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

Day 14 Redacted

February 22, 2016

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Monday, 22nd February 2016

(10.30 am)

(Open session)

Housekeeping

MR HOSKINS: Good morning, sir.

MR JUSTICE BARLING: Good morning, Mr Hoskins. Good morning, Mr von Hinten-Reed.

MR HOSKINS: There is a couple of --

MR JUSTICE BARLING: Housekeeping points. We have one too. Can I just mention one first.

MR HOSKINS: Of course.

MR JUSTICE BARLING: We have to rise at 4.15 pm pretty sharply today, just so everyone is aware, because we need the court for something else at 4.30 pm.

MR HOSKINS: Will it involve dressing up?

MR JUSTICE BARLING: Yes. Well, some people dressing up. Not us, I'm glad to say.

MR HOSKINS: There was a limousine traffic jam outside chambers this morning.

MR JUSTICE BARLING: Was there? I think we have a record number of people coming for tea today.

MR HOSKINS: I have got a bit of housekeeping and Mr Brealey has some housekeeping.

My housekeeping is to answer Mr Smith's question about Visa premium cards. The best evidence we have

been able to find of it is in Mr Douglas' statement, so that is C2, tab 2 at page 31. It is paragraph 38. It is the second half that, really.

It starts:

"MasterCard and Visa have for a long time been the main players in the standard credit card space in the UK. That segment has, however, contracted with the development of mass affluent rewards cards, ie premium credit cards, where MasterCard primarily competes with Amex. Visa does offer a premium credit card, Visa Signature, but this is only a small percentage market share in this respect, likely to be less than 1%."

I hope that's sufficient. It is short, but if that answers your question?

MR SMITH: That's helpful, thank you.

MR HOSKINS: Mr Brealey wants to raise something.

MR JUSTICE BARLING: Mr Brealey.

MR BREALEY: I have a little grumble in the way that Mr von Hinten-Reed is being cross-examined.

As the Tribunal will have seen, we were given the bundle E14, which had undisclosed documents in it. Since then we have had more undisclosed documents that I have complained to, but not to the Tribunal, so we have been drip fed the undisclosed documents while Mr von Hinten-Reed has been in the box.

Then, at 8 o'clock or whenever it was on Friday evening, we get another undisclosed document relating I think, I don't know because I haven't had a chance to talk to anybody, to a speech that Mr von Hinten-Reed gave in 2008 relating to pass-on.

I take it that MasterCard, Mr Hoskins, are going to wave it in front of Mr von Hinten-Reed Perry Mason-like as if it is some coup d'etat sort of thing.

But the bottom line is that I would ask the Tribunal to look at everything with a degree of caution because a lot of the cross-examination has been -- there's been a lot of articles he hasn't had a chance to talk to his team about. And I would ask the Tribunal to give Mr von Hinten-Reed a degree of latitude when he is cross-examined on these undisclosed documents, and it may well be that if I have got a chance to talk to him afterwards I might have to recall him. I don't know.

But it has been quite unsatisfactory when we have got the thousands of documents that have been disclosed by the experts, and the majority, the lion's share of the cross-examination has been by reference to undisclosed documents.

I just put my marker down on that because we thought we had done away with trial by ambush with the Woolf reforms. In my respectful submission, it is not really

an appropriate way to go about it. If they have had this slide pack -- I understand from Mr Hoskins, who I trust implicitly -- for a week, then it should have been disclosed a week ago.

MR JUSTICE BARLING: Is that the one that we are told has just been added?

MR BREALEY: Yes, rather than late on a Friday evening, it should have been disclosed a week ago.

I don't know how long the solicitors have had it, for example. But it is not the way to go about cross-examination of experts in my submission. And that's my grumble and I would ask the Tribunal to take it into account when one looks at the transcripts and hears the evidence.

MR JUSTICE BARLING: My colleagues may have other things to say, but my reaction is that it is a legitimate grumble. It obviously is unsatisfactory that new documents come in when a witness is being cross-examined, when he hasn't necessarily had enough time to consider them. We very much are alive to that already. You can rest assured we are alive to that and to any sign that Mr von Hinten-Reed feels uncomfortable or feels he is unable to give a proper answer or to do himself justice, and we have obviously watched out for that.

MR BREALEY: I'm obliged.

MR JUSTICE BARLING: But you know, on the other hand this is not uncommon. Documents come to light when people start rooting around, and it might be equally unfair not to give the witness a chance to comment on them.

So as I say, we will keep it under review and if Mr von Hinten-Reed feels he can't answer something properly or do himself justice without having longer to study something that he hasn't read at all or hasn't read recently, then we will look at that suggestion carefully when it is made.

MR BREALEY: It is just that. To give the witness some homework to do overnight is not necessarily the way to go about it.

MR HOSKINS: Sir, I'm very grateful for Mr Brealey to say that he trusts me implicitly because it is certainly not my style or intention, I hope it has been fairly clear throughout, not just in relation to this matter but I have been very keen to accommodate Mr Brealey's witnesses to make sure people aren't caught out.

Sir, you are absolutely right that in a case of this sort when one is preparing, documents come to light because clearly there are rooms full of documents that could be relevant to an issue such as this, but you can't produce them all. And the truth of the matter is that when I was finalising my cross-examination at the

early part of last week, the two articles came to light as a result of queries I put to Oxera because obviously we had seen some helpful literature that went up to 2011.

So I asked the question then: is there anything else I should be looking at, and got the two articles which are there.

The bulk of E3.14 actually arises out of the Tribunal's questions, because three of the tabs relate to the FCA, and we went into that to answer the detailed questions in the Tribunal's table.

The other documents relate to Australia, which again were part of the detailed information that the Tribunal -- so that is why they went in. And the remaining documents in there were four printouts from the Amex and MBNA websites just to evidence the non-controversial fact that there are premium cards, or Amex cards and MBNA cards which fees aren't required for.

So I apologise for the fact that things have been this way. It is not trial by ambush certainly by design, but as you said in a case of this sort it happens and I'm certainly not trying to take anyone by disadvantage.

In relation to the slide pack that's gone in now,

that's something that I first read at the start of last week. It is not a disclosable document because we are not relying on it for the truth of anything that's contained within it. The reason why the slide pack is relevant is because in it Mr von Hinten-Reed expresses views which are different to the views he is now expressing in evidence. That's not a disclosable document.

I must admit my initial reaction was I can put this to him by handing it up in the box because that's what it goes to. But I thought actually that's not the best way to do it, so we will send it across in advance to try to avoid --

MR JUSTICE BARLING: This goes back to 2008, does it?

MR HOSKINS: It is a talk he gave in June 2008.

MR JUSTICE BARLING: I think we will wait and see, if you put it to him, whether he feels he needs further time.

MR HOSKINS: Whatever is required in order for this to work to everyone's satisfaction, I'm perfectly happy with.

These documents that are in E3.14, in a sense, once I became aware of them or became aware of the relevance of them, I had to disclose them to the Tribunal. I was under an obligation to do so and then one has to work through.

I think Mr Brealey has been very fair. He raised

trial by ambush, but it is not trial by ambush --

MR JUSTICE BARLING: He has put down a marker, that's all, and he is not taking any formal objection at the moment to any of this.

MR HOSKINS: And I'm grateful to him.

MR JUSTICE BARLING: Okay.

MR NILS VON HINTEN-REED (continued)

Cross-examination by MR HOSKINS (continued)

MR HOSKINS: Good morning, Mr von Hinten-Reed.

A. Good morning, Mr Hoskins.

Q. I'm not sure whether you have brought the Brussels weather or I have brought the Glasgow weather, but between the two of us it is not great.

Can we go to bundle A, please, tab 3. That's the list of issues, list of expert issues, the agree/disagree statement.

If you go to 1.2, it is headed "Scope and duration of claim".

A. Yes.

Q. 1.2 says:

"The claim is limited to the period from 19th December 2006 for transactions in England, Wales and Northern Ireland, and 19th December 2007 for transactions in Scotland."

A. Yes.

Q. Obviously you were aware of that difference because it's in the experts' joint statement, yes?
A. That's in the experts' joint statement, yes.
Q. I'm sorry, I'm told it is the list of issues. Are you aware of this?
A. Yes, I have seen this document.
Q. You have seen this before, thank you.
Then if we can go to D2.1, tab 6.
A. Do I still need this folder?
Q. You don't.
A. Mr Hoskins, as a matter of process, are we in confidential --
Q. It is open.
A. Okay.
Q. This should be the addendum to your second report. I am going to show you something confidential, but we are not going to go into the detail of it.
At page 7 --
A. Sorry, which tab is it?
Q. Sorry, tab 6. It should be the addendum to your second report.
A. Yes.
Q. At page 750 of the bundle, do you see the heading "Value of Commerce" halfway down the page?
A. Yes.

Q. "This section provides an update ...(Reading to the words)... commerce calculations."
Then:
"Table 2.1 shows the total domestic interchange fees paid for MasterCard transactions between January 2000 and November 2015."
Is it right, then, that this table, these value of commerce figures, include MasterCard transactions in Scotland between January 2007 and 19th December 2007?
A. I cannot tell you on the stand now. I would like to check, but to the extent they do include transactions in Scotland between 2006, outside the claim period, then they should not.
Q. Is that something that you are able to correct, obviously not now but out of the box?
A. Well, we should be able to correct it if Sainsbury's can actually provide us with a split.
Q. I should say, sir, this is something we raised in our skeleton argument but hadn't had a response on, so I'm happy for it to be tidied up after the event.
A. I apologise, it should be.
Q. Thank you. Can we go to your second report next, so that is D2.1, tab 3.
If we go to page 565, paragraph 701, at the third bullet, you say:

"Cost-based methodology is useful as a cross-check on MIT-MIF estimates."
Can you just explain why cost-based methodology is useful as a cross-check on the MIT-MIF estimates?
A. I will try and be brief. The MIT-MIF methodology in the second bullet point points to a more direct measurement. The Visa 2 methodology is a more indirect method, and to the extent that that Visa 2 has transaction -- the costs of processing payments and the cost of card fraud, it acts as a proxy.
And so if you look at your MIT-MIF estimate of -- I have got 0.15 and then you look at the Visa 2 type methodology of 0.02, that gives you a sort of an informal cross-check.
Q. You are going to need D2.1 quite a lot --
A. I will keep it here.
Q. Yes.
A. I will create my mountain.
Q. Exactly. E3.14, tab 270. You will see this is an issues paper dated March 2015, issued by the Reserve Bank of Australia, yes?
A. It is, yes.
Q. If we can go to page 6281, you will see that on page 6281, just below halfway there is a paragraph that begins "the board's reform process". Do you have that?

A. I see that.
Q. Then the final sentence of that paragraph says:
"The board announced a package of reforms in August 2002 after extensive consultation."
The next paragraph refers to the first reform measure. The final paragraph on page 621 says:
"The second measure, the standard on interchange fees came into effect in July 2003."
Then over the page, the next paragraph:
"The standard set an interchange fee benchmark for each scheme and increased transparency of these fees. The benchmark was based on the average costs of the issuers of each scheme. Since November 2006 there has been a common cost-based benchmark ...(Reading to the words)... for both MasterCard and Visa."
So the RBA tells us the benchmark was based on average costs of the issuers of each scheme.
It is correct, isn't it, that their RBA adopted an issuer costs-based approach to compute its cap on interchange fees?
A. Yes.
Q. Are you aware that in the US, the Federal Reserve system adopted a rule on debit card interchange fees in 2011?
A. Yes.
Q. Are you aware that the interchange cap adopted was based

on issuer costs?
A. Yes.
Q. Can we go back to D2.1, this time to page 547.
615, this is where you deal with the cost-based methodology and in particular respond to Dr Niels' analysis.
You say:
"In his first expert report, Dr Niels argues that issuers costs are a practical proxy to assess benefits accrued to merchants from the use of cards. He subsequently uses the results of cost studies ...(Reading to the words)... by EDC to estimate a cost-based MIF for credit cards. The resulting estimated MIF is 0.75% to 1.31%. This result is mainly driven by the inclusion of credit costs.
"When these costs are excluded, as they should be as ...(Reading to the words)... transactional benefits ought to be taken into account, the cost-based MIF falls to 0.2% to 0.35%."
Just to make sure I have understood the position correctly, your position, and the main difference on this issue with Dr Niels, is that the provision of credit is of no benefit to merchants and therefore should be wholly excluded from a calculation based on issuer costs; is that correct?

A. That is correct.
Q. You have already agreed that a merchant which accepts credit cards has a competitive advantage over one which does not, correct?
A. It offers the consumer an alternative, yes.
Q. Can we go to E3.14, 266, the Rysman and Wright article. If you go to page 7510, it is the second paragraph on that page.
It begins "Rochet and Tirole 2002", do you have that?
A. Yes, second paragraph.
Q. Yes:
"Rochet and Tirole 2002 focus on the case of a single card platform in which merchants all obtain the same convenience benefits of accepting cards. Homogenous merchants and consumers face fixed, for example, annual fees for holding a card. They are the first to introduce ...(Reading to the words)... regardless of how consumers pay, will tend to internalise the surplus they offer to cardholders in a decision about how much they are willing to pay to accept cards.
"In their model, this result comes from the fact that merchants take into account that card acceptance allows them to offer more surplus to their customers who

get a benefit from using cards and so can get a higher price without losing market share. Subsequent research (Farrell 2006, Wright 2010/2012, Rochet and Tirole 2011) has shown that merchant internalisation is a much more general phenomenon ...(Reading to the words)... Simply put, when a merchant accepts cards it is improving the quality of the service it offers consumers, the option of using cards for payment, and it is only natural this allows it to charge a higher price. The more surplus it can offer consumers, the more it is willing to incur a cost to do so. This phenomenon is no different from any other service a merchant may employ to attract customers for which it does not set a separate price."
That's obviously correct, isn't it?
A. It is a correct description of the theory, yes.
Q. Do you agree with the theory?
A. The theory is a theory. It is set out there.
Q. But do you agree with the theory?
A. I agree with the theory.
Q. Can we go to tab 265, that is the prior tab. This is the Tirole 2011 article.
If we go to 5687, it is the last paragraph on 5687, Tirole says:
"In general, though, the second notion exceeds the first. Consumers may inquire into whether the shop

takes the card before going to or entering a shop or else consumers may be repeat consumers. Either way, accepting the card makes the shop more attractive and results in extra sales. The merchant may then take the card even though she wished that conditional on the customer making a purchase ...(Reading to the words)... who carried American Express cards rather than by a demand for economising on the cost for cash transactions however high this cost may be."
Again, that's obviously correct, isn't it?
A. Yes.
Q. It follows that your MIT-MIF, which only takes account of narrow benefits, is lower than the result that these theories would suggest?
A. My MIT-MIF is, and the calculation of that MIT-MIF is supposed to be consistent with the requirements of the question I have been posed, which is what are the benefits under 101(3) and how do we measure them?
The theory has broader benefits because it is a regulatory literature, which I think we addressed on Friday.
Q. Do you agree that your MIT then produces a lower result than would suggested by the application of the approach that we've just seen by Rysman and Wright and Tirole?
A. It would certainly be lower than Rochet and Wright. The

Rochet and Tirole article, we have taken -- if you apply Rochet and Tirole properly --
Q. Sorry, which year are we talking about? The 2008 one?
A. 2008. I should be very clear. They must take cards.
If one literally took that article, and indeed, I think Deloittes took that article, and the Commission to that article, initially called scenario 1. That's the tourist test. And the tourist test is where you just come into the store one time and that's it. And that produces MIT-MIFs which are very low. Indeed, that was the MIT-MIF that was in the particulars of claim, 0.04.
That's why when it came to the expert report, I took a different view and that is I wanted to actually think about the avoidable costs, scenario 2, to actually measure the benefit that I think is consistent with article 101(3). And that's my expert opinion.
Q. So your MIT-MIF is less than you would get if you applied the Rysman and Wright approach. I think you just accepted that, yes?
A. Rysman and Wright is a survey article.
Q. It is this specific theory we just looked at, sorry, in Rysman and Wright, which was at page 5710, if you want to look at it again, tab 266.
A. And the specific theory is --

Q. Page 5710. So your MIT-MIF would produce a lower result than if you were to take account of the theory set out at Rysman and Wright at 5710?
A. 5710, let me just go to that.
Q. No, no, sure. It was the two paragraphs we just looked at beginning "Rochet and Tirole --
A. I just want to go back. If I recall the article in Wright that would be correct.
Q. Can we go back to the Tirole 2011 article, which we have just been looking at in the previous tab, 265?
A. Yes.
Q. And this time go to 5697.
MR JUSTICE BARLING: I'm sorry, it is my fault, I am a bit confused.
I think the witness has said that his approach to MIT-MIF would produce a lower result than would be produced looking at the model on page 5710. Was it your reply that it would produce a lower result also than the model discussed at page 5687?
A. 5687 is the traditional approach, the tourist test approach, where you have one single transaction. That is akin -- apart from altering it to valuing only the merchant benefit not the cardholder benefits. That's what Rochet and Tirole do: They maximise user surplus.
If we change that to be more 101(3), then that's

scenario 1 for Deloitte and that produces a lower number than the number I have used. My number is in scenario 2. Hopefully that clears it up.
MR JUSTICE BARLING: I think the answer is yes, then?
A. Yes.
MR HOSKINS: We have some further questions on the Tirole 2011 article which hopefully will further clarify.
MR JUSTICE BARLING: You are now at 5697?
MR HOSKINS: That's correct, yes. So it's within the same article.
A. So we are now at 5697?
Q. We are now at 5697, that is right.
A. Okay.
Q. It is the second bullet where Tirole says:
"Merchant demand for card usage could be defined in two ways: narrow, the net benefit for the merchant, how much they directly save when a card payment substitutes for a cash or a cheque payment as well as the enablement of transactions which otherwise would not occur."
Pausing there, that is your approach, isn't it?
A. The first one, yes, it is. It is about 101(3)(a), the efficiencies, and then basically the most important thing is actually the fair share for merchants.
Q. Then if we go on, he goes on to say -- so this is:

"Merchant demand for card users can be defined in two ways ..."
Narrow, which is your approach, and broad:
"... a concept that further includes the ...(Reading to the words)... in the case of a consumer who does not need to be attracted through card acceptance, the hypothetical tourist, while the broader concept applies when the merchant views her card acceptance policy as a means to attract consumers to her shop. What the merchants can bear lies between these two benchmarks."
Then, if we go to B, halfway down the page:
"Implications for policy making.
"Regulated interchange fees should not lie below the level set by the tourist test, which reflects the first benchmark. That is the interchange fee should be at least equal to the difference between the merchant's benefit from card usage and the acquiring cost."
On the basis of that analysis, you said you agreed with the theory when we saw it expressed earlier in this article. Your narrow approach will deliver the lowest end of the spectrum for the MIF, will it not?
A. I think that needs to be clarified, sir. The hypothetical tourist, the one-off purchase, produces a very low figure which I have not used. That is scenario 1. Both the Commission and I have had to alter

the -- or take on board the lessons of Rochet and Tirole. But think in terms of the avoidable cost, that is scenario 2, that produces a higher figure than the ultimately lowest one you are mentioning. But then that is lower than the other ones.

I hope that gives you --

Q. No, that's very clear, thank you.

Then can with he go to E3.6, please, tab 130A. This is the Rochet and Wright article. We have actually got two versions of it and they are slightly different. So I would like to take you to the one that was published in the Journal of Banking and Finance. That is at page .33 behind this tab.

It is the second column, the final paragraph, which begins "in our model credit cards". Do you see that? It is the second column, last paragraph.

A. Yes, I see that.

Q. "In our model, credit cards can be used for two types of transactions. Ordinary purchases for regular convenience usage for which cash or a debit card are assumed to provide identical benefits, and for credit purchases, where credit is necessary for purchases to be realised.

"Credit purchases could capture a range of different types of purchases, such as unplanned purchases, impulse

purchases ...(Reading to the words)... available to complete the purchase, or for purchases for which the deferment of payment facilitates the transaction. Thus offering credit allows individual merchants to make sales that they otherwise would not make.

"The ability to make these incremental sales is, we think, the major reason explaining why merchants accept credit cards and, indeed, are willing to pay higher fees to do so, compared to the fees paid to accept credit cards, and why prior to the ...(Reading to the words)... was much more widely used than today."

Again, your MIT-MIF is inconsistent with that analysis, isn't it?

A. Correct.

Q. The interest-free funding periods provided by credit cards allow consumers who do not have sufficient cash at the time they make a purchase to purchase goods or services earlier than they might otherwise do so. Do you agree?

A. Yes, and they pay back the next month.

Q. The shifting forward of consumption in that way produces net present value effects for merchants, doesn't it?

A. It will induce it one period and then reduce it the next.

Q. But in economic terms, money in the hand earlier has

more value than money in the hand later; that's why I used the phrase "net present value"?

A. The question is whether this produces a net benefit for all merchants, not for one.

Q. Again, you need to sometimes just answer the question that's put.

A. Okay.

Q. The shifting forward of consumption produces net present value effects for merchants, doesn't it? Net present value effects. It is a narrow question.

A. Yes, it does.

Q. Can we go back to E3.14, please.

A. Do I still need E6?

Q. You won't. Back to tab 265, the Tirole article. This time at 5688.

You see at the bottom of page 5688, Tirole says:

"Suppose first that a customer in the shop does not have enough money in his bank account to purchase the good or service immediately. Either the purchase was unforeseen or the transaction costs of asking for an overdraft facility at his bank were perceived as high. Were the merchant not to accept credit cards, the transaction would not take place, generating a loss for the cardholder but also for the merchant who would then lose ...(Reading to the words)... is therefore

an important benefit for the merchant."

Again, that's obviously right, isn't it?

A. There may be this benefit.

Q. Say it again? I didn't quite catch it.

A. There may be this benefit.

Q. But if it does miss a sale then the benefit is missed, yes?

A. For the individual supermarket. Yes.

Q. He goes on to say:

"There is indirect evidence that this benefit may be sizeable. For durable goods, large merchants often subsidise credit on their own despite the ...(Reading to the words)... additional transaction costs stemming from a new loan contract and the multiplication of the consumer's creditors making the surveillance of consumer solvency more difficult."

Again, that is correct, isn't it?

A. That may be correct, but I'm not sure that actually -- I don't see the additionality here.

We have got a credit card. That's in existence, and then large merchants are subsidising credit. The cardholder could actually get the same benefit from getting a loan from the bank or getting an increased debit card, or indeed having a debit card.

Q. That's what I would like to come on to. Let's go to

D2.1, tab 3, which is your second report. If we go to page 555, it begins at the previous page, 554. At paragraph 653, you are dealing with aggregate merchant benefits.

In the last sentence of paragraph 653, you say:

"Thus, an increased use of credit cards is more likely to crowd out other types of consumer loans rather than to lead to more borrowing."

It is very unlikely that consumer loans would be used in many instances where a credit card is used to make individual purchases, isn't it?

A. There's always an alternative. The banks -- the point here is the banks offer credit and it is profitable to do so. You can then basically use your debit card because the loan money would be in your current account and the debit card is attached to the current account.

So the alternative to a credit card here is maybe actually the debit card.

Q. But only if the person who wants to make the purchase has sufficient money in their account at the relevant time to make the purchase, otherwise the debit card is not an alternative?

A. For example, if it is a large transaction one would hope they actually understand how much they have in their current account and also think about whether they can

afford the purchase.

Q. Absolutely. So imagine a worker who gets paid at the end of each month but wants to buy something before then. So they know at the end of the month they will have the money, but they don't have it now. They might well choose to use their credit card to make that purchase earlier than would otherwise be possible, correct?

A. They would, and then they -- if they don't repay it, then the next month they have to have the principal and then there is interest on top. So they are worse off the next period.

Q. A worker in that position is much more likely to use a credit card rather than go through the burdensome process of trying to obtain a personal loan to make that purchase, is he not?

A. They may do, but there's no additional sale overall because the next period they actually have to pay off the interest on the principal. If they keep it any longer, that builds up.

Q. The truth is although there is some overlap, credit cards and consumer loans are not very close substitutes, are they, in practical terms?

A. The issue is whether the bank wishes to offer money. It can offer money via a credit card. It can offer money

via a loan. Here, we are talking about whether there are -- in this section -- is about whether there are aggregate merchant benefits.

Q. I'm dealing with the likelihood that the man in the street who wants to make a purchase a bit earlier than usual will either take the interest-free period on his credit card or go through the formal process of obtaining a personal loan from the bank. It is obvious that in the majority of cases the former will be preferable because it is much less hassle, correct?

A. It can be less hassle. I would refer you to the FCA chapter 5, which has a very good discussion on this.

Q. You told us before that you are aware of section 75 of the Consumer Credit Act 1974?

A. Yes.

Q. That makes credit providers liable on the same basis as suppliers for breach of contract to misrepresentation?

A. Yes.

Q. Now, that's a benefit for holders of credit cards, isn't it?

A. It is a benefit for holders of credit cards, yes.

Q. That legal right is particularly important in e-commerce, isn't it, because it encourages consumers to transact with merchants they may know nothing about safe in the knowledge that if anything goes wrong they will

have a claim against their credit card provider, correct?

A. Yes, the law provides an underpinning. It is not the MIF.

Q. There may also be a benefit for merchants insofar as the cardholder looks to its credit card provider for compensation rather than the merchant, correct?

A. The merchants -- the benefit is the -- the merchant in terms of online sales, it is another distribution channel. So it is just a matter of whether they benefit from the additional sale.

Q. I've not made my question clear enough and it is my fault.

A. Okay. Please.

Q. Imagine a situation in which there is in fact something wrong with the goods purchased and the consumer makes the claim against the credit card provider rather than the merchant. That's a benefit for the merchant, isn't it?

A. The merchant benefits to the extent the cardholder actually gets his or her money back.

Q. From the credit card provider rather than the merchant?

A. From the credit card rather than the merchant, but it is a basic thing that this would happen anyway.

Q. Can we go to page 565 in your second report.

Paragraph 699 begins:
"However, this overestimates the benefits that merchants receive from card payments as compared to cash. This is because a proportion of these costs ...(Reading to the words)... just as safe as cash payments.
"These costs do not create benefits to merchants above the use of cash. They just prevent that merchants are much worse off because of card payments. If ...(Reading to the words)... cash to cards does not create any safety related efficiencies or benefits. Thus, only that proportion of costs which serves to make cards safer than cash can be seen as creating a benefit to merchants."
On that basis do you agree that a merchant obtains a benefit when a customer pays by card but subsequently defaults on payments to his issuing bank?
A. What I'm not clear is how that is then safer than cash.
Q. But do you agree that a merchant obtains a benefit when a customer pays by card but subsequently defaults on payment to his issuing bank?
A. Again, that doesn't tell me why cash is not to be compared.
Q. Let's leave that and answer the particular question, which is: do you agree that a merchant obtains a benefit

when a customer pays by card but subsequently defaults on payment to his issuing bank?
A. There is an element -- okay, I will agree the cost of default on that payment may be a benefit for the merchant. I do not quite see why that is compared with cash, where the efficiency lies.
So if we are moving from cash to cards, which is what the efficiency is, what is the additional benefit that we are deriving here and where does the MIF actually come into this?
Q. And therefore in those sorts of sales what happens is they lead to additional transactions by customers who have access to credit cards but don't have the cash to make a transaction. So a merchant therefore makes more sales than he would if all customers had to pay in cash.
A. A merchant. We have not identified that that is a benefit to all merchants.
Q. But you accept the premise I just put?
A. I accept part of the premise you just put.
Q. Which bit do you accept and which bit do you not accept?
A. I think I have just said we have not established that this is a benefit to all merchants, and I do not think we have accepted this is a benefit derived from the MIF.
Q. Can we go to D3, tab 3, which is Dr Niels' first report. If we can go to page 291. I want you to look at

table 5.1, but we both need to bear in mind that the figures are confidential, so we can't say the specific figures out aloud.
You will see in the table 5.1, the heading "Cost category":
"Credit and fraud ...(Reading to the words)... credit write-offs."
Then there are two percentage figures to the right of that. Do you have that?
A. Sorry, could you do that again, please, Mr Hoskins?
Q. Of course. So it's table 5.1. Then there are certain figures, and to the left of them there is the heading in bold "Cost category". Then the first entry is:
"Credit and fraud losses including risk control of which credit write-offs," then there are two figures for credit write-offs in percentages.
Are you with me?
A. Yes, I am.
Q. Those credit write-offs of which merchants get the benefit compare favourably with the average level of the MasterCard MIF which was under 1% for the period of the claim, don't they?
A. The point here is that this is a cost borne by the banks, the issuers, at the same time they benefit from the revenue. There is no additionality. As I mentioned

a minute ago, this is not a benefit to merchants in terms of resulting from the MIF.
Q. But you did accept that in relation to default payments, the merchants do benefit, or at least you say the merchant benefits from additional sales, correct?
A. No, I said additional sales, a merchant, not all merchants --
Q. Yes.
A. That is the point that we get to when we think about measurement.
Q. Yes. But individual merchants you accepted benefit from that sort of default transaction, yes?
A. There may be a benefit to the extent that there is -- that the bank takes up the cost, but the bank takes up the cost because it makes increased revenue from the credit card.
Q. But the merchant makes a sale, receives money for the sale that it would not otherwise have got because the bank pays rather than the customer who cannot pay?
A. It is a bit like the analogy that MasterCard ought to be asked by Sainsbury's for a contribution to the shop till wages. You know, this is something that is provided with a credit card, this is a service. You have got a cost, there is a revenue associated with it at the issuer bank.

To the extent we are talking about transaction costs, which is the processing costs and to some extent a fraud cost, the funding costs are a 28-day period. Then that's where my point 2 comes from. And the funding costs I say are not in necessarily in Visa 2 for domestics, so you don't include those. And the rest are basically credit costs which are borne by the issuer and they get the revenue.

I hope I'm clear.

Q. You disagree with Dr Niels that the availability of credit leads to a long-term increase in aggregate spending by consumers, don't you?

A. Yes, I do.

Q. But you don't suggest, do you, that the correct position has been conclusively proved either way, do you?

A. I think actually that, not to invoke sort of Margaret Thatcher, but most people do not kind of believe that having a credit card or increasing the number of credit cards necessarily increases aggregate spend in the economy.

Q. But there are views expressed both ways in the literature, correct?

A. I think mostly they are on my side.

Q. But there are views expressed both ways in the literature?

A. There is some evidence produced by Dr Niels, but as I said, I don't believe that is conclusive evidence sufficient to conclude there is additional sales at the merchant levels.

MR HOSKINS: Sir, I now have to move into confidential elements so I'm in your hands as to how to structure the morning.

MR JUSTICE BARLING: You are satisfied it can't be done --

MR HOSKINS: No, I have to do something on this topic and then I move into pass-through where all of Sainsbury's pricing methodology is confidential. It is just not possible to tip toe through that.

MR JUSTICE BARLING: Okay. I think what we will do in that case, I'm afraid, it does mean, as people are now getting used to, that those who are not in the confidentiality ring will have to leave the courtroom until we take the notice off the door, which we will do as soon as we possibly can. I don't know when that will be.

MR HOSKINS: It will be the whole of pass-through so it will be a while. The one thing I want to say, it is yellow confidentiality, not blue.

MR JUSTICE BARLING: Yes, it is the claimant's.

MR HOSKINS: I don't know if that makes a difference to who can stay and who can go.

MR JUSTICE BARLING: Right. So anyone who is entitled to remain during the claimant's confidential material being canvassed, can remain because it is only going to be the claimant's confidential material.

So we will take a short break now while you work out whether you are entitled to be here or not. Thank you.

(11.20 am)

(End of open session)

(A short break)

(11.36 am)

(Beginning of yellow confidentiality session - REDACTED)

(4.20 pm)

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