cardholder, I apply to Barclays Bank, I say can  
 20 I have a card? Yes, you meet the criteria and do you  
 21 know what, you get all these points. I say great. But  
 22 that's being funded by the merchants, that if the  
 23 merchants stopped funding that I would not get those  
 24 points.  
 25 So I do again pray in aid this circular argument,

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1 which is that, yes, these cardholders are getting  
 2 benefits, but they are only getting benefits because of  
 3 some price arrangement which the merchants are  
 4 paying for.  
 5 MR SMITH: Going back to my very tentative test which I'm  
 6 just trying to run past you, which you didn't like,  
 7 wouldn't rewards be an arguable legitimate cost? And  
 8 one might say it is an illegitimate cost. But what I'm  
 9 groping for, if one takes into account the entirely  
 10 clearly legitimate costs of the scheme, things like  
 11 fraud, one applies a merchant indifference test to work  
 12 out the efficiencies or the gains to the merchants, say  
 13 one does the same, the cardholder indifference test, to  
 14 the cardholders and say the two don't add up to the  
 15 overall costs of the scheme, that might be --  
 16 MR BREALEY: Then you should be having a bilateral and you  
 17 should let everyone sort themselves out.  
 18 If the result of the overall price fixing agreement  
 19 both sides -- both sides -- are not getting a fair  
 20 share, then there is something wrong with your agreement  
 21 and it falls away.  
 22 MR SMITH: I think you are agreeing with me you don't factor  
 23 in the overall scheme benefits, you look at the very  
 24 narrow benefits to a segment of consumer --  
 25 MR BREALEY: To give him his due, all that

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1 Mr von Hinten-Reed was doing was trying to articulate  
 2 the criteria of 101(3), as articulated by the Commission  
 3 as well and endorsed by the courts.  
 4 MR SMITH: Thank you. I'm sorry to have taken up your time.  
 5 MR BREALEY: I will try and finish exemption before -- we  
 6 have got -- just very quickly then on exemption.  
 7 If we look at paragraph 220 of the closing,  
 8 I would -- we have done this almost to death now, but  
 9 I would urge the -- page 86 of the closing. We say this  
 10 is the third -- the numbers have dropped out, but where  
 11 you see:  
 12 "If the scheme is beneficial, then so too is the  
 13 MIF."  
 14 We have put number 3 next to that because that is  
 15 what we say is the third misconception. And, again, if  
 16 you want, I am sure the Tribunal has it, but if you take  
 17 that cite from the main court, four lines up:  
 18 "Analysis of the first condition 101(3) called for  
 19 an examination of the appreciable objective advantages  
 20 arising specifically from the MIF and not from the  
 21 MasterCard system as a whole."  
 22 So there is a clear distinction being made by the  
 23 CJEU that there are advantages from the system as  
 24 a whole and advantages from the MIF.  
 25 All I'm trying to do is try and articulate what the

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1 CJEU has said there. MasterCard have been arguing for  
 2 a considerable period of time, you have got to look at  
 3 the advantages of the system as a whole and that has  
 4 been held to be wrong.  
 5 They are to a large extent repeating the same  
 6 arguments again. The fourth is the aggregate thing we  
 7 have done. Then fifth, which is above paragraph 234, is  
 8 the credit. At paragraph 241, if you remember on Friday  
 9 morning I started off with the credit write-offs,  
 10 paragraph 241 is about credit write-offs. They were not  
 11 included in the Visa decision.  
 12 So that really is the misconception, we say. If we  
 13 go to paragraph 248, I think it is important, clearly  
 14 Dr Niels is trying to justify ex post facto MasterCard's  
 15 UK MIF, but here we set out three reasons, 248 onwards,  
 16 as to why the UK MIF was actually set by MasterCard, it  
 17 was erroneous, and we rely to a large extent on their  
 18 own witness evidence.  
 19 The first reason is they simply cannot have a free  
 20 rein -- it is not a subjective test. They can't have  
 21 free rein, they have got to apply objective criteria.  
 22 Because if the Tribunal disagrees with that and allows  
 23 Visa and MasterCard to set any fee that it wants because  
 24 it feels that it needs a certain level to compete with  
 25 its competitor, then the fees on the merchants will just

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1 go higher and higher.  
 2 At 250 it is a question from Professor Beath, so  
 3 that is a question. I'm still trying to get -- that is  
 4 not evidence, that is a question from Professor Beath.  
 5 At 254, again, we do say that Dr Niels has not  
 6 sought to justify any actual calculations, he has sought  
 7 to do it ex post facto.  
 8 And at 257, this was the cross-examination of  
 9 Mr Sidenius. It is, we would say, unsatisfactory that  
 10 the data that is being relied on in this case by  
 11 MasterCard does relate to 2007. With great respect to  
 12 Dr Niels, he tried to wriggle out of it by saying, well,  
 13 he had a conservative -- whatever that does mean -- but  
 14 he tried to pretend that it didn't really matter because  
 15 it would have gone against MasterCard.  
 16 That is just too simplistic, as we have seen from  
 17 the free funding. If he had said credit write-offs are  
 18 just not a cost that should be loaded onto merchants,  
 19 free funding maybe, then you would have to ask yourself  
 20 the question: well, has that changed because it has gone  
 21 from 6% to 0.6%?  
 22 The data in the Edgar Dunn 2008 is not, we would  
 23 submit, robust, sufficient enough for MasterCard to come  
 24 to court, come to this Tribunal, and say, well, actually  
 25 it was a sound basis to charge the merchants.

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1 So that is the actual. We then deal with the  
 2 adjusted benefit cost balancing approach. To a certain  
 3 extent I have dealt with this in that little paper on  
 4 free funding, and I think it just -- I don't need to  
 5 take -- I'm just conscious of the time and we have got  
 6 quite a lot to do.  
 7 MR JUSTICE BARLING: Just so you know, Mr Brealey, what  
 8 I think we will do, bearing in mind the needs of the  
 9 transcript writers, if we break for lunch a bit earlier,  
 10 say quarter to and start at quarter to, you still get  
 11 a proper lunch, we can even start a bit earlier if you  
 12 preferred, we can then, with suitable breaks, go on  
 13 a bit longer if necessary in the afternoon, so people  
 14 don't get exhausted now.  
 15 MR BREALEY: Yes, it is a long day.  
 16 MR JUSTICE BARLING: So you know. If you aim to stop at  
 17 about 12.45 pm, something like that.  
 18 MR BREALEY: So, I'm looking at page 99 of our closing, the  
 19 adjusted benefit cost balances approach. We say it has  
 20 not got a great pedigree, remembering that this has been  
 21 jettisoned by the Commission and the European Union  
 22 itself.  
 23 At 268 we give five reasons why we say MasterCard  
 24 are wrong and, again, they should have numbers next to  
 25 them. So at 269, outdated inappropriate cost studies.

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1 That should have a number 1 next to it. So these are  
 2 five reasons.  
 3 Then no robust evidence of relevant benefits. That  
 4 is number 2. We go on to page 104. That still has a 3.  
 5 Failure to take account is 4.  
 6 MR JUSTICE BARLING: Then cross subsidy is 5.  
 7 MR BREALEY: No, cross subsidy is part of the revenue. The  
 8 Baxter analysis is part of it. Then the fifth one is as  
 9 it says at paragraph 216.  
 10 MR JUSTICE BARLING: Yes.  
 11 MR BREALEY: What I suggest we do there is if we stop, then  
 12 I will quickly go through the adjusted MIF after lunch.  
 13 I just want to go through a couple of documents on the  
 14 adjusted MIT approach. I think that will take me about  
 15 half an hour. Then I have got pass-on and ex turpi  
 16 causa. I don't know whether -- pass-on is pretty  
 17 yellowed out and I did kind of flag the point on Friday  
 18 whether --  
 19 MR JUSTICE BARLING: You did, yes.  
 20 MR BREALEY: -- you wanted --  
 21 MR JUSTICE BARLING: You asked us to read it and we did.  
 22 MR BREALEY: And whether you need me to go through it. You  
 23 can indicate it.  
 24 MR JUSTICE BARLING: We have read it carefully, so I don't  
 25 think you need to spend too much time.

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1 MR BREALEY: I will just kind of go through it and then we  
 2 don't have to clear the court. I can quickly deal with  
 3 ex turpi causa because that's essentially in the thing,  
 4 and if Mr Smith or whoever wants to question --  
 5 MR JUSTICE BARLING: And Mr Spitz has got to --  
 6 MR BREALEY: I have got that impression, sir, and then  
 7 Mr Spitz can take over and deal with interest and  
 8 benefits, and then we hopefully can finish today and let  
 9 Mr Hoskins take over tomorrow.  
 10 MR JUSTICE BARLING: I am conscious that we have been taking  
 11 up some time with questions.  
 12 MR BREALEY: It is important.  
 13 MR JUSTICE BARLING: Let's see where we get to.  
 14 If we had a few minutes before we come back, which  
 15 bit -- you would like us to read, presumably, the  
 16 paragraph to refresh our memories on 264, that bit,  
 17 would you, and the adjusted MIF?  
 18 MR BREALEY: Yes.  
 19 MR JUSTICE BARLING: That's where you are going to next?  
 20 MR BREALEY: I'm going to go to the adjusted MIF and I'm  
 21 going to go to --  
 22 MR JUSTICE BARLING: With cross benefit.  
 23 MR BREALEY: -- a couple of documents on merchants, and the  
 24 main thing on that is Dr Niels' exclusion of category 8.  
 25 MR JUSTICE BARLING: Yes.

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1 MR BREALEY: Which we say is a bit odd.  
 2 MR JUSTICE BARLING: Yes, right. We will say 1.45 pm.  
 3 (12.45 pm)  
 4 (The short adjournment)  
 5 (1.45 pm)  
 6 MR BREALEY: Sir, I just wanted to finish exemption with the  
 7 adjusted MIT approach.  
 8 MR JUSTICE BARLING: Yes.  
 9 MR BREALEY: That is the one that uses Amex as the  
 10 comparator.  
 11 As the Tribunal will remember, there are three  
 12 adjustments. One is to scenario 3. This is at  
 13 page 110.  
 14 MR JUSTICE BARLING: Yes.  
 15 MR BREALEY: One is the change to scenario 3, one is  
 16 excluding large merchants and one is essentially taking  
 17 Amex as the comparator to cash.  
 18 I would like to just focus in the 15 minutes on the  
 19 second one of those, because it is all in here, which is  
 20 excluding the largest merchants.  
 21 MR JUSTICE BARLING: Yes.  
 22 MR BREALEY: We can pick this up at paragraph 307. There  
 23 are probably three documents that I would like to go to.  
 24 But if we just remind ourselves, if the Tribunal can go  
 25 to E3.10 to remind ourselves of what we are talking

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1 about when Dr Niels is getting rid of category 8. So  
 2 that is E3.10, tab 202, which is the Commission's survey  
 3 cash and card payments. It is at page 4335, internal  
 4 page 44. It is at the top of the page and we see there  
 5 you have got eight categories of merchant.  
 6 We don't have information on class 1 to 5. We do  
 7 have information on 6, 7, 8. And what Dr Niels does is  
 8 he excludes class 8. He takes it out.  
 9 So that is the thing that he does. I just want to  
 10 tease through some of the justification for that. It  
 11 might be interesting just to have that open while we  
 12 look at it, but at paragraph 307 of our closing, this is  
 13 the re-weighting to exclude the largest versions:  
 14 "As Dr Niels accepted the effect of his proposed  
 15 re-weighting of the sample is essentially to exclude all  
 16 category 8 merchants, ie those with turnover of in  
 17 excess of 200 million."  
 18 So the effect of that is that 19 of the 27 UK  
 19 participants in the survey are thrown out and the  
 20 remaining participants are drawn from the category of  
 21 merchant that accounted in 2013 for only 9% of the UK's  
 22 retail turnover:  
 23 "I think my adjustment is quite clear, yes, it  
 24 throws out the very largest merchants. I'm clear on  
 25 that."

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1 Then we get the interchange between Professor Beath  
 2 and Dr Niels at 308 where the Professor says:  
 3 "I would just like to ask you for clarification."  
 4 And you will see there the last "A" for "answer".  
 5 In answer to the question.  
 6 "Question: You chopped off the top end of the  
 7 distribution?  
 8 "Answer: Yes, because what we are missing is the  
 9 other very large tail. I thought therefore the middle  
 10 bit, indeed the truncated middle bit, so merchants of  
 11 categories 6 and 7. I have taken those to be more  
 12 likely to be representative of the overall average."  
 13 Remember he is not taking the average transaction,  
 14 he is taking the average merchant, which we say is  
 15 wrong.  
 16 We know we don't have any information on 1 and 5, he  
 17 has taken out 8 and concentrated on what he has called  
 18 the middle bit. I will come to the justification for  
 19 that in a moment so far as the MIT-MIF approach is  
 20 concerned. But I would just like to highlight two  
 21 previous merchant studies that MasterCard have put  
 22 before the regulators, where they have emphasised the  
 23 importance of large merchants.  
 24 Now, I know all surveys are different, but when it  
 25 comes to MasterCard doing the surveys, they have

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1 emphasised large merchants. Why? Because they  
 2 represent a significant proportion of sales.  
 3 I want to go to one document that I'm not sure we  
 4 have seen before, then quickly to another document, the  
 5 2008 study that we have, and then I will go on to the  
 6 reasons why we say that he is wrong on the MIT-MIF.  
 7 I just want to draw the Tribunal's attention to  
 8 MasterCard's kind of previous stance on large merchants.  
 9 The first merchant survey is at E2, tab 3. We have seen  
 10 this to a certain extent before, I think. This is  
 11 an annex to the economic evidence in support of  
 12 MasterCard's response to the statement of objections.  
 13 In my version it is not blue. I am sure people can  
 14 tell me. All I want to do, if I can go to page 115,  
 15 here is a survey that MasterCard adduced, and  
 16 essentially this survey was to look at distribution  
 17 channels in particular. But if one looks at page 115 we  
 18 see -- paragraph 93, 94 and then, can I ask the  
 19 Tribunal -- I know this is going rather quickly -- but  
 20 at paragraphs 100 and 101 we see:  
 21 "In order to provide data from organisations of  
 22 different size, the quotas are not pro rata'd to the  
 23 universal merchant..."  
 24 Then you have small, medium and large.  
 25 Then what I want:

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1 "The sampling was designed to over sample merchants  
 2 with high turnover."  
 3 They go on:  
 4 "If a purely random sample had been selected without  
 5 quotas."  
 6 They basically say:  
 7 "Whilst such organisations account for a large  
 8 proportion of all UK sales, they represent a small  
 9 fraction of individual businesses."  
 10 Then over the page.  
 11 So what they are doing is that:  
 12 "Within each of the three turnover categories,  
 13 companies were contacted randomly with the exception  
 14 that for large companies a small number of key  
 15 companies, eg the large supermarket chains, were added  
 16 to the sample."  
 17 So this is a survey where if they just took it  
 18 randomly, they may miss out large ones. And they were  
 19 actually positively putting forward the big ones:  
 20 "Such companies account for many billions of sales,  
 21 and it was therefore considered important that each had  
 22 the opportunity to participate in the study."  
 23 If one goes to 125, now again these are all  
 24 different surveys, but I want to -- and there are small  
 25 ones included -- but when we get to 125, paragraph 111,

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1 112:  
 2 "As noted above, the sampling method was designed to  
 3 ensure that larger merchants who account for a great  
 4 proportion of all transactions are well represented in  
 5 the survey. This inevitably leads to some over and under  
 6 sampling but also in terms of representation of  
 7 different sectors."  
 8 But what I want to emphasise is that it is always  
 9 difficult to do these surveys and you want, as best as  
 10 you can. But this is an example of MasterCard itself  
 11 saying how important it is to have large merchants in  
 12 the survey.  
 13 So that was one example just on the evidence in this  
 14 case. And the other example that we have seen is at  
 15 E3.6, which is the very -- I cross-examined Dr Niels on  
 16 this, but in closing it is important to remind ourselves  
 17 of it.  
 18 E3.6, tab 126, which is the very survey that  
 19 Dr Niels relies on. This is the Edgar Dunn 2008 cost  
 20 study. If we go to page 2501, the sampling methodology,  
 21 we have been through this before, but the overall  
 22 objective of the sample selection was to achieve  
 23 a representative sample of issuers.  
 24 Then the second paragraph:  
 25 "The proposed approach: focused on the largest

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1 issuers."  
 2 When we got to -- and at the bottom --  
 3 a representative sample, it would be achieved if the  
 4 participating banks would account for at least 70% of  
 5 the transaction volumes.  
 6 We are looking at volume there, and then what was  
 7 confidential was the identity of the banks. But I asked  
 8 Mr Sidenius in cross-examination, and I said:  
 9 "So picking the largest you thought was  
 10 representative?  
 11 "Answer: Yes."  
 12 That is Day 11, page 28, line 8.  
 13 So I just mention that here because MasterCard  
 14 itself, when it is basing its data on issuing banks, is  
 15 picking the largest banks because they think it is  
 16 representative.  
 17 They are not saying "We have got to include all the  
 18 smaller ones and have an average issuer", they are  
 19 trying to take those issuers who essentially account for  
 20 the majority of the transactions.  
 21 So Dr Niels himself in relying on this study, the  
 22 2008 study, is acknowledging that Edgar Dunn picked the  
 23 largest issuers. Why? Because they account for  
 24 a significant proportion of the turnover.  
 25 Just as a matter of impression, you think to

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1 yourself why on earth is Dr Niels doing what he is  
 2 doing, which is chopping off this category 8? So I have  
 3 done 308, which is the exchange between Dr Niels and  
 4 Professor Beath. We say there are at least four  
 5 difficulties with this reasoning. That is to say taking  
 6 that class 8 out completely.  
 7 The first is if we just take class 6 and 7, there is  
 8 a -- and Dr Niels is somehow looking for the average  
 9 merchant here. We say it is the wrong test, but the  
 10 average merchant. There is no guarantee that category 6  
 11 of merchants are actually more representative than if  
 12 you just include 8.  
 13 Just as if you -- he has taken the middle bit, it is  
 14 not very scientific to say "I have taken the middle  
 15 bit", and actually he hasn't taken the middle bit,  
 16 because if you are just taking a set of numbers and it  
 17 is an even set of numbers, the median is the mean of the  
 18 middle two, which should be four and five, and he has no  
 19 data on that.  
 20 So he has not actually, if he has taken the median,  
 21 taken the middle two. So why 6 and 7? Also if one is  
 22 looking at E3.10, if one goes to page 4394, if you put  
 23 this away -- I apologise. We are back to the cost of  
 24 study, tab 202. So we were at 4335. So we have got  
 25 those classes there.

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1 Just to re-cap, if you take class 8 out, you are  
 2 excluding 19 out of 27 participants in the UK survey. 6  
 3 and 7 only account for 9% of UK turnover. Category 8  
 4 accounts for about 70% of UK turnover.  
 5 But if Dr Niels is trying to take the average  
 6 merchant, he is not doing a very good job. Because if  
 7 one goes to 4394, where one sees the number -- the size  
 8 by category -- the number at 4394, you see that just  
 9 picking 6 and 7 is no way representative of the average  
 10 merchant, because you have over 3 million. This is the  
 11 table, table 53 on 4394. You have got 4 million in  
 12 category 1 merchants, so it is hard to see, if you are  
 13 just looking to work out what the average merchant is,  
 14 taking 6 and 7 gets you any further than 6, 7 and 8.  
 15 But what 8 is doing is totally and utterly  
 16 destroying the sample as far as the UK is concerned.  
 17 So that is our first reason at paragraph 3.10. If  
 18 he is looking at an average merchant, we are not quite  
 19 sure where that takes him. Keeping within E3.10, but  
 20 going to page 4324, again something I examined with  
 21 Dr Niels in cross-examination, but this is our second  
 22 point at paragraph 3.11. So paragraph 3.11 of our  
 23 closing says:  
 24 "Second, as the Commission observed, it is not  
 25 necessarily the case that focusing on larger merchants

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1 has biased the MIT-MIF downwards as economies of scale  
 2 may apply to both cash and cards. The point that  
 3 Dr Niels accepted at least in theory was valid."  
 4 The Tribunal remember paragraph 122 of this study.  
 5 The Commission actually undertook a consultation on the  
 6 methodology.  
 7 And says:  
 8 "An argument often made with respect to merchants'  
 9 cost of payment is that they exhibit economies of scale,  
 10 and as larger merchants may have considerably lower  
 11 costs of payments than smaller merchants, several  
 12 stakeholders pointed out that surveying ... (Reading to  
 13 the words)... it should be noted that this potential  
 14 bias would not necessarily result in lower MIT-MIFs  
 15 since such economies of scale might concern both cash  
 16 and cards."  
 17 It is just too simplistic to say, well, smaller  
 18 merchants will skew the figure. The Commission has  
 19 actually looked at this and actually went out on  
 20 consultation and said it is not that clear cut.  
 21 So that is our second point. I think we can put  
 22 that away now.  
 23 Again, the third point that's in the closing, and  
 24 I won't go over it, but the third point concerns the  
 25 issue -- and we do see this from the document we just

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1 put away -- there is a dispute between the experts as to  
 2 whether it is the average merchant or the average  
 3 transaction, and that's our third point.  
 4 The fourth point at 315 comes back to our fair share  
 5 point. So this is where, if the Tribunal remembers,  
 6 Mr von Hinten-Reed has tried to sense check the absence  
 7 of the smaller merchants. This is the table that  
 8 reflects the homework that he was given by increasing  
 9 the smaller merchants' costs, as it were. And clearly  
 10 the higher you go, the higher the MIF, but you can see  
 11 from 318 of the closing:  
 12 "As can be seen from above, if one assumes larger  
 13 differences between small merchants and larger  
 14 merchants' costs, then one can generate higher numbers.  
 15 This is unsurprising ..."  
 16 Which it is, but this is an important point:  
 17 "... but that does not mean that making such  
 18 assumptions and imposing on all merchants a higher  
 19 MIT-MIF is consistent with the requirements of  
 20 article 101(3)(b). The data in relation to categories 6  
 21 to 8 indicates that the upper bound on the level, even  
 22 on Dr Niels' scenario, is 0.23. To impose on such  
 23 merchants a higher level of MIT is to make them pay to  
 24 issuers sums that are well in excess of the transaction  
 25 efficiencies and therefore contrary to the fair share

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1 condition."  
 2 So the smaller merchants might benefit, but if you  
 3 are going to make the larger merchants pay a lot more,  
 4 even though they account for 70% of the volume of  
 5 transactions in the UK, we say that you have got  
 6 a problem with the fair share aspect.  
 7 But you will note that even if, when  
 8 Mr von Hinten-Reed has increased the costs of the  
 9 smaller merchants, this is paragraph 318, you get up to  
 10 around the current level under the interchange fees'  
 11 regulations.  
 12 One assumes larger differences between small  
 13 merchants and larger merchants' costs up to around the  
 14 covenant level under the interchange of 0.3.  
 15 So essentially you can do anything with statistics,  
 16 but there is a limit, we say, to which you can go. And  
 17 remembering the burden is not on us, the burden is on  
 18 MasterCard to prove exemption. All that Dr Niels has  
 19 done is "taken the middle bit", which doesn't seem to be  
 20 particularly robust.  
 21 That is all I was going to say on that. Again, it  
 22 is all set out in our closing.  
 23 Pass-on, unless you have questions for me, we were  
 24 going to leave.  
 25 Can I essentially just make two very general points

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1 on pass-on. One is when one reads MasterCard's skeleton  
 2 on pass-on, it emphasises time and time again the  
 3 importance of price. I think it is the very first thing  
 4 they mention, the importance of price, and how being  
 5 price competitive is important, lower prices are  
 6 important. That's what they major on.  
 7 These supermarkets must be price competitive and  
 8 have low prices. That is for the period of the claim,  
 9 2007, and there has been a period of price competition,  
 10 competition quality and service etc, but they emphasise  
 11 price.  
 12 So one asks the question, actually, what is the  
 13 relevance of all this? Because you are supposed to be  
 14 working out whether Sainsbury's have charged higher  
 15 prices to their customers as a result of the overcharge.  
 16 So there is a slight tension in the argument that they  
 17 are putting forward, which is whilst at the same time  
 18 the focus has been on price, price, price, when it comes  
 19 to the overcharge they are almost denying that, and they  
 20 are saying, well, actually prices were higher.  
 21 This was a time when there have been significant  
 22 cost cutting exercises. You know that Sainsbury's is  
 23 a complex machine of many billions of pounds, thousands  
 24 of moving parts, all interacting with one another, both  
 25 internally and externally. And so the notion that you

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1 have got this very important aspect of price, but you  
 2 are going to just increase your prices because of this  
 3 overcharge, and it not being absorbed into costs as part  
 4 of this complex machine, we say, is not -- it has  
 5 a degree of illogicality about it.  
 6 At the same time you are emphasising it's got to be  
 7 price, price, price. But at the same time you are  
 8 saying your prices are higher than it otherwise would  
 9 have been.  
 10 We say that the small -- it is relatively --  
 11 Sainsbury's have billions and billions of costs and this  
 12 gets lost in the noise. I do just, while we are on  
 13 pass-on, need to go on to ex turpi causa in a minute, if  
 14 I go to the section on pass-on and just explain where we  
 15 have come on from our perspective.  
 16 So the pass-on section, E, is pretty similar at the  
 17 beginning. That relates to the law. The one document  
 18 I won't go to, but I do ask the Tribunal to go back and  
 19 have a look at is the document referred to at  
 20 footnote 455, which is referred to at paragraph 427  
 21 and 428.  
 22 MR JUSTICE BARLING: E3.6, yes.  
 23 MR BREALEY: The last thing I would mention and then I will  
 24 go on to ex turpi causa because of the time, as you will  
 25 have seen from our closing we start off by trying to

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1 test the proposition, were prices higher than they would  
 2 otherwise have been?  
 3 We go then to paragraph 440 to look at whether lower  
 4 interchange fees inevitably mean lower prices.  
 5 Dr Niels says:  
 6 "Conceptually it can also be instructed to consider  
 7 what would happen if it decreased."  
 8 So as we have seen, rather than work out whether  
 9 the prices were higher than they would otherwise have  
 10 been, they have tried to have an assumption upon  
 11 an assumption, which is that had they been lower, would  
 12 they have translated into lower prices. If they  
 13 wouldn't, they would have been higher.  
 14 And conceptually that does not necessarily work. So  
 15 it doesn't necessarily mean that simply because you are  
 16 given a bonus, or your cost has gone down, you would  
 17 have increased prices in the mirror image. Because you  
 18 may not have wanted to raise price. You may have  
 19 absorbed it in your cost base.  
 20 So it is not a perfect conceptual mirror image  
 21 simply to say, well, what would have happened if it had  
 22 lower interchange fees? You may have had promotions,  
 23 you might have had lower prices, but that doesn't  
 24 necessarily tell you what would have happened had  
 25 interchange fees gone up, as we have seen from that

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1 document that I have just referred to, which is about  
 2 the only real-life piece of evidence before the Tribunal  
 3 as to Sainsbury's reaction when interchange fees went  
 4 up.  
 5 We saw what happened. It certainly did not get  
 6 translated into (inaudible).  
 7 MR SMITH: Mr Brealey, you will remember the exchange in  
 8 cross-examination that you had with Dr Niels where one  
 9 saw perhaps quite clearly the difference between what  
 10 an economist would label as pass-on and what a lawyer  
 11 would label as pass-on.  
 12 MR BREALEY: Yes.  
 13 MR SMITH: Would I be right in saying that the test to  
 14 pass-on you would propound is at 378 of your closing  
 15 page 131, which focuses on the higher prices charged to  
 16 a third party further down the stream, rather than, as  
 17 Dr Niels was considering from an economic point of view,  
 18 the possibility that pass-on might occur for instance by  
 19 reducing costs?  
 20 So your sweet shop example was suppose there was  
 21 a wholesale increase in the price of sweets, which is  
 22 an overcharge which is legitimate, maybe one could pass  
 23 it on to the purchasers of the sweets, in which case  
 24 that would be what you would say is pass-on.  
 25 MR BREALEY: Yes.

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1 MR SMITH: But if you transfer that cost to, say, the  
 2 workforce in the sweet shop, and require them to receive  
 3 less by way of their hourly earnings, that would not be  
 4 pass-on?  
 5 MR BREALEY: Absolutely. I know you have gone through this,  
 6 but if I could take you to paragraph 391 where I tried  
 7 to deal with this.  
 8 At 391 we are looking at the Court of Appeal in  
 9 Devenish. You are absolutely right, we have just looked  
 10 at the concept of unjust enrichment in EU law and then  
 11 we get to paragraph 391 and how the Court of Appeal have  
 12 looked at it:  
 13 "If the claimant has in fact passed excessive price  
 14 onto its purchasers and not absorbed the excessive price  
 15 itself, there is no obvious reason why the profit made  
 16 by the defendants should be transferred to the claimant  
 17 without the claimant being obliged to transfer it down  
 18 the line to those who had actually suffered the loss.  
 19 Neither the law of ...(Reading to the words)... monetary  
 20 gain ..."  
 21 I emphasise "monetary gain":  
 22 "... from one ... recipient to another."  
 23 I think to a certain extent what we had in mind in  
 24 the cross-examination between me and Dr Niels is  
 25 reflected in that passage there. And he accepted that

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1 in that sweet shop example basically there is no  
 2 transfer of monetary gain, and we would say that is the  
 3 end of pass-on because it is all about unjust enrichment  
 4 and what you have ...  
 5 MR JUSTICE BARLING: I think Dr Niels accepted at some point  
 6 that, from an economist point of view, unless it hit the  
 7 bottom line, it was passed on in economic terms.  
 8 MR BREALEY: In economic terms. I give due deference to the  
 9 economists, but we have to apply the law at the end of  
 10 the day.  
 11 The law says: Transfer monetary gain, unjust  
 12 enrichment, have you really suffered any loss because as  
 13 a direct result of the overcharge, you charge somebody  
 14 else.  
 15 MR JUSTICE BARLING: If you are representing the acquiring  
 16 bank seeking to recover the alleged overcharge you might  
 17 be in a worse position.  
 18 MR BREALEY: But it is basically accepted, it is part of  
 19 MasterCard's case actually, that it is passed on to the  
 20 merchant.  
 21 MR JUSTICE BARLING: Yes, exactly.  
 22 MR BREALEY: It is directly passed on.  
 23 MR SMITH: Just to explore for a moment why the law might  
 24 take a different route to the economist, would that  
 25 perhaps be because if you have got a monetary pass-on

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1 from the first in line, from the person who initially  
2 pays the overcharge to someone further down the line and  
3 it was, as it were, a very clean transfer of the  
4 disbenefit, if I can call it that. Whereas if, to go  
5 back to your sweet shop example, the sweet shop says "We  
6 have got to save the money somehow" and so it hammers  
7 down the marginal rate it pays its employees, that is on  
8 one level a disbenefit to the employees, but it may be  
9 that the enterprise itself reaps a disbenefit because it  
10 has got a more disgruntled workforce, so it is not quite  
11 so clear cut.

12 MR BREALEY: I think that is absolutely right. I will add  
13 two extra things as to why it is not pass-on, maybe it  
14 is linked to this, but unless you can show the transfer  
15 of money up the chain, the system of compensatory -- you  
16 are trying to ask whether you have suffered any loss,  
17 and let's assume that the overcharge is 100 and you pass  
18 that on to your indirect purchasers. Then you can see  
19 that you have not suffered any financial loss. So that  
20 is the first point. That's why they talk about transfer  
21 of monetary gain.

22 The third point I believe is nigh on important is  
23 that -- again, Courage v Crehan was about the right to  
24 damages based on policy considerations of private  
25 enforcement of competition law. And if you are going to

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1 deny someone like a sweet shop, who has not charged the  
2 children, the customers, any more at all, if you are  
3 going to deny that sweet shop a claim of 100, then the  
4 cartelist at the end of the day gets a windfall.

5 That is something that absolutely no doubt that the  
6 European Court would say just can't happen.

7 MR SMITH: So even if it is at a theoretic level you have to  
8 be able to identify a clear class of person further down  
9 the line to whom the overcharge has been passed on?

10 MR BREALEY: And if you can prove direct pass-on then you  
11 can see that clear category of indirect purchaser. If  
12 I go to ex turpi causa and again just essentially flag  
13 what we are trying to do in the ex turpi causa.

14 There is just a point on attribution and economic  
15 unit that I would like to just -- I think I dealt with  
16 it before, but I -- so just taking the Tribunal -- what  
17 we have tried to do and we set out the evidence.

18 If I can start at page 247. So there are at least  
19 two main issues, and within these two issues there are  
20 sub-issues. The first issue is the single economic  
21 entity and the second is what is meant by the turpitude.

22 So at 762 we deal with the law on single economic  
23 entity. When we get to the MasterCard skeleton on  
24 single economic unit, I would ask the Tribunal just to  
25 note two things. The first is they refer to Provimi,

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1 and of course things have slightly moved on with  
2 Promivi. You have the Toshiba carrier saying that,  
3 look, sister companies, you can't presume they are an  
4 economic unit.

5 I note they mention Mr Justice Aikens in Provimi.  
6 I'm not sure why they don't just put that in context.  
7 But the other thing that's important is that we take  
8 a slightly different view to MasterCard on economic  
9 unit. So we emphasise the need to prove decisive  
10 influence. So you have got two half sisters at the  
11 beginning, they then become sisters. You have two half  
12 sisters. We say for there to be an economic units, the  
13 case law would suggest you have got to have some sort of  
14 decisive influence, and therefore you can show that you  
15 are part of the economic unit.

16 Now, why does that matter? MasterCard tends to  
17 downplay the decisive influence and they say, well, you  
18 can look at it more generally. If you have got some  
19 sort of common interest, if you -- you can infer  
20 an economic unit far more simply.

21 Now why does that kind of difference between the  
22 parties matter? It matters potentially for the  
23 application of English law, and it matters for two  
24 reasons. First is as a question of attribution, whether  
25 you are going to impute the acts or the knowledge from

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1 one to the other, because if you are going to too  
2 readily find this economic unit in the absence of any  
3 decisive influence, the English law of attribution may  
4 actually start playing more of a the role, whereas it  
5 has a lesser role to play if you have essentially  
6 decided that by reference to decisive influence.

7 Secondly, again we have put this in the closing,  
8 that at least it would appear from the English law that  
9 on the question of turpitude, it has to be related to  
10 the claim. And again, if you are going to -- so in  
11 Hydrotherm v Andreoli, the economic unit, you are  
12 looking at the joint enterprise for the purposes of the  
13 agreement.

14 Again, you can more readily see that it is related  
15 to the claim. But if you are going to infer an economic  
16 unit outside relating to the claim, so it is not so much  
17 concerned about issuing cards but ATMs in your store and  
18 you are inferring an economic unit on that basis, then  
19 again the English law may more readily insist on the  
20 conduct being related to the claim.

21 I flag that because these two aspects of English  
22 law, attribution and relation to the claim, may not  
23 matter so much if the Tribunal is with us. And there is  
24 this decisive influence, although it still may play  
25 a part, but in my submission it will play a greater part

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1 if MasterCard are correct. And you can too readily  
 2 infer from the facts the economic ...  
 3 So we do the law on economic unit. We have the  
 4 application to the facts at 777. We emphasise at 777  
 5 onwards the evidence relating to the independence of the  
 6 bank. Then at 783 -- so the first bit is whether  
 7 Sainsbury's and Bank of Scotland -- Sainsbury's Bank is  
 8 a single economic unit. Then we ask whether Sainsbury's  
 9 and Sainsbury's Bank are a single economic unit. And we  
 10 say not.  
 11 Then at page 261 we deal with ex turpi causa.  
 12 Again, this is where we have the English law. At  
 13 paragraph 813, we mention here the points of domestic  
 14 law that I have just been referring to:  
 15 "What acts constitute turpitude? On what principal  
 16 should it be attributed? What is the relationship of  
 17 the turpitude to the claim?"  
 18 As I say, where you have EU Commission law, those  
 19 principles may take more of a back role if you have got  
 20 the economic unit being inferred to readily. Other than  
 21 that, I think it is all pretty straightforward. Unless  
 22 you have some questions for me.  
 23 MR SMITH: Just two. One is where we approach the  
 24 definition of an undertaking. And looking at the law,  
 25 the starting point, as you say, is look at the specific

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1 activity under scrutiny and let's take an example of  
 2 sister companies in a group who are both overcharging  
 3 for widgets in a collusive way, and one does it in one  
 4 geographic market and another does it in another  
 5 geographic market.  
 6 With those facts there is no problem of undertaking,  
 7 both are overcharging for widgets?  
 8 MR BREALEY: Unless they were doing it completely  
 9 independently. If they were doing it collusively,  
 10 absolutely, yes.  
 11 MR SMITH: I'm assuming a degree of collusion and the  
 12 difference is simply geography. You don't get into  
 13 decisive influence. They are both involved in the same  
 14 economic activity and are the same undertaking.  
 15 MR BREALEY: Well, I don't want to completely disagree, but  
 16 it may well be that they are not part of the same  
 17 undertaking because neither has decisive influence over  
 18 the other. They are just separate undertakings, but  
 19 they are acting in concert with each other, and  
 20 therefore article 81(1) would apply because they are  
 21 actually operating independently --  
 22 MR JUSTICE BARLING: There is a case, isn't there, where  
 23 a wholly owned subsidiary of a parent was doing  
 24 something naughty in one market and the parent  
 25 company -- I may have got the facts slightly wrong --

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1 was said not to be involved. Which one am I thinking  
 2 of? It is one of the fairly well known.  
 3 MR SMITH: It is Akza Nobel.  
 4 Your point about decisive influence was actually my  
 5 next point, because it seemed to me that decisive  
 6 influence occurred in those cases where you have  
 7 established that there is an entity, to use a neutral  
 8 word, that has been involved in anti-competitive  
 9 behaviour and the whole undertaking, therefore, to be  
 10 fined.  
 11 That entity has got a parent, and the Commission, to  
 12 take Akza Nobel, the Commission seeks to fine the  
 13 parent. And the parent says "Hang on a minute, I have  
 14 done nothing here, I wasn't involved in this cartel, it  
 15 was all this naughty subsidiary, it wasn't me".  
 16 What the Commission says is "We need to establish  
 17 whether you are by virtue of your decisive influence  
 18 a part of the undertaking".  
 19 What we see is a series of presumptions emerging,  
 20 namely that if there is a 100% holding by the parent of  
 21 the subsidiary, there is a presumption that the parent  
 22 directs the activities of the subsidiary. Whereas if  
 23 you have sister company, then the presumption of  
 24 decisive influence doesn't pertain. You have to  
 25 establish it. And only if you establish decisive

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1 influence can you say that the two form part of a single  
 2 undertaking.  
 3 But as I understood it, that was where the only link  
 4 was the decisive influence, not where, as in my first  
 5 example, the two entities are both involved in the  
 6 economic activity which is the subject of the  
 7 anti-competitive conduct.  
 8 MR BREALEY: I apologise, I slightly disagree with that.  
 9 And the reason I disagree with that is, let's assume --  
 10 and I will answer that question in a moment -- that  
 11 a parent who owns 100% of the subsidiary -- and this is  
 12 essentially Hydrotherm and Andreoli actually -- the  
 13 parent and the subsidiary agree with each other that  
 14 they will charge a certain price on the market.  
 15 Now, if the parent owns the subsidiary, there is no  
 16 agreement for the purposes of article 101(1).  
 17 Similarly, if you have two sister companies that are  
 18 part of the same economic unit, there will be no  
 19 agreement there either. If they are part of the same  
 20 economic unit. That's why I said, if they are acting in  
 21 collusion and they are independent because there's no  
 22 decisive influence -- so let's assume you have two  
 23 sister companies and in one -- I forget which one of the  
 24 case now -- but one --  
 25 MR SMITH: But you are presuming a cartel of two, of course?

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1 MR BREALEY: Yes, you have to have a cartel of two.  
 2 MR SMITH: I know, but there doesn't have to be a cartel  
 3 simply comprising sister companies. The issue --  
 4 MR BREALEY: No, of course not.  
 5 MR SMITH: -- in the case law is one of fining. And what  
 6 you get is, you get the Commission seeking to identify  
 7 which legal entities it can fine, it can impose  
 8 a penalty on. And that, on my reading of these European  
 9 cases, is what gives rise to this decisive influence  
 10 test, namely you have got an entity which the Commission  
 11 wishes to fine; that entity has had nothing to do with  
 12 the infringement apart from its relationship in terms of  
 13 shareholding with the actually infringing company.  
 14 The Commission says "How do I test whether this parent  
 15 company can be brought into the concept of undertaking  
 16 so as to render it liable to penalty?"  
 17 Now, at that point, you get the decisive influence  
 18 test.  
 19 MR BREALEY: Correct, in order to determine whether it is  
 20 an economic unit.  
 21 MR SMITH: In order to determine whether it is the same  
 22 economic unit --  
 23 MR BREALEY: Yes.  
 24 MR SMITH: -- as the child company that actually did the  
 25 anti-competitive thing.

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1 MR BREALEY: Correct.  
 2 MR SMITH: I may be dramatically oversimplifying, but my  
 3 understanding of the case law is that if it is 100%  
 4 ownership, decisive influence is presumed; if it is not,  
 5 it needs to be proved.  
 6 MR BREALEY: As in -- yes.  
 7 MR SMITH: And if it is sister companies, again it may be  
 8 there but it has to be proved.  
 9 MR BREALEY: Correct, yes. I'm sorry.  
 10 MR SMITH: I think we are in agreement.  
 11 MR JUSTICE BARLING: Sorry, because I'm a bit confused now  
 12 because I thought what you were putting to Mr Brealey --  
 13 sorry, I shouldn't be questioning.  
 14 If there are two sister companies engaged in  
 15 a cartel, you still have to show that if they are part  
 16 of the same economic unit, which they may be because,  
 17 for example, they might be controlled by the same  
 18 parent. But I suppose, if two sister companies are  
 19 wholly owned by a single parent, both sister companies  
 20 operate in a cartel, the parent and the two sister  
 21 companies, because of the decisive influence of the  
 22 parent it might well be that all three are a single  
 23 economic unit within that cartel, mightn't they?  
 24 MR BREALEY: If you have two sister companies, simply  
 25 because you have a common parent doesn't get you home.

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1 So you have to prove that the two sister companies --  
 2 let's take it in stages. So you have a Japanese sister  
 3 and an American sister and they have a cartel with  
 4 a separate British company. There is a cartel because  
 5 either the British company has agreed with one person or  
 6 two people. And it may make a difference to any fine,  
 7 to the Japanese sister --  
 8 MR JUSTICE BARLING: That's because you have one company  
 9 outside the group.  
 10 MR BREALEY: If the two sisters, the Japanese sister and the  
 11 American sister, are regarded as one economic  
 12 undertaking because one actually has decisive influence  
 13 over the other, you can treat it as an economic unit --  
 14 MR JUSTICE BARLING: You can fine the one with the deep  
 15 pocket.  
 16 MR BREALEY: Absolutely. But let's assume that they are on  
 17 the facts completely autonomous. They don't even know  
 18 what the other one is doing. Although they are sisters  
 19 or half sisters they will be treated as separate legal  
 20 entities, which is what they are. And then they would  
 21 be fined on their own basis.  
 22 MR JUSTICE BARLING: Even if they are in the same cartel.  
 23 MR BREALEY: Even if they are in the same cartel.  
 24 MR JUSTICE BARLING: That was my understanding.  
 25 MR BREALEY: Because if they are completely separate and

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1 don't have any common directors, do their own thing, why  
 2 do you lump the Japanese sister in with the American  
 3 sister? You cannot.  
 4 Unless there is some proof of --  
 5 MR JUSTICE BARLING: It is unlikely scenario --  
 6 MR BREALEY: It is.  
 7 MR JUSTICE BARLING: -- because if they are in the same  
 8 cartel and they are sisters, probably there is some  
 9 controlling --  
 10 MR BREALEY: Probably. But on the assumption that it is  
 11 not. But what we do know is the fact that they are  
 12 owned by a common parent, who may actually just leave  
 13 its two children to get on with what they want to do and  
 14 has no interference with what they have -- they have  
 15 a head office in Geneva, based with two people, or  
 16 whatever. You are left with two legal entities and they  
 17 are not one economic unit.  
 18 MR JUSTICE BARLING: Your submission is being in the same,  
 19 how can I put it, business selling widgets, the fact  
 20 they both sell widgets and they are sister companies  
 21 doesn't add up to single economic unit of itself?  
 22 MR BREALEY: No, of itself. I mean, they are both --  
 23 obviously if they are independent, they are both guilty  
 24 of an infringement and are both liable to pay damages on  
 25 a joint and several liability and they are both liable

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1 to be fined. But you wouldn't -- as you say, if the  
 2 Japanese is really small and the American is huge, you  
 3 would not be fining the small Japanese sister by  
 4 reference to the turnover of the American.  
 5 I'm just theorising without knowing many of the  
 6 facts.  
 7 MR SMITH: Are you saying that in order for there to be  
 8 a single undertaking, you do need an element of common  
 9 personnel or control, some sort of bleed through in  
 10 terms of how the companies interact at the directing  
 11 mind level?  
 12 MR BREALEY: That is essentially what we get from the two  
 13 cases that I referred to in opening, which are referred  
 14 to basically from 765, 766, 767.  
 15 767:  
 16 "As regards sister companies, although the  
 17 ...(Reading to the words)... may apply, there is no such  
 18 presumption of decisive influence between sister  
 19 companies."  
 20 MR SMITH: Yes, I think --  
 21 MR BREALEY: But you have to prove it by common directors,  
 22 shareholding, the way you manage the business.  
 23 MR SMITH: Let's suppose a cartel with three entities  
 24 involved --  
 25 MR BREALEY: Legal entities.

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1 MR SMITH: Legal entities. Let's focus on the legal level  
 2 first, A, B and C. And A is entirely separate from B  
 3 and C apart from the fact that it has agreed to raise  
 4 the price of widgets with B and C.  
 5 B and C are sister companies, each involved in  
 6 selling widgets at an overpriced level, but in different  
 7 geographic areas. They are co-operating in terms of  
 8 partitioning the market geographically, so one focuses  
 9 on France, one focuses on Germany. But they are  
 10 separate in terms of their --  
 11 MR BREALEY: Decision-making.  
 12 MR SMITH: -- decision-making powers.  
 13 Now, would you say that they were one undertaking or  
 14 two in those circumstances?  
 15 MR BREALEY: Two.  
 16 MR SMITH: Even though you can say that they are, in terms  
 17 of economic unit, looking rather like one?  
 18 MR BREALEY: Then you are very close to making the  
 19 presumption just because they look like it, they are  
 20 part of the same corporate group. You are making  
 21 essentially a presumption that they are one economic  
 22 unit and there is some sort of joint control of one over  
 23 the other.  
 24 MR SMITH: What I was thinking the case law went to. Let's  
 25 presuppose a common parent of B and C, Z. And Z is

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1 utterly uninvolved in all this but simply owns 100% of  
 2 the two sister companies and the Commission wants to  
 3 fine Z.  
 4 Now, there I entirely understand that the test is  
 5 one of decisive influence because Z isn't involved at  
 6 all in the cartellists' behaviour, can only be said to be  
 7 part of the economic unit by virtue of its ownership of  
 8 the subsidiaries. At that point clearly you need  
 9 a decisive influence test. Whether you get the benefit  
 10 of presumption or not rather depends on the level of  
 11 ownership. It is much more the extent to which one  
 12 needs a decisive influence between the sister companies  
 13 that are both doing the same thing, albeit in distinct  
 14 markets.  
 15 MR BREALEY: I do understand. You could say you've got the  
 16 two sister companies, they are acting in the same way  
 17 just in different geographic markets. There is,  
 18 Mr Hoskins would probably say, unity of conduct in the  
 19 market. Therefore, they are one economic unit. And  
 20 I would submit that is wrong and I would say that if  
 21 they are completely independent of each other, so they  
 22 vote to price fix, and they vote to price fix, and no  
 23 one has any influence over the other, it is done  
 24 completely separately, they are both guilty of  
 25 an infringement but they remain separate legal entities.

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1 MR JUSTICE BARLING: If they were the only two in the  
 2 cartel, they would not be able to take advantage of the  
 3 Hydrotherm defence?  
 4 MR BREALEY: Correct. That is a very good point, a policy  
 5 reason, why maybe I'm right, because if you presumed  
 6 that too readily, that they were one economic unit, then  
 7 they would have a defence saying actually --  
 8 MR SMITH: There is no agreement. There can be no  
 9 agreement.  
 10 MR BREALEY: No agreement.  
 11 MR SMITH: I see that. It seems on your submission there's  
 12 perhaps less difference between the legal personal  
 13 approach that English law adopts to groups and the  
 14 economic undertaking approach that European law adopts.  
 15 MR BREALEY: I kind of mentioned this interaction between  
 16 economic unit and the law of attribution, and I think to  
 17 a certain extent the English law of attribution is  
 18 trying to do what you have got to prove in economic  
 19 unit. And I will say it again, the acts have got to be  
 20 attributed to somebody else, the knowledge has to be  
 21 attributed to somebody else.  
 22 To a certain extent you get that on my view of your  
 23 two sister companies. But it is a point that if you too  
 24 readily infer an economic unit, then there is no  
 25 agreement. And when they appear to have acted

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1 independently, they may have their own shareholders, may  
 2 have their own directors, come to their own decisions.  
 3 They might have different names. They don't all have to  
 4 be called by the same brand name.  
 5 I don't know whether you want to have a five-minute  
 6 break while Mr Spitz --  
 7 MR JUSTICE BARLING: Have you finished on ex turpi causa?  
 8 MR BREALEY: I wasn't going to unless, again, there was any  
 9 questions, there was another question or ...  
 10 MR SMITH: There was only one which arises in part out of  
 11 the application of European concepts, which is let's  
 12 suppose so far as attribution is concerned we looked to  
 13 European law and the concept of the undertaking.  
 14 So that if, and let's not relay what an undertaking  
 15 is, but if there is an undertaking, the turpitudinous  
 16 state of mind of one company is automatically  
 17 transferred into that of the other because what's  
 18 relevant is the undertaking, not the individual  
 19 entities. Can that principle extend to other forms of  
 20 defence or assessment of damages, for instance?  
 21 And we have here, for example, let's suppose we  
 22 regard Sainsbury's Supermarkets and Sainsbury's Bank as  
 23 the same undertaking. We know that Sainsbury's Bank has  
 24 received the benefit of interchange fees over the years.  
 25 If one takes the undertaking approach and looks at the

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1 undertaking, ought we to be setting off in damages the  
 2 amounts received by Sainsbury's Bank against what  
 3 notionally we might award to Sainsbury's Supermarkets?  
 4 MR BREALEY: Certainly if they are different, you don't.  
 5 MR SMITH: Assume they are the same undertaking.  
 6 MR BREALEY: Well, this is something Mr Spitz is going to  
 7 deal with and I will provisionally do it and then he may  
 8 tell me I have got it all wrong.  
 9 The answer is no. It might sound strange, but if  
 10 you accept what the European Court said in Lady & Kid,  
 11 in Lady & Kid you have a situation where there has been  
 12 an unlawful charge by say the government -- sorry.  
 13 (Pause)  
 14 MR SMITH: You have got it wrong already?  
 15 MR BREALEY: It is not what MasterCard have pleaded.  
 16 I don't know who that is from.  
 17 So I'm told that what is being put to me has not  
 18 been pleaded by MasterCard. Although it is in --  
 19 MR JUSTICE BARLING: They have not pleaded that there should  
 20 be any set-off in those circumstances?  
 21 MR BREALEY: No. Obviously there has been a degree of  
 22 evidence about it from the reports, but it has not  
 23 been -- I will leave it to Mr Spitz. So in Lady & Kid,  
 24 if you remember, there was an overcharge and there was  
 25 a question of pass-on. And the government said, well,

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1 actually, we don't have to give you the money back  
 2 because we are getting you some benefits here.  
 3 The European Court said you don't have to give  
 4 credit for those benefits. Now, is that right or wrong,  
 5 or whatever? They are looking at it from a very strict  
 6 interpretation of getting money from someone who has  
 7 carried out an unlawful activity. Actually, the same  
 8 issue arises in the States; it is not at all clear cut  
 9 simply because -- one of the reasons for it, again,  
 10 is -- actually Mr Spitz, and we were talking about this  
 11 over the weekend, one of the reasons for it, if you  
 12 think of it, when you have got the benefits, you know  
 13 you are being paid the interchange fee. I mean, I can  
 14 understand where they are coming from, but let's --  
 15 although I disagree with it on the basis of Lady & Kid.  
 16 If you take a cartel who has raised the price of  
 17 a widget and the claimant then says, I want my £100  
 18 overcharge, and the cartel says you don't get your £100  
 19 because actually you have paid me the extra money, but  
 20 I used some of that extra money to make the product  
 21 better. You actually got a better product.  
 22 You can see all sorts of arguments that a cartel is  
 23 going to start running where actually the cartel  
 24 produced benefits to you.  
 25 MR JUSTICE BARLING: That's slightly different though, isn't

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1 it? That is a bit like Westinghouse, isn't it? A bit  
 2 like that? Where incidental benefits -- although they  
 3 get it there, I think.  
 4 MR BREALEY: That is a breach of contract. I can understand  
 5 in the breach of contract where the breach of contract  
 6 says "I broke the contract, but I gave the opportunity  
 7 to actually make a fortune".  
 8 I'm sure Mr Spitz is going to do this, but all I am  
 9 doing is saying that it is not quite as clear cut to say  
 10 "I'm going to deduct the benefits from the overcharge"  
 11 because there are deeper issues here, if every time you  
 12 have acted unlawfully and you have caused someone  
 13 damage, you can also say "Well, my unlawful conduct gave  
 14 you a benefit and therefore that extinguishes the claim  
 15 for overpayment".  
 16 MR SMITH: No, it just seems in this case and, again,  
 17 assuming a single undertaking, quite odd that  
 18 Sainsbury's can be claiming for all MIFs paid over time,  
 19 including MIFs that arose by virtue of transactions with  
 20 a Sainsbury's card in a Sainsbury's Supermarket, where  
 21 the payment through the interchange system went from  
 22 Sainsbury's Supermarket to Sainsbury's Bank.  
 23 MR BREALEY: I understand that.  
 24 MR SMITH: But your answer is --  
 25 MR BREALEY: I understand that. I do understand it. All

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1 I'm saying is if you take that logic and apply it in  
 2 other cases, you may not have such a meritorious case,  
 3 as it were, and you have to be careful how you define  
 4 the principle.  
 5 MR JUSTICE BARLING: We will take a short break so Mr Spitz  
 6 can take over.  
 7 (2.56 pm)  
 8 (A short break)  
 9 (3.05 pm)  
 10 Closing submissions by MR SPITZ  
 11 MR SPITZ: Thank you, sir.  
 12 MR JUSTICE BARLING: Mr Spitz.  
 13 MR SPITZ: The two topics that I will be dealing with, the  
 14 first is benefits and the second is the question of  
 15 interest, simple or compound, and if compound, at what  
 16 rate.  
 17 MR JUSTICE BARLING: Mr Spitz, you have a very nice gentle  
 18 voice, but make sure you --  
 19 MR SPITZ: I will speak up.  
 20 MR JUSTICE BARLING: Just because it has to get through to  
 21 the system.  
 22 MR SPITZ: The skeleton argument on benefits is at  
 23 paragraph 693 of our written closing submissions,  
 24 internal page 231. And it runs to internal page 242 at  
 25 page 740.

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1 The Tribunal will recall that the issue is that  
 2 MasterCard are contending that Sainsbury's should give  
 3 credit for the entire reduction of interchange fees on  
 4 all spending by all holders of Sainsbury's Bank cards,  
 5 not just in Sainsbury's stores but wherever that  
 6 spending may take place.  
 7 They say that Sainsbury's should replace all of  
 8 Sainsbury's Bank's lost interchange revenue arising from  
 9 these interchange fees, not just the part that relates  
 10 to incremental spend in Sainsbury's stores.  
 11 On that basis and given the suggested figures that  
 12 Mr Harman put forward and the figures suggested in  
 13 MasterCard's closing submissions, they contend that  
 14 around 25% of the damages claim -- I think the figures  
 15 are confidential, but some 56 or 54 million, depending  
 16 on the approach used, should be knocked off the total  
 17 claim.  
 18 There are three points that I would like to make in  
 19 response to the argument. I will enumerate them and  
 20 then flesh them out a little bit after that.  
 21 The first point is that the argument is highly  
 22 speculative. It depends on a number of assumptions. It  
 23 lacks a sound evidential base and the documents which  
 24 Mr Harman sought to interpret were not put to any of  
 25 Sainsbury's factual witnesses for their observations or

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1 comments. That's the first point.  
 2 The second point is that we are able to look in fact  
 3 at what actually happened when interchange fees were  
 4 used in the run-up to the interchange fee regulation and  
 5 after the regulation came into effect.  
 6 Sainsbury's Bank credit scheme is still in effect  
 7 and it is apparently viable. Sainsbury's has not been  
 8 making additional payments to Sainsbury's Bank and  
 9 there's no evidence that Sainsbury's has lost  
 10 incremental spend in its stores as a result of the  
 11 reduction of double Nectar points. The second point, in  
 12 other words, is that we can look at what has happened in  
 13 the actual world.  
 14 The third point is the legal point to which  
 15 Mr Brealey referred a few moments ago, and I will look  
 16 at that in due course. The European case law suggests  
 17 that it is not self-evident that these sorts of benefits  
 18 ought to be taken into account in a-- competition law  
 19 claim for the repayment of an overcharge because that  
 20 would reduce the right of the victim of the  
 21 anti-competitive conduct to obtain repayment of the  
 22 entire overcharge. Lady & Kid is the authority and it  
 23 is probably worth it in due course to have a quick look  
 24 at that decision.  
 25 Taking those three points in turn, the first in

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1 relation to the speculative nature of the defence. The  
 2 Tribunal will see that the point does not loom large in  
 3 MasterCard's opening submissions. I will refer to those  
 4 briefly at Z, A2, 250.  
 5 This is section 5 of MasterCard's opening  
 6 submissions on the appropriate damages counterfactual.  
 7 Paragraph 307 on page 250 sets out the framework that  
 8 MasterCard is adopting towards the appropriate damages  
 9 counterfactual.  
 10 It says that it would be necessary to consider what  
 11 would have occurred if MasterCard had charged a MIF at  
 12 the exemptible level as found by the Tribunal. This is  
 13 then elaborated at 308. The first subparagraph refers  
 14 to what would have happened in relation to Visa and  
 15 Amex.  
 16 Then, at paragraph 311 on page 352, MasterCard says  
 17 that any calculation of damages must take account of the  
 18 competitive dynamics which would have occurred in the UK  
 19 market. And the Tribunal will see from the last two  
 20 lines that that specifically contemplates the impact of  
 21 a lower MasterCard MIF if the Visa MIF and the Amex MIF  
 22 do not come down.  
 23 So that is what they have in mind as being of  
 24 relevance to the appropriate damages counterfactual, and  
 25 the second issue that they have in mind appears at 313,

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1 paragraph 313.  
 2 There, this is a point that, as it happened, we  
 3 heard very little about indeed, but at the time  
 4 MasterCard was suggesting that it would have made  
 5 changes -- other changes to the scheme rules and these  
 6 would have offset any reduction in the MIF or reduced  
 7 the benefits which Sainsbury's received from accepting  
 8 credit cards.  
 9 So that was what was contemplated as the key issues  
 10 for the appropriate damages counterfactual in the  
 11 opening. The Tribunal will also recall that in the  
 12 course of his evidence, Mr Harman said that the evidence  
 13 underpinning his report was thin. I have dealt with  
 14 this in the section of the skeleton argument, but the  
 15 reference was in the transcript, Day 18, internal  
 16 page 171, line 25 to 172, line 1. And what Mr Harman  
 17 said was, he made the point that he has stated  
 18 throughout his report, that it is a broad brush  
 19 calculation because the evidence is thin.  
 20 The submission is that what Mr Harman's opinion was  
 21 based on, his several reports on the question of  
 22 benefits was his own interpretation of certain  
 23 documents, particularly the Sainsbury's Bank 2012 credit  
 24 card presentation and slide 5 of that presentation.  
 25 The Tribunal will recall, based on that

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1 interpretation, he said that Sainsbury's Bank cards  
 2 would be loss-making. As I said in the introduction,  
 3 that document was never put to Sainsbury's factual  
 4 witnesses. None of them were asked about that  
 5 presentation or about the profitability of Sainsbury's  
 6 Bank generally or, indeed, about the Sainsbury's Bank  
 7 credit card scheme.  
 8 Other documents to which Mr Harman referred were  
 9 also not put to those witnesses for their comment and  
 10 observation. So what the Tribunal has in these reports  
 11 is Mr Harman's interpretation of these documents in the  
 12 absence of factual evidence from the witnesses who would  
 13 have been able to speak to the documents. The  
 14 interpretation of the documents is obviously a matter  
 15 for the Tribunal on the basis of the evidence before it,  
 16 and the evidence is not robust.  
 17 Slide 5 of the 2012 presentation suggested, as you  
 18 will recall in the course of the cross-examination, that  
 19 it is actually focused on a relatively young  
 20 distribution channel for Sainsbury's Bank credit cards  
 21 that were signed up for by customers present in store.  
 22 And the slide also suggested that Sainsbury's Bank was  
 23 still trying to optimise profitability and reduce  
 24 operating costs.  
 25 Contrary to the interpretation of the documents

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1 offered by Mr Harman, we looked at slide 3 of the  
 2 presentation and that slide is reproduced in the closing  
 3 submissions at page 392. We looked at that slide and it  
 4 suggests that Sainsbury's Bank's card performance has in  
 5 fact been profitable since at least 2008. We have  
 6 explained in paragraph 712, in response to a question  
 7 that Mr Smith raised in relation to profit before  
 8 taxation, that PBT in this slide includes all expenses  
 9 apart from taxation.  
 10 So that although there is a separate line that  
 11 represents bad debts, and that's the red line on the  
 12 graph, bad debts are included as an expense within  
 13 profit before tax. They are not a separate item, but  
 14 they have been identified in that graph because, as the  
 15 Tribunal will recall, they were -- the reduction --  
 16 MR JUSTICE BARLING: Sorry, where is it, Mr Spitz?  
 17 PROFESSOR JOHN BEATH: Page 235.  
 18 MR SPITZ: It is internal page 235, I beg your pardon,  
 19 below 711.  
 20 MR JUSTICE BARLING: Got it.  
 21 MR SPITZ: So that was slide 3. PBT is the blue line. The  
 22 profit before tax line. Bad debts is the red line and  
 23 the Tribunal will see there is a natural correlation  
 24 between the bad debts line and the PBT in the sense that  
 25 as the bad debts decrease, in other words, as the line

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1 moves closer to zero on the graph, you can see  
 2 a corresponding movement in profit before tax.  
 3 But in any event, interpretation of the document  
 4 suggests that in fact far from the interpretation that  
 5 Mr Harman arrived at and far from the cross-examination  
 6 that was put to Mr von Hinten-Reed, since at least 2008,  
 7 Sainsbury's Banks' card performance has been profitable,  
 8 it has not been break even or marginal.  
 9 It was also the case, as was dealt with in the  
 10 cross-examination, that the scheme would remain  
 11 profitable even without the MIF income. This was shown  
 12 in cross-examination through a comparison of slide 3  
 13 with paragraph 22 of Mr Abrahams' witness statement.  
 14 It is not necessary to go there, but for the  
 15 Tribunal's note, 392 to 393. In fact, I have set it out  
 16 on internal page 236 to 237. So that was the exchange  
 17 that took place.  
 18 In those circumstances, Sainsbury's submits that it  
 19 is simply not safe or robust to conclude that the entire  
 20 Sainsbury's Bank credit card scheme was marginal and  
 21 would be heavily loss-making in a low interchange fee  
 22 environment.  
 23 Notwithstanding all of this, MasterCard's contention  
 24 is that Sainsbury's would have been willing to pay for  
 25 the whole of the reduction in interchange fees to

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1 Sainsbury's Bank. Not just a portion that relates to  
 2 incremental spend in Sainsbury's stores, which is after  
 3 all the benefit that Sainsbury's obtains from the  
 4 Sainsbury's credit cards. And the Tribunal is being  
 5 asked also to speculate in a counterfactual world on  
 6 what two parties would have agreed. Mr Coupe and  
 7 Mr Rogers, Sainsbury's Bank and  
 8 Sainsbury's Supermarkets, what would they have agreed in  
 9 relation to the incremental spend stretch, even though  
 10 that question was never put to the witnesses.

11 Now, Sainsbury's was only ever funding double Nectar  
 12 points for instore spend in its stores, and Sainsbury's  
 13 Bank was funding the base Nectar points. On those  
 14 facts, it is difficult to imagine, for example, Mr Coupe  
 15 agreeing to fund Sainsbury's Bank for Nectar points on  
 16 spending that would take place in Tesco's stores, for  
 17 example. It is practically inconceivable to imagine  
 18 Mr Coupe agreeing that.

19 It is also difficult to imagine that Sainsbury's  
 20 would effectively subsidise the Bank of Scotland as  
 21 J Sainsbury's joint venture partner for a share of the  
 22 reduced interchange fee revenue to Sainsbury's Bank.  
 23 But, again, the point being these questions were not  
 24 canvassed with the witnesses of fact.

25 So the Tribunal is left with both experts

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1 acknowledging that the evidentiary basis is very thin.  
 2 Both Mr von Hinten-Reed and Mr Harman, and the experts  
 3 are speculating on what would have happened, and they  
 4 are interpreting documents which bear, as I have  
 5 suggested, interpretations that are contrary to those  
 6 that were put to the witnesses.

7 So that, then, is the first submission in relation  
 8 to the question of benefits. The defence is too  
 9 speculative, too heavily reliant on questionable  
 10 assumptions to be robust, particularly given the size of  
 11 the reduction in the quantum that MasterCard is now  
 12 advancing.

13 I think it is also important to note that this  
 14 defence was not pleaded in MasterCard's defence, and  
 15 that's not simply a pleading point. It explains why the  
 16 point has only come up in the course of these  
 17 proceedings and why it is not addressed, for example, in  
 18 the witness statements. It certainly was not a pleaded  
 19 issue.

20 The second point to make relates to the events that  
 21 have actually happened. What we see is that Sainsbury's  
 22 Bank is viable and its card scheme is viable, the bank  
 23 continues to issue credit cards, it has not withdrawn  
 24 them. Hannah Bernard's evidence, that was paragraph 71  
 25 of her witness statement, which is also set out in the

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1 closing submission -- probably worth turning to that for  
 2 a moment. It is internal page 232 at paragraph 700. It  
 3 is in yellow so I won't read it out.

4 The last two sentences are the particularly relevant  
 5 ones. That relates to the funding of double Nectar  
 6 points for instore spend. Now, Sainsbury's has, since  
 7 April 2015, effectively reduced its double Nectar point  
 8 offering. But even having done so, there's no evidence  
 9 of any request from Sainsbury's Bank for a further  
 10 contribution to any further funding to Sainsbury's Bank.  
 11 There is no evidence that Sainsbury's has paid anything  
 12 more to Sainsbury's Bank following the reduction of  
 13 Nectar points. And importantly, there's no evidence to  
 14 show what, if anything, has happened to the incremental  
 15 spend in Sainsbury's stores as a result of the change to  
 16 the double Nectar points.

17 No evidence of that. There's also nothing to  
 18 suggest in the actual world that people who hold  
 19 Sainsbury's Bank cards are giving up those cards as  
 20 a consequence of the change to the Nectar card scheme.

21 In its written closing argument at paragraph 686  
 22 MasterCard refer to a payment of £5 million. It is  
 23 paragraph 686, internal page 210.

24 They explain this as a new annual payment. This  
 25 description appears to be incorrect, and it is necessary

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1 to look at one or two documents to see this. The figure  
 2 is drawn from the intercompany recharges document, which  
 3 the Tribunal will possibly recall from the course of  
 4 cross-examination but that we will look at. And that's  
 5 at E3.15, tab 284.

6 One can see at page 6638, the fourth bullet point  
 7 under the executive summary, just before the table:  
 8 "This document records that the only recommended  
 9 changes are to discontinue the following recharges with  
 10 effect from the beginning of the 2015/16 financial  
 11 year."

12 On the next page, 6639, one can see at the first  
 13 bullet point:

14 "The impact of the recommended changes ..."

15 And in the table the first line:

16 "... double Nectar points on instore spend."

17 SB and SSL and the two figures that are mentioned  
 18 there.

19 Then one can see the commercial rationale for the  
 20 discontinuation of the recharge. That is these costs  
 21 properly sit with SSL as it benefits from the increased  
 22 customer spend relating to these offers.

23 If the Tribunal turns to page 6643 of this document,  
 24 under "Nectar points" you will see that the document  
 25 says, on the right-hand side, "Discontinue SSL to pick

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1 up these costs going forward as it benefits from the  
 2 increased customer spend in store".  
 3 The figure mentioned by MasterCard comes from that  
 4 intercompany recharge document. The document, the  
 5 recharges, are being reviewed -- I closed it a moment  
 6 too quickly.  
 7 MR JUSTICE BARLING: Is there a reference to a paragraph in  
 8 your closings, just so I have that on my note as well,  
 9 the point you are on now? Maybe not. Don't worry if  
 10 there isn't.  
 11 PROFESSOR JOHN BEATH: I think it is a response.  
 12 MR SPITZ: It is a response to the way that it's been  
 13 invoked.  
 14 MR JUSTICE BARLING: Okay, that's fine. That's all right,  
 15 thank you.  
 16 MR SPITZ: So that is the recharge document and the  
 17 rationale underlying the recharge, and it suggests that  
 18 whereas before Sainsbury's was recharging Sainsbury's  
 19 Bank in relation to double Nectar points, from 2015 all  
 20 of the costs of double Nectar points will sit with  
 21 Sainsbury's and there will be no recharge. That's what  
 22 the documents suggests.  
 23 But it is also worthwhile looking at a second  
 24 document, again a document that is referred to by  
 25 MasterCard. And that is the Sainsbury's Bank 2012

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1 business plan. It is E9.2, tab 54. It is at  
 2 page 1142.104, which is internal page 16. The relevant  
 3 bit to show the Tribunal is the four lines just above  
 4 the heading "Impairment", two-thirds of the way down  
 5 that page. It is the sentence that reads:  
 6 "Whilst the cost of the rewards on the new  
 7 products ..."  
 8 Internal page 16 at tab 54:  
 9 "While the cost of the rewards on the new products  
 10 is forecast to increase interest from 2.1 million in  
 11 2013 to 5.9 in 2016, the JS contribution is also  
 12 forecast to increase from 1.8 in 2013 to 3.9 in 2016.  
 13 That's the relevant bit because it appears from this  
 14 that in 2013 the cost of double Nectar points was that  
 15 figure of 2.1 and that Sainsbury's was making  
 16 a contribution to that cost of 1.8. And it appears that  
 17 in 2016 the cost of double Nectar was going to increase  
 18 to 5.9 and that Sainsbury's could be making  
 19 a contribution of 3.9 to that cost.  
 20 According to the recharge document that we looked  
 21 at, the full cost of the double Nectar points on  
 22 23rd December 2014 is 5.9. The same amount that is  
 23 forecast in the 2012 business plan. So on that basis,  
 24 it appears that the discontinuation of the recharge is  
 25 not a new payment of 5.9, because even in 2012

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1 Sainsbury's was forecast to be picking up around  
 2 two-thirds of the total cost of that to the tune of  
 3 3.9 million.  
 4 Sainsbury's is now taking on the entire amount for  
 5 double Nectar points. The new payment in the 2015/2016  
 6 financial year is a further amount of 2 million. This  
 7 is because of the agreement that Sainsbury's will be  
 8 funding the full cost of double Nectar points. So this  
 9 payment has nothing to do with the reduction of  
 10 interchange fees.  
 11 So we can put those away. All that has happened in  
 12 the real world, then, is that Sainsbury's has reduced  
 13 its double Nectar points. It has not made any  
 14 additional contribution to Sainsbury's Bank. By  
 15 discontinuing the recharge, Sainsbury's is now paying  
 16 for all of the double Nectar points rather than just  
 17 making a contribution to the cost of double Nectar  
 18 points.  
 19 Sainsbury's Bank continues to exist, continues to  
 20 issue its credit cards, and we have no evidence that  
 21 Sainsbury's has lost out on incremental spend because of  
 22 a reduction in double Nectar points. In the events that  
 23 actually have happened, these do not provide any support  
 24 for MasterCard's contention that Sainsbury's must give  
 25 credit for the benefits received either through

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1 incremental spend or more generally.  
 2 If, contrary to these submissions, the Tribunal  
 3 takes the view that some credit should be given, then we  
 4 submit that there is a range. The upper bound of that  
 5 range -- and this emerged from the cross-examination --  
 6 is 16.6 million, and that is the total loss of  
 7 interchange fees to Sainsbury's Bank on all in-store  
 8 spend, not just incremental spend. The lower bound is  
 9 the figure provided by Mr von Hinten-Reed of 4.1 million  
 10 and that was calculated as representing the total loss  
 11 of interchange fees on Sainsbury's Bank on incremental  
 12 spend in Sainsbury's store.  
 13 The bottom of the range is solely targeted on  
 14 incremental spend in Sainsbury's stores. That, after  
 15 all, is the benefit that Sainsbury's obtained. The  
 16 upper bound of 16.6 is the total loss of interchange  
 17 fees on all spend in Sainsbury's, not just incremental  
 18 spend.  
 19 On the upper bound we will submit there is no  
 20 justification for requiring Sainsbury's to give credit  
 21 because it should not be necessary to pay for all spend  
 22 in Sainsbury's stores when the only relevant benefit is  
 23 the incremental spend.  
 24 So that, then, is the second point to be made in  
 25 relation to the question of benefits in addition to the

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1 points that are set out in writing in the written  
 2 closing.  
 3 The third point is in relation to EU law. It is the  
 4 point that Mr Brealey referred you to briefly a few  
 5 minutes ago. Lady & Kid is at bundle I4, tab 9.  
 6 It is worth going briefly through part of the  
 7 headnote and then picking up the key passages in the  
 8 judgment. So the headnote sets out the facts by saying:  
 9 "Denmark introduced a business tax known as the  
 10 employment market contribution, the AMBI. The AMBI was  
 11 in principle calculated on the same basis as value added  
 12 tax, but unlike VAT it was charged on the imported  
 13 good's first sale price upon first sale in Denmark. In  
 14 return for the introduction of the AMBI, a number of  
 15 employer social security contributions which had to be  
 16 paid by Danish undertakings were abolished."  
 17 Then picking it up five or six lines down in the  
 18 same paragraph, the sentence beginning:  
 19 "Various conditions had to be fulfilled by  
 20 an undertaking seeking reimbursement such as that the  
 21 AMBI could not have been passed on through price  
 22 increases. The four applicants in the main proceedings  
 23 were undertakings active in retail trade. They lodge  
 24 complaints before the district court. The ground given  
 25 for the refusal to reimburse was that the undertaking

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1 savings during the period when they were liable to pay  
 2 the AMBI as a result of the abolished employer social  
 3 security contributions, exceeded the AMBI paid, which  
 4 meant that the undertakings had received full coverings  
 5 for the AMBI paid."  
 6 Then turning to page 176, next to the letter D on  
 7 the left-hand margin:  
 8 "The Danish court found it necessary to request a  
 9 ruling from the Court of Justice on the interpretation  
 10 of EU law on recovery of amounts wrongly paid. In  
 11 essence, the questions referred asked whether the mere  
 12 passing off of an unlawfully charged levy by an increase  
 13 in the sale price of goods on which that levy was made  
 14 could, in the event of recovery of amounts wrongly paid,  
 15 give rise to unjust enrichment on the part of the  
 16 taxpayer or whether unjust enrichment could also follow  
 17 from a saving made as a result of the concomitant  
 18 abolition of other levies charged on a different basis,  
 19 even where the taxpayer had not altered its sale  
 20 prices."  
 21 The Court of Justice then deals with this issue from  
 22 paragraph 10 on page 200.  
 23 The Tribunal will see the last sentence on page 200  
 24 in paragraph 10:  
 25 "The ground given for the refusal," that is the

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1 refusal of the reimbursement, "was that the  
 2 undertaking's savings during the period when they were  
 3 liable to pay the AMBI as a result of the abolished  
 4 employer social security contributions exceeded the AMBI  
 5 paid in that period, which meant that the undertaking  
 6 had received full coverage for the AMBI paid."  
 7 The Court of Justice decision on the issue is from  
 8 paragraph 16 to paragraph 20 on page 203.  
 9 Perhaps I will pause for a moment to read those  
 10 paragraphs rather than reading them aloud.  
 11 MR JUSTICE BARLING: All right, I think we have seen them  
 12 but we will refresh our memory.  
 13 MR SPITZ: Then at paragraph 22, the court deals with the  
 14 setting off of benefits under the abolition of the other  
 15 legislation, and concludes:  
 16 "The member state may not reject an application for  
 17 reimbursement of an unlawful tax on the ground that the  
 18 amount of that tax has been set-off by the abolition of  
 19 the lawful levy of an equivalent amount."  
 20 Paragraph 26:  
 21 "The answer to the second and third questions is  
 22 therefore that the recovery of sums wrongly paid can  
 23 give rise to unjust enrichment only when the amounts  
 24 wrongly paid by a taxpayer under a tax levied in a  
 25 member state in breach of the European Union law have

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1 been passed on direct to the purchaser. Consequently,  
 2 European law precludes a member state from refusing  
 3 reimbursement of the tax wrongfully levied on the ground  
 4 that the amounts wrongly paid by the taxpayer have been  
 5 set off by a saving made as a result of the concomitant  
 6 abolition of the other levies since such a set-off  
 7 cannot be regarded from a point of view of the European  
 8 law as an unjust enrichment as regards that tax."  
 9 So that's how the European law has defined and  
 10 understood its concept of unjust enrichment and the fact  
 11 that any restriction or limitation on the right needs to  
 12 be very narrowly construed. The sole exception is  
 13 direct pass-on, and the offsetting that has been done in  
 14 relation to legislation that has been abolished cannot  
 15 be factored in to reduce the amount of unlawfully levied  
 16 charge that needs to be reimbursed.  
 17 Our submission is similarly the right to recover  
 18 damages for an infringement of competition law is  
 19 conferred directly by EU law. Our case is that the only  
 20 exception to the right to receive reimbursement of the  
 21 full amount is where the overcharge has been passed on.  
 22 So it is not at all clear that these sorts of benefits  
 23 can be offset against the entire amount of the  
 24 overcharge to reduce that amount.  
 25 One can see the considerations of EU law and

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1 considerations of the ordinary approach to damages do  
2 not necessarily sit completely compatibly and easily in  
3 this sort of circumstance. But our submission is that  
4 Lady & Kid suggests that it is not simply a matter of  
5 saying "What is the amount of credit that needs to be  
6 given?" and that that credit should be deducted from the  
7 full amount of the overcharge.

8 That's what I wanted to say on benefits. On  
9 interest, the submissions are from internal page 184,  
10 paragraph 529. I would like to refer the Tribunal  
11 briefly to what was pleaded, and that's at B2, page 31  
12 to paragraphs 61 to 62.

13 This is the claim for compound interest. Then the  
14 pleading is halfway down paragraph 62:

15 "In the absence of MasterCard's establishing setting  
16 and imposition of the unlawful UK MIFs, Sainsbury's  
17 would have reinvested a substantial portion of the sums  
18 claimed above in its business thereby generating  
19 ...(Reading to the words)... its capital expenditure and  
20 operations, and it has suffered a loss of return on  
21 investment and/or additional financing costs and/or  
22 interest losses as a result."

23 The evidence to which both Sainsbury's and  
24 MasterCard refer is from Mr Coupe's witness statement  
25 and Mr Rogers' witness statement. Mr Coupe's is at C1,

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1 tab 1, page 21, paragraph 82. I won't read it out. It  
2 is in yellow.

3 The relevant passage from Mr Rogers' evidence is the  
4 same bundle, C1, tab 2 at page 30. That's paragraph 29.  
5 Again, I don't propose to read that paragraph out.

6 From an economic perspective, one of the few areas  
7 on which the experts agreed was that from an economic  
8 perspective it wasn't difficult to conclude that the  
9 appropriate form of interest in a commercial context  
10 should be compound interest rather than simple interest,  
11 and that that reflected day-to-day commercial reality.

12 The question is what has to be pleaded, what has to  
13 be established in order to obtain compound interest as  
14 a matter of law?

15 This question is dealt with helpfully in a decision  
16 of Mr Justice Males in the Equitas case. It is at I5,  
17 tab 2A. Some of the relevant passages are set out in  
18 the written closing at paragraph 542, internal page 186.

19 MR JUSTICE BARLING: Do you want us just to look at the  
20 closing or should we keep the report open?

21 MR SPITZ: If you wouldn't mind, there are several passages  
22 in the judgment itself that it is worth simply flagging.

23 MR JUSTICE BARLING: Sure.

24 MR SPITZ: The first one is picking it up at 107. Now, this  
25 concerns the question of compound interest after Semptra

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1 Metals. In this case what was at issue was damages for  
2 loss of investment income.

3 Mr Justice Males says at 108:

4 "It is therefore necessary to examine what Semptra  
5 Metals has to say about the circumstances in which  
6 a conventional interest rate can be used, when compound  
7 interest can be awarded and what is meant by the need  
8 for proof of loss in such circumstances."

9 Now, cases is important because it was suggested by  
10 MasterCard in the course of their opening that the  
11 courts never award compound interest at a conventional  
12 rate. In fact, this is an example post-Semptra Metals  
13 when the courts are doing precisely that. They are  
14 awarding compound interest at a conventional rate.

15 So there are really two options available to the  
16 court. The first is to take a claimant-specific  
17 approach, to look at Sainsbury's actual position. And  
18 it is on that basis that Sainsbury's has submitted that  
19 the appropriate measure is its weighted average cost of  
20 capital. That's one approach.

21 The alternative approach is the approach that the  
22 courts are familiar with and that is in the context of  
23 awarding compound interest, nevertheless to do so at  
24 a conventional rate where one takes into consideration  
25 not the specifics of the particular claimant, but the

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1 category or class to which the claimant belongs. The  
2 same sort of approach as the courts have long adopted in  
3 awarding simple interest.

4 Then the question becomes compound interest at  
5 a conventional rate, and should there or should there  
6 not be any premium over the ordinary rate to take  
7 account of particular relevant factors such as the cost  
8 of borrowing to the relevant category of claimants.

9 So that is one reason why this decision is relevant,  
10 because what it indicates is that there are two routes  
11 that are available post-Semptra: one that focuses on the  
12 specifics of the claimant; one that focuses on the  
13 category and looks at a conventional award.

14 The case is also useful because of what it has to  
15 say about the standard or threshold of proof that is  
16 required to make a claim for compound interest.

17 The discussion runs from paragraph 109. I will  
18 simply note these for the Tribunal's reference and then  
19 come to the key passage. But from 109, the discussion  
20 continues.

21 Mr Justice Males highlights some of the relevant  
22 dicta that will be very familiar to the Tribunal from  
23 Semptra Metals over the next paragraphs 111, 112 and 113.  
24 Continues by citing Lord Scott at 115 and Lord Walker  
25 at 116.

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1 At 118 it states:  
 2 "Thus, Sempra Metals was a case where, despite what  
 3 was said about the need to plead and prove a loss, the  
 4 damages actually awarded were determined by taking  
 5 a conventional rate and awarding compound interest.  
 6 This did not depend on any evidence as to the taxpayer's  
 7 actual loss, but was simply the interest which  
 8 a substantial commercial company would have to pay to  
 9 borrow the amount in question in the market at the  
 10 relevant time regardless of what the taxpayer had  
 11 actually done.  
 12 Although it may be that this approach was not the  
 13 subject of specific argument in the House of Lords, it  
 14 was clearly an approach which the House endorsed."  
 15 Then, the court moves on to draw together the  
 16 various strands of its analysis and it does so in  
 17 paragraph 123 of the decision. Just to highlight one or  
 18 two parts of this discussion, the court begins at  
 19 subparagraph 123, (i), making the point that in  
 20 principle the damages are recoverable, subject to the  
 21 ordinary principles of remoteness and mitigation.  
 22 In (ii):  
 23 "Unless there is some positive reason to do  
 24 otherwise, the law will proceed on the basis, at any  
 25 rate in a commercial context, that a claimant kept out

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1 of its money has suffered loss as a result. That  
 2 represents commercial reality and everyday experience.  
 3 Specific evidence to that effect is not required and  
 4 even if adduced may well be somewhat hypothetical and  
 5 thus of little assistance. For example, a businessman  
 6 may well be unable to say precisely what he would have  
 7 done differently if a particular payment had been made  
 8 to him when it ought to have been made, especially if,  
 9 as apparently in this case, he was unaware that the  
 10 money was being withheld."  
 11 Moving down to subparagraph 4:  
 12 "I consider that it is not necessary for the  
 13 claimant to produce specific evidence of what it would  
 14 have done with the money, or what steps, if any, it took  
 15 to borrow or otherwise to replace the money of which it  
 16 was deprived. As noted above, it may often be  
 17 impossible, or at any rate extremely difficult, to  
 18 produce such evidence especially if that would mean  
 19 attempting to disentangle the claimant's overall  
 20 business operations in an artificial attempt to  
 21 attribute specific activity such as borrowing to the  
 22 non-remittance of specific funds."  
 23 The court then continues a few lines down:  
 24 "A conventional rate will be used which represents  
 25 the cost to commercial entities such as the claimant and

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1 is not necessarily the rate at which the Claimant itself  
 2 could have borrowed or did in fact borrow."  
 3 Finally, in subparagraph (v):  
 4 "If a conventional borrowing cost is to be adopted  
 5 in this way, the question whether interest should be  
 6 simple or compound answers itself."  
 7 The court then goes on to discuss why that is so.  
 8 So the second important point that emerges from this  
 9 decision is the realism in this judgment. The  
 10 recognition that it will often be very difficult to  
 11 indicate precisely what would have been done to fund  
 12 a specific overpayment. And the approach adopted in  
 13 this decision offers a way of dealing with that.  
 14 So the first approach that Sainsbury's adopts is the  
 15 claimant-specific approach, and that is at paragraph 544  
 16 of the closing submissions, page 188. There are a set  
 17 of key points that are made and summarised in the  
 18 skeleton in support of the contention that the  
 19 appropriate rate of compound interest is at the weighted  
 20 average cost of capital.  
 21 At paragraph 547, we say:  
 22 "Sainsbury's raised substantial external capital  
 23 over the claim period, particularly in the form of sale  
 24 and leasebacks."  
 25 And underneath that the relevant references are set

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1 out.  
 2 In 548 we make the point that Sainsbury's would have  
 3 used its additional profits to help fund," I don't know  
 4 why that's in yellow, but one can read it in any event.  
 5 "In doing so, it would not have needed to raise as  
 6 much capital externally as it did. It would have saved  
 7 its weighted average cost of capital."  
 8 We have set out there the relevant supporting  
 9 materials.  
 10 The third point that Mr Reynolds made and the  
 11 Tribunal will recall is at 549. His opinion was that  
 12 the weighted average cost of capital was the appropriate  
 13 interest rate irrespective of whether the overcharge is  
 14 viewed as resulting in the need to raise additional  
 15 capital or as reducing profits available to fund  
 16 investment.  
 17 The fourth point we make, adopting Mr Reynolds'  
 18 opinion, is that the weighted average cost of capital is  
 19 the appropriate interest rate irrespective of what  
 20 assumption is made as to the precise mix of the funding  
 21 that comprised the additional capital.  
 22 There we have referred to some of the writing on the  
 23 subject in 550A and 550B. One point to mention in  
 24 relation to this paragraph is that the Tribunal may  
 25 recall that Mr Reynolds was asked why he had not dealt

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1 with all of the paragraphs in the FTI article that bore  
 2 on the matter, and it was put to him that the article  
 3 explained that the weighted average cost of capital may  
 4 not be appropriate if it was compensating for risks that  
 5 the claimant did not bear.  
 6 The important point about this is it has not been  
 7 MasterCard's expert evidence that there are risks that  
 8 Sainsbury's did not bear. That has not been part of the  
 9 expert reports at any stage in these proceedings.  
 10 The fifth point is that weighted average cost of  
 11 capital would be an appropriate interest rate if the  
 12 overcharge caused Sainsbury's to reduce other  
 13 expenditure. And the relevant evidence is set out  
 14 there.  
 15 Then at 552 we summarise Mr Reynolds' evidence that  
 16 where a company is unlisted it is standard practice to  
 17 utilise the weighted average cost of capital of  
 18 a comparable listed company.  
 19 This too was not a matter that Mr Harman disputed or  
 20 put in issue, and so there was no challenge in the  
 21 expert evidence to the appropriateness of using  
 22 J Sainsbury's weighted average cost of capital as  
 23 a proxy for the weighted average cost of capital of  
 24 Sainsbury's itself.  
 25 There is a challenge in the closing submissions to

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1 that, and it is useful I think simply to give the court  
 2 the relevant references. The challenge is at  
 3 paragraph 744 of MasterCard's written closings. The  
 4 Tribunal will see there that an effort is made to  
 5 suggest that it is inappropriate to utilise the weighted  
 6 average cost of capital of the holding company of  
 7 J Sainsbury's. And that is continued into  
 8 paragraph 745.  
 9 These points do not appear to derive from the expert  
 10 reports of Mr Harman. But a challenge is mounted to  
 11 something that didn't appear to be in issue up until  
 12 this point. It is said in paragraph 746. You will see  
 13 that the numbers themselves are in yellow, but:  
 14 "Mr Reynolds contended that this percentage of  
 15 J Sainsbury plc's earnings at the start of the claim  
 16 period derived from Sainsbury's. Mr Reynolds did  
 17 acknowledge, however, that by later in the claim period,  
 18 this proportion had dropped to," and a different  
 19 percentage is given.  
 20 I would simply refer the Tribunal, without needing  
 21 to turn it up, to what Mr Reynolds said in his first  
 22 report. So the reference is Reynolds 1, paragraph 17,  
 23 and it is at D2, tab 1, page 7. What it shows is that  
 24 the percentage share that Sainsbury's represented of  
 25 J Sainsbury's earnings was at that level, at the high

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1 level indicated in the paragraph for all of the years of  
 2 the claim, except for 2015 when it was reduced to the  
 3 lower percentage.  
 4 So that is the first point --  
 5 MR JUSTICE BARLING: Paragraph? The higher levels shown in  
 6 paragraph 746.  
 7 MR SPITZ: 746 of MasterCard's written closing.  
 8 MR JUSTICE BARLING: Except for 2015.  
 9 MR SPITZ: The second point to make in relation to  
 10 MasterCard's challenge to the use of the J Sainsbury's  
 11 weighted average cost of capital is what Mr Reynolds  
 12 explained in his evidence. And the reference there  
 13 is -- again, I think for convenience it's probably  
 14 simply sufficient for me to give you that reference  
 15 rather than open the evidence and go to it. It is  
 16 transcript Day 15, pages 27 to 30 and that's where  
 17 Mr Reynolds explained that the risk that is relevant is  
 18 the market risk that cannot be avoided through holding  
 19 a diversified portfolio, not the kind of risk that  
 20 MasterCard is raising in its written closings.  
 21 Turning back, then, to our submissions on interest.  
 22 We make the point at paragraph 554 that the overall  
 23 estimates that Mr Reynolds produced were in line with  
 24 those of UBS. Then the next section of the closing sets  
 25 out MasterCard's main arguments and deals with

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1 Sainsbury's response.  
 2 So the Tribunal will see, for example, that on  
 3 page 193, we have dealt with the question whether any  
 4 profits would have been kept as cash. We have dealt on  
 5 page 195 with the question whether higher debt affects  
 6 the cost of equity. I am not going to rehearse that at  
 7 this stage. Page 196, two-thirds of the way down, we  
 8 have also dealt with the question: would the overcharge  
 9 have affected lease finance and equity finance?  
 10 At 197, we have addressed the question whether  
 11 an increase in the cost of equity is a loss to  
 12 Sainsbury's.  
 13 The remaining key issue at 199 was the issue -- the  
 14 assumption that Sainsbury's optimised its mix of  
 15 funding, and we have addressed that in the paragraphs  
 16 following from page 199 to 200.  
 17 I will briefly mention the two fairly narrow areas  
 18 of disagreement in relation to the calculation of  
 19 weighted average cost of capital itself. Mr Harman, as  
 20 the Tribunal knows, took the view that a different  
 21 approach should be adopted: the cost of borrowing or the  
 22 interest available on cash balances. But if he was to  
 23 look at the weighted average cost of capital  
 24 calculation, there were two differences between the  
 25 experts.

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1 The first one, in relation to the cost of debt,  
 2 concerned whether to include a trailing average in the  
 3 calculation. And that is dealt with in paragraph 592.  
 4 On the cost of equity, and that's dealt with in 594,  
 5 the issue between them was whether to use only  
 6 a historical approach or an approach that was both  
 7 historical and forward-looking, and if the latter,  
 8 whether the Bloomberg forward-looking approach was  
 9 appropriate and reasonable to use. And we have set out  
 10 our submissions on that issue.  
 11 Sir, I will be able to complete these submissions  
 12 this afternoon, but I may need a few more minutes beyond  
 13 4.30 pm, but not very much, I wouldn't think.  
 14 MR JUSTICE BARLING: The message I have had is that the  
 15 transcript writers could go on after then, but at  
 16 4.30 pm we would need a short break. We can make it  
 17 a very short break.  
 18 MR SPITZ: Indeed, and if it does run on after 4.30 pm it is  
 19 not going to be for very long. What I would like to do  
 20 is I would like to outline the alternative basis on  
 21 which Sainsbury's puts its case, which relates to the  
 22 Equitas decision we saw. And then I would simply like  
 23 to highlight those passages in MasterCard's written  
 24 closing with which we take issue and give the court the  
 25 references that contain the difference of opinion, and

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1 that's probably sufficient.  
 2 MR JUSTICE BARLING: Good.  
 3 MR SPITZ: On the alternative case, we are now dealing of  
 4 course with the secondary, the alternative claim for  
 5 compound interest at a conventional rate if the court is  
 6 disinclined to make an award at the weighted average  
 7 cost of capital and opts for the conventional rate.  
 8 On that basis, the submission is that it would be  
 9 appropriate to consider something of a premium over Bank  
 10 of England base rate plus 2% to reflect the gap that has  
 11 opened up, largely as a result of the financial crisis,  
 12 between the low rates of Bank of England interest and  
 13 the rates at which companies in the category into which  
 14 Sainsbury's fits can in fact borrow.  
 15 There are a couple of building blocks that are set  
 16 out in 596 and 597 of the written closing. The first is  
 17 actual interest of the bank and that is I5, tab 1C.  
 18 A very short passage to draw to the court's attention.  
 19 It is tab 1C, and it is relevant to mention of  
 20 course that this was a case that considered whether or  
 21 not a premium should be awarded above Bank of England  
 22 rate, in this case to reflect the cost of unsecured  
 23 borrowing to an individual. So obviously a different  
 24 circumstance to the cost of borrowing to a large  
 25 corporation. But the approach is nevertheless

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1 instructive.  
 2 At paragraph 3 of the judgment, there the court will  
 3 see the claimants contend for an interest rate of 5%  
 4 above Barclays Bank base rate from time to time from  
 5 29th January 2009 to the date of payment.  
 6 Submitted on their behalf that such a rate reflects  
 7 the cost of borrowing for a private individual over the  
 8 relevant period. Then there is the reference to the  
 9 impact of the global financial crisis.  
 10 At the bottom of this page the evidence that was  
 11 adduced in support of the claim for an interest rate  
 12 above the Barclays Bank rate. And the court said that  
 13 the Bank of England quarterly bulletin demonstrated the  
 14 divergence between bank rates and new unsecured lending  
 15 rates from 2008 to the date of the bulletin.  
 16 At paragraph 5, the court accepted this evidence and  
 17 decided that it was appropriate to award interest at  
 18 a rate of 5% above Barclays Bank rate.  
 19 It appears for the sake of clarity that this was  
 20 a case dealing with simple interest and not compound  
 21 interest. There's no indication in the decision itself  
 22 that it was dealing with compound interest, but it is  
 23 illustrative for our purposes in demonstrating the sort  
 24 of consideration that would be useful to take into  
 25 account in deciding on a premium over a Bank of England

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1 base rate.  
 2 MR JUSTICE BARLING: He seems to think a commercial case  
 3 might be dealt with differently.  
 4 MR SPITZ: Indeed. He certainly makes the point that this  
 5 was not a commercial case and that 5% may be applicable  
 6 for the cost of unsecured borrowing for an individual,  
 7 but not necessarily a commercial enterprise.  
 8 What Mr Reynolds has said is -- and this is at  
 9 paragraph 597 -- with reference to the cost of debt of  
 10 UK companies, he said in his first report:  
 11 "Bank of England's quarterly bulletin 2013 Q4 shows  
 12 that the cost of debt for UK companies was around 6%  
 13 in 2007. Then increased with the financial crisis  
 14 before falling from 2009 to around 4.5% in 2013."  
 15 He exhibited a chart to his report that reflected  
 16 this movement. That chart is in the bundle at E7.1. It  
 17 is not necessary to turn it up, but it is referred to in  
 18 footnote 611.  
 19 We also then make the point that UBS calculated the  
 20 cost of ordinary debt as part of its analysis of  
 21 J Sainsbury's weighted average cost of capital, and its  
 22 long-term analysis showed, and you will see this at the  
 23 top of page 203, the long-term average of 10 years  
 24 pre-tax cost of debt was estimated at 6.4.  
 25 In paragraph 600 of the written submissions we have

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1 set out Mr Reynolds' description of Sainsbury's ratings  
 2 and his analysis of the average cost of debt to  
 3 Sainsbury's. And the submission then is made in  
 4 paragraph 601, and that is if the Tribunal is inclined  
 5 to make an award on a conventional basis of compound  
 6 interest then the submission is that the spread between  
 7 Bank of England base rate and the level of corporate  
 8 borrowing means that it would not be over-compensating  
 9 Sainsbury's to make the award at a premium over the base  
 10 rate that is reflected in the percentages marked in  
 11 yellow in paragraph 601. That's on the alternative  
 12 approach.  
 13 MR JUSTICE BARLING: In paragraph 601.  
 14 MR SPITZ: Sir, the last section that I need to canvass is  
 15 to refer to the various passages of MasterCard's written  
 16 closing and to give the Tribunal the references that  
 17 respond to that. But perhaps we should do that after  
 18 the break.  
 19 MR JUSTICE BARLING: We will just have a couple of minutes.  
 20 Thank you.  
 21 (4.30 pm)  
 22 (A short break)  
 23 (4.32 pm)  
 24 MR JUSTICE BARLING: Mr Spitz, if it is a few references  
 25 then obviously we are happy to take those in writing.

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1 If it is a bit more than that, then bash on.  
 2 MR SPITZ: Sir, thank you, that's helpful. I think we can  
 3 probably provide those in writing.  
 4 MR JUSTICE BARLING: Because we are going to -- I mean,  
 5 rather than --  
 6 MR SPITZ: I think I will need to get it to my colleagues  
 7 shortly so that they have the opportunity to look at  
 8 them. But I think it would save everyone time if we  
 9 produce a list of the references for the Tribunal and  
 10 for Mr Cook.  
 11 MR JUSTICE BARLING: That would be very helpful. You could  
 12 send us an email, or --  
 13 PROFESSOR JOHN BEATH: Yes, and we can follow these  
 14 references up tonight because --  
 15 MR JUSTICE BARLING: If they come within a reasonable time.  
 16 We are not trying to cut you short or anything.  
 17 MR SPITZ: After a 9.30 start.  
 18 MR JUSTICE BARLING: No, exactly. I think you'd finished on  
 19 interest at the moment, haven't you, then?  
 20 MR SPITZ: Yes. My topics were interests and benefits.  
 21 MR JUSTICE BARLING: I think there is a couple of questions  
 22 on the weighted average cost of capital.  
 23 MR SMITH: Yes. On interest, Mr Spitz.  
 24 Just starting with Sempra Metals. What Sempra  
 25 Metals seems to do is treat interest as any other head

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1 of loss, one to be pleaded and proved. But for our  
 2 purposes, we are talking about a breach of statutory  
 3 duty. And so what we must ask ourselves, but correct me  
 4 if I'm wrong, is what would put Sainsbury's in the  
 5 position that it would have been in had the wrong never  
 6 been committed?  
 7 It is the standard tortious test for damages. So  
 8 don't we have to ask ourselves what would have happened  
 9 had the wrong not been committed? In which case, what  
 10 would have happened is there would have been month by  
 11 month or transaction by transaction less overcharge paid  
 12 by Sainsbury's to the various issuing banks.  
 13 So the immediate consequence would have been the  
 14 receipt of more cash in the bank, or rather Sainsbury's  
 15 would have had more cash in the bank because it would  
 16 have paid less away.  
 17 MR SPITZ: Yes.  
 18 MR SMITH: Then in the short to medium term, depending on  
 19 how much cash Sainsbury's had in the bank and how  
 20 comfortable it felt, there would have been less  
 21 borrowing by way of debt?  
 22 MR SPITZ: That's one possibility. Less borrowing by means  
 23 of debt. It may have enabled them to pay down further  
 24 debt, they may have been able to reduce their debt. It  
 25 may have changed their mix of funding that was required.

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1 There are several possibilities as to what they  
 2 would have done with the funds represented by the  
 3 overcharge.  
 4 MR SMITH: Indeed, but clearly, one thing that might have  
 5 happened is that the overcharge might have resulted in  
 6 savings being made to other costs. So you identify that  
 7 you are spending X amount on merchant service charges  
 8 and you try and gain efficiencies elsewhere to ensure  
 9 that you maintain that expected level of profit.  
 10 But assume that that's not the route it goes, that  
 11 instead it was a depletion of the cash in bank and quite  
 12 possibly a consequential higher level of indebtedness  
 13 than it otherwise would have been. When you talk about  
 14 a mix of borrowing or a mix of funds, was the other mix  
 15 a reference to the sales and leasebacks?  
 16 MR SPITZ: Yes, indeed.  
 17 MR SMITH: Correct me if I'm wrong, weren't the sale and  
 18 leasebacks to do with the acquisition and financing of  
 19 capital projects like new supermarkets and stores, or is  
 20 that wrong?  
 21 MR SPITZ: Yes, that's indeed so. That was the main focus  
 22 of the sale and leasebacks.  
 23 MR SMITH: So isn't it overwhelmingly more likely that the  
 24 lowering of the cost would have resulted in less debt in  
 25 terms of the revolving creditors and other forms of

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1 short-term borrowings that Sainsbury's would have had?  
 2 MR SPITZ: I think it is unlikely that the funds would  
 3 simply have sat as cash in the bank, attracting the  
 4 lowest possible rate of interest, because that would  
 5 assume irrational management, or at least imprudent  
 6 management on the part of the listed company. That is  
 7 very unlikely. So I think it highly unlikely that it  
 8 would be sat as cash in the bank.  
 9 Mr Rogers says it could have been used to reduce  
 10 debt. Mr Coupe says it could have been used for  
 11 a variety of reasons. It is difficult to speculate as  
 12 to what the most likely use of the funds would be. The  
 13 evidence goes as far as it goes and one is then left  
 14 with the question, well, in those circumstances, what  
 15 sort of measure? Does one weigh the various sources of  
 16 funds together, or does one take a view that it is  
 17 confined to the cost of borrowing?  
 18 MR SMITH: But what would have happened -- again, correct me  
 19 if I'm wrong -- is that the lower cost of the merchant  
 20 service charge would have been reflected in Sainsbury's  
 21 next budget or its next half yearly, and I have  
 22 forgotten what it is called, its half yearly budget that  
 23 is a combination of a forward looking and backward  
 24 looking approach. And what Sainsbury's would have seen  
 25 is that one cost line, its operational costs on retail,

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1 would have fallen and that would have simply been  
 2 factored into the general Sainsbury's budget as one cost  
 3 line amongst many thousands against the anticipated  
 4 income from sales that Sainsbury's hoped to make.  
 5 So I entirely accept what you say, that you can't  
 6 say precisely what would have happened. But isn't this  
 7 a question of applying a broad brush and saying what, in  
 8 terms of either -- well, borrowing really -- would  
 9 Sainsbury's have done? Because you can't really  
 10 attribute a specific saving to a specific allocation  
 11 simply because that's not the way Sainsbury's appears to  
 12 have worked.  
 13 So my question really is why, then, do we focus on  
 14 the weighted average cost of capital rather than simply  
 15 the cost of debt and possibly an amount for cash in  
 16 bank? Why is the weighted average cost of capital the  
 17 measure?  
 18 MR SPITZ: Because one tries to measure what the cost of  
 19 capital across the board, what all the various sources  
 20 of capital, the cost of all those, would be when one is  
 21 dealing with an attempt to compensate for the loss of  
 22 not having the funds in hand.  
 23 MR SMITH: But suppose, and this is putting it much too  
 24 highly, but suppose we know that what would have  
 25 happened is that Sainsbury's simply borrowed less by way

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1 of short-term debt, that that is what would have  
 2 happened. Would you accept that that is the appropriate  
 3 measure and the reason you will be reverting to the  
 4 weighted average cost of capital is because there is  
 5 an uncertainty about what Sainsbury's would have done?  
 6 MR SPITZ: That's partly -- yes, that there is  
 7 an uncertainty as to what Sainsbury's would have done.  
 8 And it is partly that this is the usual approach that is  
 9 adopted to assessing the cost of raising new capital to  
 10 a company.  
 11 MR SMITH: Thank you very much.  
 12 MR JUSTICE BARLING: You are satisfied we look at the most  
 13 likely? Is that the right test? We look at what was  
 14 the most likely approach?  
 15 MR SPITZ: To the extent that one can determine that on the  
 16 basis of the evidence.  
 17 MR JUSTICE BARLING: Of what we know.  
 18 So, Mr Spitz, is there anything else on either of  
 19 those two subjects that you want to finish with?  
 20 MR SPITZ: No, thank you, sir.  
 21 MR JUSTICE BARLING: We will await those references, and  
 22 thank you very much indeed.  
 23 Mr Hoskins, do we need to sit early tomorrow?  
 24 MR HOSKINS: I would go for 10.30 am tomorrow and then if we  
 25 need early we will do it the next day.

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1 MR JUSTICE BARLING: We will go on the next day, right.  
 2 MR HOSKINS: We will burn that bridge when we come to it.  
 3 MR JUSTICE BARLING: Anyway you are not anticipating any  
 4 problems at this stage?  
 5 MR HOSKINS: No. There is a lot to get through and it is  
 6 not just in my hands, but we have got over a day and  
 7 a half. You have seen the written submissions.  
 8 MR JUSTICE BARLING: We will see how we go then, shall we?  
 9 MR HOSKINS: I think if we are struggling we can always  
 10 start early on Wednesday.  
 11 MR JUSTICE BARLING: Okay. All right.  
 12 Thank you very much. See you tomorrow.  
 13 (4.45 pm)  
 14 (The court adjourned until 10.30 am on  
 15 Tuesday, 15th March 2016)  
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