

1 mechanism and therefore should be banned.
 2 The conclusion of the case, it was more likely than
 3 not that the payment system required a form of balancing
 4 payment, interchange, but that the participants in such
 5 an arrangement could not do so without setting the
 6 interchange with reference to cost.
 7 So every time you wanted to revisit on a periodical
 8 basis the interchange in the market to ensure it was
 9 correct, there would be a requirement to undertake
 10 a cost study.
 11 So from Edgar Dunn's perspective that is where our
 12 methodology originated from. We looked at if there is
 13 an imbalance in the card payment system, it must be because
 14 there is probably something on the issuing side that is
 15 of value to the acquiring side. We tried to quantify
 16 those; we came up with the methodology we currently
 17 apply.
 18 Whenever this methodology was applied in the given
 19 market we believe, and we strongly advised our clients,
 20 that it would be wise to apply this periodically to
 21 update the numbers to ensure you were in line with the
 22 market. Because there would be things that are changed,
 23 such as interest rates in the market, so the cost of
 24 funds, the bad debt, the fraud, these things need to be
 25 updated periodically to ensure you are in line with what

21

1 happens.
 2 Q. The last point you just made, which seems to be a very
 3 valid point, why is it that the last Edgar Dunn cost
 4 study is 2008? Why hasn't there been an update?
 5 A. That was because of the European Commission case and the
 6 OFT at that stage basically stating that they did not
 7 believe the application of the methodology was correct
 8 anymore, and therefore MasterCard deemed that it would
 9 be -- there was no value in undertaking a cost study
 10 that would be rejected immediately.
 11 Q. And that's the reason you didn't do a further one?
 12 A. Yes.
 13 Q. But had they not intervened, you would have advised your
 14 clients strongly to update the cost studies?
 15 A. Yes. That would have been very nice for us as well.
 16 Q. If I was doing a calculation for an interchange fee
 17 today, I would not be relying on this cost study
 18 because, as you say, interest rates change and all that
 19 sort of stuff?
 20 A. I would agree.
 21 Q. In fact, it would be rather foolish to calculate
 22 an interchange fee based on this cost study?
 23 A. Yes, I think it is outdated.
 24 Q. Yes, thank you.
 25 So let's go to this cost study, and what I want to

22

1 do, and again I don't think there's anything in issue
 2 here really, it is going through the process, and it is
 3 to assist the Tribunal as to the costs that you have
 4 taken into account.
 5 If we could go to page 2499. This is at internal
 6 page 2, 2499:
 7 "MasterCard commissioned a study to review the
 8 relevant cost structures ...(Reading to the words)...
 9 interchange costs. The primary objective of this study
 10 is to gather sufficient data to be able to calculate
 11 statistically representative interchange costs for
 12 domestic pay later transaction in the UK market."
 13 So that is basically the background and purpose of
 14 the study, to calculate a statistically representative
 15 interchange cost?
 16 A. Yes.
 17 Q. Then if we go over the page, we see -- again, we will
 18 come onto this in a bit more detail later on because you
 19 deal with it -- the study was conducted according to
 20 MasterCard's global methodology:
 21 "The methodology measures the cost associated with
 22 key activities undertaken by credit and charge card
 23 issuers that relate to providing a payment guarantee to
 24 the merchants and funding and completing the
 25 transaction. The costs measured are associated

23

1 with ..."
 2 Then these are our famous friends:
 3 "Losses resulting from fraud and credit risk;
 4 non-reimbursed funding costs; operating costs incurred
 5 for risk management and transaction completion."
 6 Those are the ones we see time and time again, for
 7 example, in the Commission's 2007 decision.
 8 A. Yes, correct.
 9 Q. If one then goes over the page, I think this is 2502.
 10 Can I call it internal page 4?
 11 MR HOSKINS: 2501.
 12 MR BREALEY: It is 2501. Okay. So this is the sample size.
 13 So this is the representative sample.
 14 If I can just go to the first two paragraphs and
 15 then the last paragraph:
 16 "So the overall objective of the sample selection
 17 was to achieve a representative sample of issuers across
 18 which to measure the interchange costs. As with every
 19 sampling exercise, this involves a trade-off between the
 20 additional cost of collecting information from a larger
 21 sample and the improvement in accuracy of the results
 22 that could be obtained from an increasing sample size."
 23 Then:
 24 "Given the cost of collecting relevant information
 25 from issuers was unrelated to the size of the

24

1 ... (Reading to the words)... was focused on the largest
 2 issues in order to limit the overall number of
 3 participants, while ensuring that the sample included
 4 a significant proportion of the transactional volume in
 5 the market."
 6 So there you are concentrating on the largest issues
 7 and transactional volume, correct?
 8 A. As part of the selection for the study, yes.
 9 Q. Then you go on, I will just ask you about this:
 10 "In other regulatory environments, MasterCard has
 11 aimed to measure a majority of transactions in the
 12 market to provide a statistically valid sample. For
 13 example, MasterCard Europe has agreed with the European
 14 Commission that a representative sample for undertaking
 15 a cost study in a given market would be achieved if the
 16 participating banks would account for at least 70% of
 17 the transaction volume in the market.
 18 Edgar Dunn & Company has applied the same rationale for
 19 the selection of participants in the UK market."
 20 Could you just assist. What was this agreement with
 21 the Commission that a statistically representative
 22 sample would comprise MasterCard participating banks
 23 that accounted for at least 70% of the transaction
 24 volume? Where did that agreement come from?
 25 A. That goes back many years ago. That was when we

25

1 started, I think it was the 2004 cost study,
 2 cross-border cost study, and the Commission, as
 3 I understand it, was in discussions with both the major
 4 schemes, Visa and MasterCard, about how they collected
 5 their data, what the sample sizes were and whether it
 6 was representative or not.
 7 They put two requirements in place. One was
 8 a minimum sample size that would cover a certain
 9 percentage of the market. And the second was that the
 10 study process should be audited and that they should be
 11 supplied with an audit report on it to ensure that the
 12 application of the methodology and the process indeed
 13 came back with fair and reasonable results.
 14 We did not change any of our process in applying and
 15 complying with this, and in our case Deloitte audited
 16 the cross-border studies. And when you see the reports
 17 linked to the 2005 and the 2008 studies, what we did was
 18 we actually were commissioned by MasterCard to do
 19 cross-border studies and for a select number of markets
 20 to do a domestic study at the same time.
 21 To do a domestic study at the same time we had
 22 a much more specific domestic information data
 23 collection set that enabled us to calculate at a more
 24 detailed level what happened in the specific domestic
 25 market.

26

1 So in reference to this, the 70% was a minimum
 2 requirement. We have tried always where we could to go
 3 higher than that --
 4 Q. Pausing there. 70% was sufficient for a robust study?
 5 A. Well, for the purposes of the Commission. But you
 6 should compare that to markets such as -- I will take
 7 a small market, Norway. Norway is predominantly small
 8 independent savings banks, and you have 400 savings
 9 banks for a country of 5.5 million people. It is
 10 clearly totally impossible to undertake a cost study of
 11 400 savings banks.
 12 What we would do was to segment in strategies the
 13 size of the banks and then pick over -- I believe we had
 14 four segments, and we picked representative sample banks
 15 in each and then pro rata'd their cost structure to
 16 represent over 70% of the market.
 17 Q. Just pausing there. You look at table 1. There is
 18 seven is there? There is seven. They are the issuing
 19 banks. I mean, they seem quite large to me. Clearly in
 20 the UK, even at that time, you had other banks. You
 21 had, from memory, Clydesdale Bank, the Co-operative
 22 Bank, Coutts, Yorkshire, the building societies,
 23 Bradford & Bingley, Alliance & Leicester, we can go on.
 24 Why pick those big seven and exclude the smaller
 25 ones?

27

1 A. We are seeking representative samples of transactional
 2 activity. That's what the Commission asked us to do and
 3 that's how we chose the sample.
 4 So as you can see, this was over 90% of all the
 5 domestic transactions in the UK. That would be, in all
 6 instances I have come across, deemed to be a very
 7 representative sample.
 8 Q. So picking the largest you thought was a representative
 9 sample?
 10 A. Yes.
 11 Q. If you go to page 7, as with many studies you have to
 12 check the quality of the data. So as I understand it,
 13 you are telling the reader, me and the Tribunal and the
 14 others -- and this is, for example, the last line on
 15 page 7 -- that you draw on your extensive experience in
 16 payment service and utilised statistical methods
 17 basically to validate the quality of the data.
 18 Can you assist the Tribunal how you go about
 19 ensuring that the quality of the data is achieved?
 20 A. Yes.
 21 Q. But why is that? Is that because of some sort of self
 22 selection bias? The issuers here know the reason that
 23 they are giving the data, I guess. They know that it is
 24 going to go and form the basis of an interchange fee?
 25 A. You could argue that. In our case I think it is just as

28

1 much if we are going to put our name on a study you want
2 to make sure that that data is correct. We are not just
3 going to accept what people tell us.

4 Q. Right.

5 A. So we have several levels of analysis to undertake. The
6 first is that we ensure that the data sources they use
7 for costs are linked to their internal cost mechanisms.
8 So they are cost centre reports; the P&L basically for
9 the organisation. And we know where the data came from.

10 The second is we then ask for a whole range of
11 activity numbers around that. So we might ask for, or
12 we would ask for the number of applications received,
13 the number of those that have been approved, the number
14 of cards issued in a given year of which how many were
15 new cards, how many were replacement cards, in terms
16 just they expired and renewed, and how many were ad hoc
17 renewals.

18 And by looking at what we call performance
19 statistics around the bank, we would be able to see
20 outliers.

21 So if we saw a bank, for example, that had very low
22 customer recruitment cost, we would be looking for
23 a reason for that. And we would be trying to understand
24 whether it was operational, whether it was they ran some
25 kind of very successful recruitment programme that could

29

1 explain that low cost there, and if they did that that
2 was all right.

3 Q. So you are looking for outliers, are you?

4 A. We are looking for outliers as well as understanding the
5 organisational structure of them. You know, how big is
6 the department they're running and how many applications
7 are they running through it. Do they outsource, and if
8 they're outsourcing does that look as if it's expected
9 to be in that cost range for that volume of business
10 that they are outsourcing.

11 Q. I see. Even after that, drawing on your expertise, as
12 I understand it you get the cost study audited by, or
13 you did, by Ernst & Young; is that right?

14 A. As I said, this was the EC Commission that requested
15 that the study should be audited. It was a complete
16 independent process.

17 I think Deloitte -- no, it was Ernst & Young, you
18 are absolutely right. Ernst & Young told us -- we
19 informed them: here is the study, here is the scope of
20 it. They then told us what they wanted to do in terms
21 to audit the study. So they looked at our
22 questionnaires, the models we built, they participated
23 in member banks, they looked at the audit trail
24 documentation we had built so that if we had a question
25 on some cost we could go back and say you reported this,

30

1 that and the other, can you just check these areas
2 because there seems to be something that looks odd,
3 either too low, too high, whatever it might be.

4 They then looked at our -- in detail we submitted
5 the cost model to them and they had some Excel auditors
6 actually run through it in detail to make sure there
7 weren't any wrong links or anything that was going on.

8 So it was a very hands-on detailed audit process
9 developed for the benefit of the Commission. We never
10 saw the report. It was submitted to MasterCard and
11 I believe then submitted to the Commission together with
12 our study.

13 Q. I see, thank you.

14 Now, I would like to go to the categories of cost,
15 which is clearly important in this case. And I just
16 need to ask a few questions on these types of cost.
17 I would like to go to -- first of all, if we just --

18 Taking it in stages, 2506, which is internal page 9.
19 And I'm actually going to go to page 12 ultimately, but
20 we will get the feel of what's going on at internal
21 page 9, 2506.

22 From the total costs collected, the costs were
23 allocated into cost component categories associated with
24 providing issuing services.

25 Then you have table 2 where we have our famous

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1 friends, the credit write-offs, collection department,
2 fraud losses, fraud investigation department, funding
3 costs, processing costs. We are going to come onto
4 those in more detail in a moment.

5 Then over the page, again we see table 3:

6 "These cost components ..."

7 Again, the famous friends:

8 "Actual credit write-offs, collection department,
9 fraud losses, fraud investigation, funding costs."

10 Then:

11 "Transaction costs", number 6, is split into 12
12 subcategories. Yes?

13 A. Yes.

14 Q. I know it is a long time ago --

15 A. No, no.

16 Q. You are probably well aware of it. Then over the page
17 to internal page 10, 2508 --

18 MR JUSTICE BARLING: Page 11, actually.

19 MR BREALEY: Is it? I will blame Mr Spitz. It is internal
20 page 10. No, 11, sorry.

21 The internal paragraph:

22 "The cost analyses with the model are conducted on
23 a purely historic basis with no forward-looking element
24 applied."

25 What does that actually mean, "no forward-looking

32

1 element applied"?

2 A. Because the question has been asked before. What if you

3 expect in the next two years we are going to see

4 a downward trend in funding costs, for example? Why

5 wouldn't you build that in?

6 Q. Yes.

7 A. The reason that we have always preferred to take purely

8 historical data is in the hypothetical case that you

9 predicted wrongly, that a development might happen on

10 interest rates or bad debt or something, let's assume

11 that we predicted too low an interest rate and it was in

12 fact higher, what do you then do the next time period

13 you are doing a cost study? Do you ignore that? Do you

14 try to recover the under recovery? You end up

15 potentially in a purposing effect, and therefore we just

16 went on purely historical data. And as long as it is

17 updated in a reasonable time period, that's probably the

18 best you can do.

19 Q. Thank you.

20 So then we go to internal page 12, which is a table.

21 What I would also like you to do, please, we are going

22 to have a look at that table, but also could you go to

23 bundle D2.1, tab 3, page 550 and 551.

24 If we put that to one side, but I will be coming to

25 that in a moment. Just so you know, all these figures

33

1 are agreed. It is essentially, just to let you know,

2 CEG is Sainsbury's expert in this case. It is table 8.1

3 and 8.2 we will be looking at, but the figures come

4 from -- we see the source, table 8.1, Dr Niels' first

5 expert report.

6 A. Yes.

7 Q. You've probably met Dr Niels. He is the expert for

8 MasterCard.

9 Table 5.1. Essentially if you go to table 5.1 and

10 5.2, all that CEG is doing is replicating Dr Niels'

11 figures. But these figures, you will see, are very

12 similar, if not identical to the figures in this 2008

13 cost study report.

14 Now, we have, just to be careful, table 8.1,

15 MasterCard would prefer to keep confidential. So that

16 is the reason they are in blue. But the figures in

17 table 8.2 are not confidential because essentially they

18 are aggregated, yes?

19 A. Yes. They look similar.

20 Q. I want to go through the categories of cost, and going

21 back to your report, so the 2007, what we need to do is

22 keep a finger in internal page 12 and internal page 16.

23 Internal page 16 --

24 MR JUSTICE BARLING: Sorry, Mr Brealey, just for my note,

25 did you say that these were the same as the ones in

34

1 tables 2 and 3, or in the summary table, or -- probably

2 both, I suppose -- in the EDC report?

3 MR BREALEY: Yes. So the figures -- I'm going to get the

4 numbers right --

5 MR JUSTICE BARLING: The figures in 8.1 and 8.2.

6 MR BREALEY: Yes, we are going to go through that in

7 a moment.

8 The figures in the table on page 12 we shall see

9 will reflect the figures in table 8.1.

10 MR JUSTICE BARLING: Right, thank you.

11 MR BREALEY: These are confidential so I won't read them

12 out, but if you compare 8.1, credit write-offs, and we

13 are looking at 2008 not 2005, so if you have a finger

14 under credit write-offs, the percentages is almost -- it

15 is rounded up. Collections department again is the same

16 figure. So we are looking at the 2008 study, total

17 fraud costs.

18 In table 8.1 that figure is the combination of the

19 total fraud costs and the fraud investigation

20 department. So that is why it is -- then, you get the

21 total direct risk control, and then you have the

22 funding.

23 So if you look at table 8.1, the funding costs for

24 2008, the figure is almost identical, except that (iii)

25 has gone right at the end because you have rounded down.

35

1 Then the processing costs, if you go all the way down,

2 so you have got those -- I think those ten

3 subcategories. You end up with a figure in table 8.1

4 which is equivalent to that subtotal processing.

5 How it goes is this table 5.1 of Dr Niels' and

6 table 8.1 of Mr von Hinten-Reed's. But the figures are

7 the same. That's the kind of ... (Pause)

8 I think you can put D2.1 away now if you want to.

9 It is important to know the relevance of this to the

10 experts. So, again, these figures are in blue: We have

11 actual credit write-offs and we get a definition of that

12 on internal page 16. So actual credit write-off, net of

13 recoveries.

14 So this says:

15 "The cost category relates to actual net credit

16 write-offs of balances on accounts considered to be

17 uncollectable during the year. The average cost of

18 actual credit write-offs is ..."

19 Then we blue that out.

20 Can you explain in a little bit more detail what

21 "actual credit write-offs" mean to the Tribunal?

22 A. When a customer initially goes bad, as it is termed in

23 the industry, you have a front end collection process,

24 which is typically people up to two to three cycles bad,

25 up to 90 days. You try to work them in a polite manner

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1 and try to just convince them to make payments in
 2 accordance with the agreement. That's called front
 3 office.
 4 Then you have the back office collection team who
 5 are typically people three cycles over get transferred
 6 to, and that is when you start doing actual collection
 7 cases. And they are regulations enforced in the UK as
 8 to how long you can have an account sitting in the back
 9 office collection process before writing it off if you
 10 don't make any progress on collecting on it.
 11 So you can have a voluntary repayment agreement with
 12 the customer, in which case it doesn't get written off;
 13 it is actually a worked account. But if it is one where
 14 you have made no progress, you will have to, after
 15 a certain time period, write it off and it goes into the
 16 P&L as an written off account. You do not have to stop
 17 working. You can have an unexpected recovery, which is
 18 why we net those off from the actual bad debt that's
 19 been collected.
 20 Now, the UK is one of the more developed markets.
 21 There are certain, for example, Eastern European
 22 markets, there's no guidelines as to when do you have to
 23 write an account off. And therefore, these figures can
 24 be quite difficult to determine. The UK is very clear.
 25 Q. Let's be clear on that, then. If I kind of buy, I don't

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1 know, a mobile phone for £100 on a credit card, and
 2 I don't pay it off at the beginning, so I start paying
 3 interest, and let's assume I pay £10 interest, but then
 4 I default. Do you write off the £100, or the £90?
 5 A. From memory, I -- this is a long time since I have
 6 looked at it so I will stand corrected if I'm wrong on
 7 this. But from memory, I do not believe you are allowed
 8 to record interest payments as bad debt.
 9 Up to the point where the account went into -- I'm
 10 trying to recall it. I think up to the time when the
 11 account goes into collections, the interest can accrue
 12 to the account. Once it is in collections, you can no
 13 longer have interest charged or written off to it.
 14 But I will stand corrected on that. I really cannot
 15 recall off the top of my head what the rules are in the
 16 UK. I could find out if that helps.
 17 Q. You may have to assist MasterCard on that at some point,
 18 but you can't remember whether --
 19 A. The data we collected was in compliance with the UK
 20 regulations as to what could be written off or not
 21 written off in your accounts. These are the audited
 22 accounts by the participants in the studies.
 23 MR JUSTICE BARLING: Just remind me, these regulations, are
 24 they accounting or banking regulations or just consumer
 25 credit --

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1 A. I think they are consumer credit regulations. They are
 2 part of the credit licence regulations and banking
 3 regulations, I believe.
 4 MR JUSTICE BARLING: Maybe take a break in the next five or
 5 10 minutes, whenever it is convenient, just so the
 6 transcript writers can have a rest. It is up to you
 7 when.
 8 MR BREALEY: Yes. If I have got, say, 10 minutes --
 9 MR JUSTICE BARLING: Sure.
 10 MR BREALEY: Then I can finish. Not finish, but finish
 11 Mr Sidenius 1 and then I have got to go on to
 12 Mr Sidenius 2.
 13 MR JUSTICE BARLING: Right. That's probably a natural --
 14 MR BREALEY: A natural break and I will try and hurry this
 15 up a bit.
 16 MR JUSTICE BARLING: Don't feel you have to.
 17 MR BREALEY: That is the actual credit write-offs.
 18 If we go back to internal page 12, page 5081. So we
 19 have done actual write-offs. Now we have collections
 20 department. That's the next one on the list. Again, if
 21 we go back to internal page 16. I'm going to flip to
 22 and fro in these pages.
 23 The collections:
 24 "Collections relate to the cost of monitoring and
 25 managing the collection of outstanding and past due card

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1 receivables [ie debts] ...(Reading to the words)...
 2 telephone calls to cardholders whose payments are past
 3 due, the amortisation of equipment and systems used
 4 solely by the department, or the relevant portion of
 5 shared equipment and other related costs. The cost
 6 category does not, however, include head office and
 7 other corporate level costs allocated to the collections
 8 department."
 9 Is there anything you can add to that to assist the
 10 Tribunal as to what is meant by collections, or do you
 11 think that is a fair summary?
 12 A. I think it is a fair summary. It is basically once
 13 an account goes into default, then -- and that
 14 delinquency -- I should probably use as a term rather
 15 than default. Once it becomes delinquent, so payments
 16 have ceased to happen on the account, then you start
 17 working it. You send either reminders, nowadays emails,
 18 telephone people, not at 6 o'clock because that has been
 19 banned now, but you try to contact them politely to make
 20 them make a payment. And as I said, if it then
 21 continues, there's no progression in getting any
 22 payments on the account then it goes to back office and
 23 then you start initiating legal proceedings.
 24 Q. So that is the collections department. Then can we just
 25 park total fraud costs and fraud investigation

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1 department and go to the funding cost, which is on
 2 internal page 2, (ii). The funding costs. Yes?
 3 That is defined on internal page 16.
 4 Again, funding costs:
 5 "These are non-reimbursed funding costs represented
 6 by interest expenses the issuer incurs to fund the
 7 cardholder receivables from the time of posting to
 8 cardholder account or cleared funds settlement with the
 9 acquirer, if this is earlier, until payment is received
 10 from the cardholder or interest begins to accrue if the
 11 cardholder revolves the account ...(Reading to the
 12 words)... sixty days."
 13 Is there anything you can add to that definition as
 14 to what funding costs would amount to?
 15 A. They are -- there are -- those balances that do not
 16 generate any interest income for the issuer. So
 17 a revolving account generally. If you post a new
 18 transaction to the account that revolves from day one,
 19 it accrues interest. So the costs of that are not
 20 covered, the revolving outstandings are not included in
 21 this amount either. And the rule of thumb if you go
 22 around Europe is that, sort of two-thirds, 60%, 70%,
 23 80%, 75% are revolving balances, and the remainders, so
 24 the minority of outstanding balances, are not incurring
 25 any interest income for the issuer and would be the free

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1 funding period costs that we measure here. And they
 2 support approximately two-thirds, 60%, two-thirds of
 3 accounts.
 4 MR JUSTICE BARLING: Sorry, I'm not quite sure -- does all
 5 that mean that the funding cost here is the free --
 6 A. Purely the free period, that only some of the customers
 7 benefit from. But the vast majority of customers.
 8 MR JUSTICE BARLING: Yes.
 9 A. So as I said, about --
 10 MR JUSTICE BARLING: Sorry, why do only some benefit?
 11 A. Because those that are paying interest will be charged
 12 interest from day one on transactions as well.
 13 MR JUSTICE BARLING: I see. If you have been revolving, you
 14 have got a revolved debt on your card, you don't get the
 15 28-day, or whatever it is, free period?
 16 A. No.
 17 MR JUSTICE BARLING: I follow. Only those who are --
 18 A. Full payers.
 19 MR JUSTICE BARLING: Who pay off get that free period.
 20 A. That is correct.
 21 MR JUSTICE BARLING: I see. I hadn't appreciated that.
 22 MR BREALEY: Is it not the case that two-thirds of credit
 23 card users are revolvers?
 24 A. No. Balances, yes. Only about one-third of account
 25 holders revolve. Probably in the UK 35% to 40%, I would

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1 say, revolve, but as a rule of thumb going around the
 2 world. And if I do a portfolio evaluation and I look at
 3 the convenience users, as we call them, I expect them to
 4 be about two-thirds of the accounts and I start asking
 5 questions if they are not. And for outstanding balances
 6 if I see much less than two-thirds revolving, then
 7 there's something to question on the valuation of that
 8 portfolio as well.
 9 MR BREALEY: I think I'm just about to go on to the second
 10 witness statement, so maybe that is a --
 11 MR JUSTICE BARLING: We will take a short break now.
 12 MR BREALEY: Thank you.
 13 A. Thank you.
 14 MR JUSTICE BARLING: Thank you very much.
 15 Mr Sidenius, have a wander round by all means, but
 16 don't talk to anyone.
 17 (3.08 pm)
 18 (A short break)
 19 (3.20 pm)
 20 MR BREALEY: Mr Sidenius, I'm moving slightly out of my
 21 depth here because we are going into economics, but can
 22 we just again -- my Lord, you may have been handed that.
 23 I'm going to take the witness through this document.
 24 MR JUSTICE BARLING: Right. Thank you.
 25 MR BREALEY: It puts as best we can what Mr Sidenius says in

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1 his second statement.
 2 MR JUSTICE BARLING: Right.
 3 MR BREALEY: Just to kind of flag where we are going to put
 4 that pie chart in context, have you still got your first
 5 statement open?
 6 A. I do, yes.
 7 Q. At paragraph 5 onwards for a few paragraphs, you refer
 8 to the cost study methodologies. You refer to, for
 9 example, paragraph 6, that you have used two main
 10 methods for assessing interchange costs associated with
 11 payment cards. The proxy method, we could say, is the
 12 issuer's cost methodology?
 13 A. Yes. That's your terminology.
 14 Q. And the Baxter methodology you say is based on a --
 15 proxy, whereas the Baxter-style methodology is now used
 16 to measure debit cards and the Baxter methodology
 17 involves the measurement of the end-to-end costs
 18 involved in a payment card transaction.
 19 So it is looking at end-to-end costs, issuers and
 20 acquirers. And you say that you have applied the proxy
 21 method, ie the issuer's cost, to credit cards. Can you
 22 say correct or not, because a nod --
 23 A. Sorry, a nod doesn't work. Correct.
 24 Q. But then you flagged in paragraph 10 of your statement
 25 that you have:

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1 "... applied our proxy method in payment card cost
 2 studies for many years. However, during the course of
 3 the OFT investigation into MasterCard's pay later
 4 interchange fees in the UK, we did carry out a mini and
 5 maxi Baxter-style analysis of credit card costs.
 6 "The end result," you say, "was close to the
 7 existing UK domestic pay later fees in place."
 8 So that was paragraph 10.
 9 Just before we go on and flesh some of that out, you
 10 are aware, of course, that the OFT and the European
 11 Commission have not found favour with the Baxter
 12 methodology? There is quite some considerable debate in
 13 both?
 14 A. The way that we use the Baxter methodology, in our view,
 15 and I am aware that they have preferred to use the
 16 merchant indifference test finally, but they have been
 17 using different methodologies. They used what we call
 18 the proxy methodology, the issuer as a reference, as you
 19 have also referred to before in the Visa ruling.
 20 Q. The Visa exemption decision?
 21 A. The Visa exemption, sorry. We felt, if anything, that
 22 was a form of endorsement of the analysis we had done.
 23 The Baxter analysis they perhaps don't agree in the same
 24 way.
 25 Q. Yes. So we have paragraph 10, and then, as it may have

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1 been explained to you, we were talking about interest
 2 and the European Commission in its decision and the
 3 General Court saying that you had to take interest into
 4 account when you are looking at proxy or the issuer cost
 5 methodology. So you are aware of that issue, yes?
 6 A. That wasn't the driving cause for the analysis we did
 7 here.
 8 Q. No?
 9 A. The question we were trying to answer was the proxy
 10 methodology, as we referred to it, which was developed,
 11 as I said, as an outcome of the NaBANCO case where we
 12 had to have a cost base reference for making decisions
 13 on interchange. And as I said, we looked at what would
 14 be fair and reasonable to say is of benefit to the
 15 acquirer that they can provide to the merchant that
 16 indicates why they are willing to pay this amount that's
 17 needed in a four-party system.
 18 But the question that came was: well, how do you
 19 know that that is reasonable relative to the economic
 20 theory? And the economic theory, having been written up
 21 by William Baxter, who actually was with the Department
 22 of Justice during the original NaBANCO case, and so he
 23 took five years to write up his economic theory --
 24 Q. He must be a very disappointed man, yes.
 25 A. Possibly. But when we then looked at what could we

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1 benchmark the proxy methodology against, we decided
 2 that, well, if we were to apply the Baxter methodology,
 3 which is to say let's measure the end-to-end cost, let's
 4 try and get a measure of demand, and by using revealed
 5 willingness to pay, which is the pricing that exists in
 6 the market, we cannot prove, and we never intended to
 7 prove, and we also -- I had several discussions with
 8 economists -- it is near on impossible to prove optimal
 9 output. But we could certainly prove for this point in
 10 the demand curve whether the distribution of costs
 11 reflected what the proxy methodology came up with, and
 12 that's what we intended to do.
 13 Q. Okay. Well, let's just then go to your second
 14 statement, which is at tab 8. We will need to go also
 15 to -- that E bundle can go away. I think they have been
 16 put in E3.13, which is the annexes to your second
 17 statement. E3.13. As I understand it, it is tab 261.
 18 So the recent documents are more or less at the back.
 19 We can go and have a look at a few -- so it is E3.13,
 20 tab 261, which is your mini Baxter, as I understand it.
 21 A. Yes.
 22 Q. We are going to have the pie chart in front of us. If
 23 I just explain, if I'm looking at the pie chart, if
 24 I just explain what this is trying to do. So as
 25 I understand it, Mr Sidenius, your second statement came

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1 about because of a question by Mr Justice Barling which
 2 related to interest payments. Are you aware? Was that
 3 explained to you?
 4 A. Yes, it was explained that a question on that had arisen
 5 and had we ever done any work that looked at the revenue
 6 side.
 7 Q. Correct. If you look at the footnote of the first page
 8 of this, this is the passage that we have seen a few
 9 times in these proceedings now from the General Court.
 10 So I'm looking at the pie chart thing, where the
 11 court says:
 12 "As the Commission has pointed out, in essence it is
 13 sufficient to note that it is based [that is the second
 14 assumption] on a partial presentation of the issuing and
 15 acquiring business taking into account only the costs
 16 borne by the issuing bank and omitting the revenues for
 17 other economic advantages they obtained from their card
 18 issuing business, notwithstanding the latter's
 19 importance."
 20 One way of looking at this -- and we would say
 21 that's clearly what the Commission had in mind because
 22 it rejected the Baxter analysis of willingness to pay --
 23 is that, and you will see this from the front page, you
 24 have got to take the issuer's revenues into account by
 25 netting off. Do you understand what I'm talking about

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1 there?
 2 A. Mmm.
 3 Q. Again, Sarah Love is responsible for these pie charts,
 4 not me. But the reference to pie comes from
 5 Professor Beath, which is where we got the idea from.
 6 PROFESSOR JOHN BEATH: Statistically they are called pie
 7 charts.
 8 MR BREALEY: So the issuer's costs pie. So these are the
 9 costs that we have been talking about: funding costs,
 10 the fraud costs, collections department, processing. So
 11 that is the pie of the issuer's costs.
 12 Then we have the issuer's revenues pie, and so you
 13 have net interest, income, about three-quarters,
 14 interchange. This comes from a MasterCard slide; we
 15 have given the source there. Yes? Again, certainly as
 16 far as the MasterCard slide is concerned, we haven't
 17 challenged it.
 18 Would you accept that if you were to take the whole
 19 of the interest that is paid to banks, which is in the
 20 region of about £8 billion, that is another slide that
 21 you have seen there, 8 billion -- would you say that
 22 they would exceed the issuer's costs of providing
 23 the credit?
 24 A. Providing the credit?
 25 Q. Look at the issuer's pie there. And then you compare

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1 that to the interest payments and other economic
 2 advantages. I would suggest to you it is plain as
 3 a pikestaff that the revenue that the banks receive in
 4 interest payments and other card fees far exceeds the
 5 costs that they incur, funding costs, processing costs
 6 fraud costs.
 7 A. The costs -- the revenues would exceed the costs,
 8 I would agree with that. Whether they do it to the
 9 extent that they generate a required return is a totally
 10 different question, and whether you would be in the
 11 business or not.
 12 The second point I think I would add there, because
 13 I'm guessing where this is going is that that revenue,
 14 the interest revenue derived from the lending comes from
 15 the minority of the cardholders, and if we are talking
 16 about whether that should be offset against
 17 transactional activity, then we are cross-subsidising
 18 one set of customers from another, I'm not sure that's
 19 a fair interpretation either.
 20 Q. Right. You mentioned the two-thirds point. I would
 21 like you to keep your finger, or if you have a pencil or
 22 something, or a pen -- I don't want to abandon that tab.
 23 A. Yes.
 24 Q. If you go to tab 249, you have mentioned this one-third
 25 a few times now, and it is at page 5315. Do you see on

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1 the left-hand side there is a figure? As I understand
 2 it, Mr Sidenius -- don't read it out because, as
 3 I understand it, MasterCard regards it as confidential.
 4 Do you see that you could be wrong on that one-third
 5 figure?
 6 A. I would think that whoever provided this slide has got
 7 his title wrong.
 8 Q. Right.
 9 A. I absolutely would reflect it for balances, not for
 10 consumers, cardholders.
 11 Q. So, whatever --
 12 A. If it said two-thirds of all credit card balances are
 13 revolving, I would agree.
 14 MR JUSTICE BARLING: So you are distinguishing balances from
 15 consumers, from customers?
 16 A. Yes, from users of transactional services.
 17 MR BREALEY: Now, as I understand it, when we go to your
 18 second witness statement -- so if we can flip forward,
 19 back to tab 262.
 20 A. Yes.
 21 MR BREALEY: The exercise that you have done in this --
 22 MR JUSTICE BARLING: Sorry, while you are looking for the
 23 place there, I just want to be absolutely sure what you
 24 are saying, all users of transactional services. How do
 25 you distinguish those again from credit card customers?

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1 A. I was looking at the slide as I was closing it.
 2 I noticed that they had interest bearing, pay down
 3 customers and then they had pure revolvers. If they had
 4 done that analysis over a full year, it is not
 5 impossible that that chart could be correct. So I grant
 6 you that.
 7 At any given time, when you ask who are paying
 8 interest on the accounts, what the interest bearing
 9 accounts are, month by month, which is what we do in our
 10 analysis, it is roughly one-third, maybe 40% of accounts
 11 that incur interest every month. The rest of them --
 12 and people transit into that proportion and out of it
 13 again, but typically about 60% will not be paying
 14 interest.
 15 MR JUSTICE BARLING: In any given month?
 16 A. In any given month. Then, because people who are
 17 revolving are using up part of their available spend
 18 limit, they tend to transact less. So you will find the
 19 people who pay in full are higher transactors; they use
 20 the transactional services on the account more than the
 21 people who are paying interest. Which is why I was
 22 saying that if you then start saying that the interest
 23 bearing balances should pay for the transactional
 24 services you are effectively forcing a subset of the
 25 customers to cross-subsidise the transactional activity

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1 of the others.
 2 You may take the view that that's an inherent
 3 product feature. You may also perhaps argue that if you
 4 had a lend business that transferred the loan balance
 5 into a separate account apart from the transactional
 6 account, you would have pure transactional cost to
 7 support in the other business. You, of course, have
 8 less collection cost and less bad debt, but that would
 9 be equivalent to a charge card, which you see in
 10 a number of European markets.
 11 MR JUSTICE BARLING: Thank you.
 12 MR BREALEY: So if we can go back to -- did I say 262? 261,
 13 which is your --
 14 A. Yes.
 15 Q. Which is not the draft one. This is the mini one.
 16 These were prepared -- these are quite old --
 17 in 2002. These were prepared for the OFT proceedings,
 18 as I understand it?
 19 A. That was correct. The mini Baxter -- we had a timeline
 20 to submit the data and that's why we undertook the mini
 21 Baxter, because we could complete that in time by having
 22 a small sample on the issuing side. And post the
 23 submission, we prepared the maxi Baxter which had
 24 a bigger issuer sample, more representative, and
 25 submitted that to MEPUK. And as I understand, they

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1 submitted it then to the OFT for information afterwards.
 2 And I do believe the OFT refer to it.
 3 Q. They actually refer to you as well --
 4 A. I was there, I know.
 5 Q. I don't need to go to it, but it is E1, tab 3A,
 6 page 250A.003 for the Tribunal's note, footnote 745.
 7 You seem to have answered a question or given evidence.
 8 I might come back to that a bit later on.
 9 But before we get to what you have done, the point
 10 of the first page of this pie chart is to show how it
 11 may be understood about taking into account revenues and
 12 netting it off.
 13 Now, when we get to what you have done in your mini
 14 Baxter, you have not netted it off?
 15 A. No.
 16 Q. And the reason that we have done these -- you might have
 17 to help the Tribunal. I will do the best I can.
 18 The steps that you have done in order to achieve
 19 an interchange fee, I will kick off and then you tell me
 20 if I get it wrong. What we have done, taking your
 21 witness statement and then the Baxter report, there
 22 seems to be five steps, so bear with me and if we get it
 23 wrong then please tell me.
 24 The first step -- and this is at internal page 11 of
 25 this report, 5561. So if you go into your report, so

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1 ultimately you are coming up with an interchange fee
 2 which you say is broadly similar to the proxy method.
 3 It is essentially what is happening here, correct?
 4 A. Yes.
 5 Q. So the first step is that you have got to create the
 6 pie, but here you don't just create the issuer's cost
 7 pie, you have an issuer's and acquirer's cost pie. And
 8 one sees on page 5561, internal page 11, the ingredient,
 9 if I can put it that way, of the issuer's part, which is
 10 far more than the three types of, or the costs --
 11 A. Yes.
 12 Q. Then we also add into the mix -- this is page internal
 13 page 12, 5562 -- acquirer's cost. This is going into
 14 the pie, and one of the acquirer's costs you will see
 15 there is the merchant service charge, which is the
 16 interchange fee.
 17 A. No. That's not an acquirer cost.
 18 Q. Sorry. I beg your pardon. The merchant service. We
 19 come onto the interchange fee. You are absolutely
 20 right, in the revenues part.
 21 So the issuer's and acquirer's cost pie, we have the
 22 acquirer's cost on page 12; is that right?
 23 A. Yes.
 24 Q. The merchant recruitment, authorisation processing,
 25 merchant servicing. So that is how we get the pie.

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1 Then, I was jumping ahead of myself, we have the
 2 issuer's and acquirer's revenue pie.
 3 A. Correct.
 4 Q. We get that from page 15. So the issuing costs, that is
 5 the first bullet point, is the card fees, interest
 6 revenues, late fees, over limit fees, other revenues,
 7 correct?
 8 A. That is correct.
 9 Q. And then the third bullet, that's where we get the
 10 merchant service charge, the interchange fee. So the
 11 interchange fee goes into the revenues pie?
 12 A. Correct.
 13 Q. As you are aware, that's one of the things that the OFT
 14 objected to, yes?
 15 A. Yes.
 16 Q. So the interchange fee goes into the acquirer's pie, and
 17 that's why that 28% is quite large. But we then go on
 18 to the third stage, we have to slice the cost pie in the
 19 revenues ratio. And pausing there, we don't actually
 20 know, do we, what the size of the revenue pie is. So
 21 although we have --
 22 A. No, there was very good reasons for that. That it was
 23 felt that it would be anti-competitive to reveal
 24 detailed revenue information. Especially the acquiring
 25 market was quite -- what do you call it --

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1 Q. Sensitive?
 2 A. No, consolidated. Quite --
 3 Q. Aggregated?
 4 A. Well, no, there were about three players who had a very
 5 significant market size, and if they backed their own
 6 revenues out of the analysis then we would be signalling
 7 basically. So that is why we just purely put the splits
 8 down.
 9 Q. You would appreciate for someone who is trying to
 10 replicate it, whereas the cost pie we can see the pence,
 11 we don't actually know what the actual size of the
 12 revenue pie is. We get your percentages, but we don't
 13 actually know what the ingredients are.
 14 A. I regret to say that was on legal advice.
 15 Q. Right. But you are where you are?
 16 A. Yes.
 17 Q. But it is very difficult to replicate, you would agree
 18 with that.
 19 Then the third stage is slice the cost pie into the
 20 revenue ratios. This is at page 14, as I understand it.
 21 So at the bottom, you say:
 22 "Given that both issuing and acquiring are highly
 23 competitive, the proportion of revenues contributed by
 24 cardholders and merchants has been assumed to be a good
 25 estimate of the relative margin of willingness to pay."

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1 This is a buzzword that comes in. You are trying to
 2 work out what is the relevant marginal willingness to
 3 pay, correct?
 4 "For both approaches the marginal willingness to pay
 5 was determined by the average issuing and acquiring
 6 revenues, excluding interchange revenues and costs of
 7 issuing and acquiring respectively."
 8 So that is the third stage: slice the cost pie in
 9 the revenues ratio, correct?
 10 A. That is correct.
 11 Q. You say, and we set out what you have said underneath
 12 the first point which is:
 13 "The proportion of revenues contributed by
 14 cardholders and merchants has been assumed to be a good
 15 estimate of the relative marginal willingness to pay."
 16 Essentially you are taking the percentages and what
 17 you are saying is that's a proxy for the willingness
 18 to pay?
 19 A. Yes, or the demand.
 20 Q. Demand, yes. I don't know whether this is confidential
 21 now, but you end up with a certain pence.
 22 A. Yes.
 23 Q. Then the fourth step is to subtract the acquirer's
 24 costs --
 25 MR JUSTICE BARLING: Sorry, can you just tell me where that

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1 something pence is again that you were referring to just
 2 then?
 3 MR BREALEY: Yes. If you take our pie chart first --
 4 MR JUSTICE BARLING: Am I looking at the pie chart or the
 5 Baxter analysis?
 6 MR BREALEY: If I take my Lord to the pie chart first. So 3
 7 "Acquirer share to pay". So the percentage times --
 8 MR JUSTICE BARLING: I was following the Baxter analysis,
 9 sorry, rather than your handout.
 10 MR BREALEY: I see. So in the Baxter analysis if you look
 11 at page 16, after "determining the optimal multilateral
 12 interchange fee", we see "full service approach", the
 13 MIF equals --
 14 MR JUSTICE BARLING: That.
 15 MR BREALEY: -- the pence. Now, that pence, just so that
 16 you -- if you go back to page 12.
 17 MR JUSTICE BARLING: Yes.
 18 MR BREALEY: Where it says "total payment system costs".
 19 MR JUSTICE BARLING: Yes.
 20 MR BREALEY: Is 2 ...
 21 MR JUSTICE BARLING: Yes, I see it. That is the same as MIF
 22 there?
 23 MR BREALEY: Yes. Then you have your percentage. Then you
 24 are going to minus the costs -- so you are now going to
 25 take away the total acquiring cost at page 12 again.

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1 MR JUSTICE BARLING: I get it now. Now that I realise you
 2 were actually looking, when questioning Mr Sidenius, at
 3 the handout rather than the -- that's fine.
 4 MR BREALEY: So the step forward, subtract the acquirer's
 5 costs. And then at 5, divide by the average transaction
 6 size. Then you get the MIF at the end.
 7 MR JUSTICE BARLING: Yes.
 8 MR SMITH: Mr Brealey, when one is talking about cost of
 9 funds, that is the cost to the bank of advancing all of
 10 the credit to the cardholder market?
 11 MR BREALEY: I think that is correct.
 12 A. That is correct.
 13 MR BREALEY: It is a much bigger cost pie. Yes.
 14 MR SMITH: So we see that it is on the second page, issues
 15 cost funds -- I don't know if I should say it -- but the
 16 figure is there in dark blue on the first issuer's and
 17 acquirer's cost pie. But it is not present on the one
 18 on the first page, the issuer's cost pie, where the only
 19 funding costs are the costs of the credit-free period.
 20 Would that be right?
 21 MR BREALEY: So Mr Sidenius, maybe you could help.
 22 A. The first pie, although it references different
 23 materials, that's taken from the previous proxy
 24 methodology. This is only the free period funding
 25 that's included in that number.

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1 MR SMITH: So under the label "Funding costs".
 2 A. Yes.
 3 MR JUSTICE BARLING: That's only the free period?
 4 A. Under pie 1, that is correct. And on page 3 the funding
 5 cost includes extended and free period.
 6 MR JUSTICE BARLING: On pie 3.
 7 A. On pie 3, yes. Actually, pie 1, the second one --
 8 MR SMITH: Yes, on page 2. We need to number our pies,
 9 I think.
 10 MR JUSTICE BARLING: So pie 3 includes the total cost of
 11 credit; is that right?
 12 A. Yes, outstanding balances.
 13 MR SMITH: As you say, it is a much higher figure. That's
 14 what I was expecting.
 15 MR BREALEY: Are you happy, my Lord?
 16 MR JUSTICE BARLING: Sorry, just remind me, Mr Sidenius, in
 17 pie 3, the acquirer's share of that total cost that you
 18 see in percentage terms, what does that --
 19 A. It represents -- and this is -- it is an interpretation
 20 of Baxter's theory where he says you take the marginal
 21 cost on both sides and add them up on the marginal
 22 transaction. Then you look at the marginal demand and
 23 you can get the split of who should carry how much of
 24 the cost to socially optimise the output.
 25 And apologies, I'm not an economist, so please

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1 correct me if I get it slightly wrong. So what we did
 2 was we are not working on marginal costs, but we work on
 3 aggregate cost in the market. We are looking at the
 4 whole issuing side and the whole acquiring side, and
 5 then we look at the revenue split as a proxy for the
 6 demand knowing that we are not proving optimal output
 7 because that is virtually impossible. I think most
 8 economists that I have discussed it with have said that
 9 is an incredibly hard burden to try and prove.
 10 But we are using the revealed willingness to pay as
 11 a point on the demand curve, that says accepting this is
 12 a point on the demand curve, we end up with this type of
 13 split. And what we have come out with is, you know
 14 what, it is not a million miles from what we have with
 15 our proxy methodology. So insofar as you accept that
 16 the market is competitive and has worked til now, it
 17 seems to be reasonable what we have done. And that was
 18 the objective for doing the study.
 19 So we are not trying to be socially optimal, we're
 20 not trying -- we are just trying to see does the proxy
 21 methodology actually replicate if you try to do a Baxter
 22 methodology on it. Regardless of whether the OFT
 23 accepts the Baxter methodology or not, that's what we
 24 set out to do.
 25 MR BREALEY: So you didn't set out with this methodology to

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1 measure a link between a MIF and any efficiency gains?
 2 A. No, we couldn't do that. As I said, you cannot measure
 3 just easily what the optimal output would be. Socially
 4 optimal.
 5 Q. So it wasn't an article 101(3) analysis?
 6 A. I don't believe so. I'm not sure what article 101(3) is
 7 specifically. So ... I believe it is about --
 8 Q. It is about efficiencies and benefiting --
 9 A. Yes.
 10 MR BREALEY: I have got no further questions. Thank you
 11 very much, Mr Sidenius.
 12 Questions by THE TRIBUNAL
 13 MR JUSTICE BARLING: Just one question.
 14 MR SMITH: Sorry, Mr Sidenius, just looking at the figures
 15 on pages 11 and 12, where do they come from?
 16 A. We designed an end-to-end activity base costing
 17 methodology which followed a life cycle approach to
 18 managing the relationship on both the issuing and
 19 acquiring side.
 20 So if we went through the issuing side, it would be
 21 the first step is account recruitment, so it would
 22 include any marketing, specific marketing to get
 23 accounts, you score the accounts, you decide whether you
 24 want to offer the client a card, if you do so you create
 25 their account on the master record.

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1 The second stage is issue a card to them. Then
 2 there is an authorisation process because hopefully they
 3 start using it. Then you have clearing and settlement,
 4 which comes -- the transaction comes in and out, also
 5 called interchange in many areas. So that is a bit
 6 confusing. Then you have cardholder billing. Then
 7 after that, cardholder service, because the bills result
 8 in people calling the cardholder centres.
 9 After that we have collections, payments that come
 10 in. Then we have collections after that; that's for
 11 those who don't use the payments function. Then we have
 12 fraud, also referred to as those customers we never knew
 13 we had. Then finally, we have the overhead function of
 14 the business. So that is the whole activity where
 15 people are engaged in the function.
 16 And then you have indirect costs. They are only
 17 indirect insofar as there is no activity that drives
 18 them, but you have to have them to run the business. So
 19 they are funding costs, write-offs, scheme membership,
 20 and stuff like that.
 21 So we use this activity-based method to go out and
 22 collect costs from the participants in the study, again
 23 using the same data quality measures. We went back to
 24 the P&L, we used their activity-based costing models to
 25 refer to allocations of cost. Then we built our quality

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1 control models that looked at performance ratios and
 2 stuff like that.
 3 MR SMITH: Taking cost of funds, that would then be derived
 4 from the accounting documents of the sample you were
 5 looking at?
 6 A. Absolutely.
 7 MR JUSTICE BARLING: Mr Sidenius, going back to when we were
 8 looking at the 2008, I think it was, report that you
 9 prepared for MasterCard or for the Commission, or both,
 10 you said that it was necessary to do fairly regular
 11 updates of costing of that sort because they did
 12 fluctuate over time.
 13 Are you able to sort of give us an indication -- you
 14 may not be able to -- of where you would expect to see,
 15 which particular heads of costs you would see most
 16 likely to reflect some changes and others that would be
 17 less likely to?
 18 A. In the proxy methodology depending on the economic cycle
 19 we would see cost of funds vary quite considerably, and
 20 we can all remember the horrible times in the early 90s
 21 when they were very, very high going down to
 22 exceptionally low levels now, but also bad debt which
 23 doesn't necessarily have to follow the cost of funds.
 24 It could be like now, very cost of funds but we had some
 25 very high bad debts recently.

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1 We would see those change over time. Many of the
 2 others, fraud varies because the fraudsters change their
 3 methods all the time, so sometimes they go up. Then you
 4 have a counter measure, they go down again. So they
 5 cycle a bit. And then the processing charges generally,
 6 we would see efficiencies of scale come in and also
 7 process efficiency come in to see them lower.
 8 The two others, the cost of funds and the bad debt,
 9 would change quite considerably. We have throughout the
 10 time of us doing studies, the measured proxy methodology
 11 results vary from the upper range, which is the number
 12 that we had looked at here, to ranges that have been at
 13 about 50% or 45% of that previously.
 14 MR JUSTICE BARLING: Over what sort of period.
 15 A. That would be back in the sort of early mid-1990s,
 16 I would guess, that we were looking at that before we
 17 had the first real --
 18 MR JUSTICE BARLING: But they would increase by 50% over
 19 what period?
 20 A. This was over, like, eight years, nine years they went
 21 up that much. But that was, as you could see, bad debt,
 22 for example, that was kicking in very severely here.
 23 And also the methodology, and I think there is some
 24 relevance in the observation that we measure what we
 25 recommended was a cap. Based on our proxy methodology,

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1 you should not surpass this cost on average of your
 2 transactions.
 3 But it was not what went into the market
 4 necessarily, and insofar as it didn't go into the
 5 market, it is, if anything, an indication that there are
 6 competitive pressures from one or other side of the
 7 payment activity who are managing to keep it below
 8 a measured cost level.
 9 But that is if you accept the proxy methodology, and
 10 I accept that there are some regulators that wouldn't.
 11 And I also accept that OFT didn't accept our Baxter
 12 methodology of proving there was a social optimal
 13 outcome of what we did. But as I said, that wasn't what
 14 we were trying to prove.
 15 MR JUSTICE BARLING: Thank you very much.
 16 PROFESSOR JOHN BEATH: I don't have any questions.
 17 Re-examination by MR HOSKINS
 18 MR HOSKINS: I would like to take you back to the first part
 19 of your evidence, and you talked about how different
 20 size banks could have different levels of costs, and you
 21 gave Norway as an example with that.
 22 A. Yes.
 23 Q. If it is possible to generalise, are costs for small
 24 banks generally higher or lower than for large banks?
 25 A. Generally they are higher. They are less sufficient.

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1 MR HOSKINS: No further questions.
 2 MR JUSTICE BARLING: Thank you very much, Mr Sidenius.
 3 A. Thank you.
 4 (The witness withdrew)
 5 MR JUSTICE BARLING: There we are. Is that it for now?
 6 MR BREALEY: Yes.
 7 MR JUSTICE BARLING: Where shall we put the helpful pie
 8 charts? We haven't got a sort of addendum bundle, have
 9 we?
 10 MR HOSKINS: You can put it behind his second witness
 11 statement.
 12 MR JUSTICE BARLING: Okay, we will do that, behind tab 8.
 13 MR HOSKINS: Just to confirm, we are not going to see you
 14 for a while.
 15 MR JUSTICE BARLING: Yes, just remind me. We are not seeing
 16 you tomorrow, and then we are not seeing you until --
 17 MR HOSKINS: It is 2 pm Thursday next week.
 18 MR JUSTICE BARLING: It is rather a long time, isn't it?
 19 MR HOSKINS: I presume it's Mr von Hinten-Reed who's giving
 20 evidence first, but that can be confirmed.
 21 MR BREALEY: I can confirm that he is.
 22 MR JUSTICE BARLING: So we will resume again next Thursday
 23 at 2 o'clock.
 24 MR BREALEY: Yes.
 25 MR JUSTICE BARLING: And with Mr von Hinten-Reed. And

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1 I suppose I will ask you just for the sake of anyone in
 2 court who is thinking of coming, we are presumably
 3 likely to spend at least some of the time -- but I don't
 4 know whether we are in camera, are we, or --
 5 MR HOSKINS: I haven't looked at my notes to see how many
 6 blue bits are in it because I did my notes and then
 7 someone put blue bits on it. I haven't focused on it,
 8 I apologise. I'm not able to say a week in advance.
 9 MR JUSTICE BARLING: What is your feeling in terms of how
 10 much if any --
 11 MR HOSKINS: Let me speak to Mr Leith because he's looked at
 12 how much confidentiality there is in the questions.
 13 MR COOK: While Mr Hoskins is doing that, in relation to
 14 Mr Reynolds, who deals with interest points and
 15 consequently considers a lot of Sainsbury's data, as
 16 matters presently stand, that is, unfortunately, all
 17 going to be in camera.
 18 Having read again through his witness statements, or
 19 his expert reports, this morning, I have very strong
 20 concerns about the way in which Sainsbury's has chosen
 21 to say that very large sections of this are
 22 confidential. For example, sections with kinds of
 23 economic theories on this, which have been blocked out
 24 as confidential.
 25 It doesn't seem to me that those are ones that are

1 legitimately confidential, and I was going to engage
 2 with the other side after this to try to see if those
 3 could be narrowed down. I understand if there are
 4 particular numbers, that those are ones that should be
 5 kept confidential, and if it is only individual numbers,
 6 as we have been doing today, it should be possible for
 7 me to cross-examine without needing to say: that says
 8 98, because we don't need to be asking questions about
 9 the specific numbers.
 10 At the moment, almost the entirety of the report is
 11 yellowed out, but as far as I can see --
 12 MR JUSTICE BARLING: I think it would be helpful if you
 13 could have that debate. We expect, roughly speaking,
 14 without committing you, Mr von Hinten-Reed to be in the
 15 witness box from and until when, roughly?
 16 MR HOSKINS: It is probably going to be some time on Monday
 17 morning, I guess.
 18 MR JUSTICE BARLING: So all --
 19 MR HOSKINS: Monday lunchtime.
 20 MR JUSTICE BARLING: Thursday afternoon, Friday, and we will
 21 finish likely some time Monday?
 22 MR HOSKINS: Yes, I think so.
 23 MR JUSTICE BARLING: Then it will be Mr Saunders, will it?
 24 MR HOSKINS: Mr Reynolds.
 25 MR JUSTICE BARLING: I'm so sorry. Mr Reynolds. So

1 Mr Reynolds is quite likely to be in the witness box on
 2 Monday at some point and to continue into Tuesday, do
 3 you think?
 4 MR COOK: It is entirely a question of when Mr Hoskins
 5 finishes with Mr von Hinten-Reed.
 6 MR HOSKINS: Having discussed it, we're sort of two, two and
 7 a half days for both of them.
 8 MR JUSTICE BARLING: I hope that gives people some idea
 9 anyway. There may well be some of both those witnesses
 10 that will be heard in camera, but not by all means all.
 11 MR HOSKINS: Correct.
 12 MR JUSTICE BARLING: Right. See you whenever it is.
 13 (4.07 pm)
 14 (The court adjourned until 2.00 pm on
 15 Thursday, 18th February 2016)
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