

1 A. Yes, I was retained in October, late October 2012.
 2 Q. Did you see the other draft, did you see the 24th July
 3 draft?
 4 A. I was on holiday.
 5 Q. Did someone in your team review the 24th July draft?
 6 A. They must have seen -- I would assume so.
 7 Q. Were you involved throughout this process, you or your
 8 organisation?
 9 A. We were involved and it would have been my Rotterdam
 10 office who would have looked at this survey.
 11 Q. But were you principally responsible for it?
 12 A. I'm always responsible for anything I say in terms of
 13 this.
 14 Q. Let's go to D2.1, tab 3, which is your second report --
 15 A. Yes.
 16 Q. -- page 520 --
 17 A. Yes.
 18 Q. -- paragraphs 466 to 467, and table 7.6.
 19 A. Mmm.
 20 Q. My understanding of this is that if we are looking at,
 21 in relation to credit, the changes made by Sainsbury's
 22 to its cost classifications from its first draft to its
 23 final submission, would cause a MIT-MIF calculated on
 24 the basis of those costs to decrease by roughly
 25 threefold; is that right?

65

1 A. This is why I need to explain the actual process. So,
 2 whoever -- I think it is Bruce Lessels or the
 3 department -- managed to come up with a survey that
 4 would have implied 0.31 and 0.29, you see the first
 5 email which is 5th July. If they had actually followed
 6 their classification in 2010/2011, basically they would
 7 have had MDR0062728, and then that 0.18.20 because they
 8 failed to actually be consistent and managed to actually
 9 get a higher MIT-MIF despite the incentive that you have
 10 outlined.
 11 So this is the error that they have made. When
 12 I received the 5th July email, I talked to my team and
 13 my team looked at the estimate and basically compared it
 14 with 2010/2011 and said: they are just not consistent.
 15 So what happened in the end was that they adopted
 16 eventually the 2010/11 classification and the rates came
 17 down, that is true, and the final submission is 0.09 and
 18 0.11.
 19 Q. So taking table 7.6, the MIT-MIF, comparing the analysis
 20 in the first draft with the final submission, the
 21 MIT-MIF -- resulting MIT-MIF decreased by roughly
 22 threefold, correct?
 23 A. As I say, if you had actually been consistent in
 24 Sainsbury's finance department, they should have
 25 employed 2010/2011 classification and they would have

66

1 had something closer to the 0.118 and 0.20.
 2 Q. But am I right about the rate of decrease --
 3 A. Sorry, let me be very clear, there is a rate of decrease
 4 here.
 5 Q. That's also consistent -- I'm not saying this did or
 6 didn't happen, but it is also consistent with a merchant
 7 categorising cost so as to achieve a lower MIF?
 8 A. If you had had applied the 2010/2011 we actually have
 9 a MIT-MIF which is in the particulars of claim, which
 10 are in April 2013, which is a MIT-MIF based upon the
 11 scenario 1 of 0.04.
 12 MR JUSTICE BARLING: That's the one based on 2010/2011,
 13 which you say is the right one?
 14 A. It is but the thing is this is based on the different
 15 methodology. The 2010/2011 survey and the particulars
 16 of claim were based upon scenario 1, which is one
 17 transaction, and I have said I did not like that in my
 18 report, I wanted something different and in Deloitte's
 19 2011/2012, (a) the survey itself is not the same as 2011
 20 but they have also gone and asked different questions to
 21 elicit the avoidable costs over three to four years. So
 22 we are talking apples and pears here.
 23 PROFESSOR JOHN BEATH: So MDR0662728 uses scenario 1?
 24 A. No, it uses the 2010/2011 cost classification.
 25 PROFESSOR JOHN BEATH: Under --

67

1 A. Under scenario 2.
 2 PROFESSOR JOHN BEATH: Under scenario 2, sorry.
 3 A. But we said "Look, at the start please do this, because
 4 you have submitted something to the Commission
 5 previously and you have got to have some sort of
 6 consistency". It is not that I wanted or I believe,
 7 even, Sainsbury's -- I mean they got it horribly wrong,
 8 horribly, and that's what I have detailed. And I hasten
 9 the add the first expert report is a totally and utterly
 10 different exercise because I viewed the final
 11 submission, and by the way, I actually -- I should state
 12 categorically, I was asked whether they should send this
 13 submission in and I said no because I was not happy
 14 about some of the supporting evidence. So when -- in
 15 June/July 2014 I started the process again, and
 16 Professor Beath that is the annex you have seen.
 17 PROFESSOR JOHN BEATH: Yes.
 18 A. I hope the Tribunal sees it is a quantitatively and
 19 qualitatively different exercise.
 20 PROFESSOR JOHN BEATH: Right.
 21 MR HOSKINS: In relation to reviewing these drafts, the
 22 Sainsbury's drafts, who at Sainsbury's was primarily
 23 responsible for dealing with you?
 24 A. David Brooks is head of finance and is still head of
 25 that particular department, but I was actually engaged

68

1 with Mr Ed Anderson and Ms Kate Botting(?), who are in
 2 Sainsbury's legal team.
 3 Q. Was Mr Brooks aware of the function you were performing?
 4 A. Yes, as an independent outside expert. He was made
 5 aware that I was not there to try to get any particular
 6 figure.
 7 Q. If we go to paragraph 468 of your second report?
 8 A. Yes.
 9 Q. You say:
 10 "Secondly, in my own analysis, I have not relied on
 11 Sainsbury's cost classification but I have thoroughly
 12 reviewed all cost items and determined how they should
 13 be classified."
 14 A. Yes.
 15 Q. If we go still in this report to paragraph 744. It is
 16 page 577 --
 17 A. Yes.
 18 Q. -- you see what your results are. The resulting average
 19 MIT-MIF is 0.15% for credit cards. That's the figure
 20 you get taking the Sainsbury's data but reclassifying
 21 it, whether you think it is fixed or variable over the
 22 three to four-year period?
 23 A. That is correct. It is my classification. It is fully
 24 set out in annex B.
 25 MR JUSTICE BARLING: Sorry, I think I have missed something,

69

1 I want to be sure before we leave this topic. When we
 2 looked at Dr Niels' report at tab 3 of D3, and we looked
 3 at the table which is confidential at page 422, which of
 4 those -- because it is so small I'm having trouble
 5 reading it -- drafts and scenarios is the one that you
 6 eventually -- is it the one dated 24th July 2013 on
 7 scenario 2, MDR0062728? Is that the one that represents
 8 your final position?
 9 A. It is not my final position.
 10 MR JUSTICE BARLING: No.
 11 A. Let's be very clear, these are emails about a process of
 12 filling out the Deloitte's 2010/2011 survey that was done
 13 in 2013. The eventual one, I think, was -- you are
 14 right it is too small -- but I think it was sent -- in
 15 fact, late September.
 16 MR JUSTICE BARLING: Yes.
 17 A. I think it is late September. But we don't have a date
 18 here. Basically there was confusion as to whether it
 19 was actually sent, and apparently it was sent even after
 20 I had said it wasn't fit for purpose.
 21 MR JUSTICE BARLING: None of these represent something which
 22 you thought was fit to be sent, is that the position?
 23 A. Exactly so.
 24 MR JUSTICE BARLING: Is that the position?
 25 A. Exactly. None of this. That's why I went through the

70

1 process which you see in annex B, in the following year.
 2 MR JUSTICE BARLING: Could you just take me -- remind me
 3 where annex B is. I'm sorry, Mr Hoskins, I just want
 4 for my note to get this right. Where is your annex B?
 5 A. Annex B to the first expert report, so I think it is
 6 in --
 7 MR JUSTICE BARLING: D2.
 8 A. This is a weight lifting course.
 9 MR JUSTICE BARLING: I don't know whether this is
 10 confidential or not.
 11 MR BREALEY: D2.1.
 12 MR JUSTICE BARLING: It is in D2.1 the annex B, is it?
 13 MR BREALEY: Tab 3A.
 14 MR JUSTICE BARLING: Tab 3A. Right, okay, sorry.
 15 A. There is a letter from Mischon de Reya at the front.
 16 MR JUSTICE BARLING: It is at table B.
 17 A. So it is 659A.10, is the start. You can see the table
 18 of contents.
 19 MR JUSTICE BARLING: Right, I see.
 20 PROFESSOR JOHN BEATH: But the meat comes at A.83, doesn't
 21 it, where you actually give the reasoning behind the
 22 cost categorisation?
 23 A. That is right, sir.
 24 PROFESSOR JOHN BEATH: That's where the meat of the report
 25 is.

71

1 A. I would say the meat is roughly --
 2 PROFESSOR JOHN BEATH: That's where the definitions are?
 3 A. It is where the definitions are and then I do
 4 a calculation. The whole purpose of this depth was to
 5 try to get a document that could be replicated by anyone
 6 who picked it up and could get the calculations and do
 7 sensitivity analysis. See, I recognise that Deloitte's
 8 and the confidentiality concerns in Deloitte's means that
 9 sometimes it is very hard to replicate.
 10 MR JUSTICE BARLING: Right. I think that's clarified that.
 11 Thank you very much. Sorry, Mr Hoskins, carry on.
 12 MR HOSKINS: Not at all. If we go back to your table 7.6,
 13 at D2.1, tab 3, 520. What we see in relation to credit,
 14 therefore, is five examples of a MIT-MIF based on
 15 different classifications of fixed and variable costs;
 16 is that correct? That's what that table is?
 17 A. There are different classifications, yes.
 18 Q. What that shows us is it proves the point of just how
 19 sensitive the MIT-MIF is to the classification of costs
 20 as fixed or variable, which the Commission described as
 21 critical, yes?
 22 A. It shows that if you get it wrong, then the numbers
 23 change, but the thing is, what you need to actually see
 24 is, if we go to the Deloitte's actual figure, that they
 25 quote, it is for credit cards, it is 0.13%. Now, let's

72

1 get the causation right, the 0.15 is based on annex B,
 2 the 0.13, which they derive over 200-odd large merchants
 3 and we ought to define that as well, is 0.13.
 4 Q. It is not just if you get it wrong that it varies
 5 because fixed variable costs is a bit of science and
 6 a bit of art. It is subjective by nature. You accept
 7 that at paragraph 469.
 8 A. I do accept that.
 9 Q. All I'm saying is that, because of the degree of
 10 subjectivity in the classification of fixed or variable
 11 costs you can actually get a quite widely divergent
 12 MIT-MIF cost as you see in table 6, correct?
 13 A. You are able to achieve that.
 14 Q. Can we go to E3.10, back to the Commission's survey.
 15 A. Yes.
 16 Q. Tab 202, page 4297. At paragraph 13 the Commission
 17 says:
 18 "DG competition undertook computations of the MIT
 19 using all the data coming from surveyed merchants,
 20 including their allocation between fixed and variable
 21 costs. It has also undertaken a computation of the MIT
 22 which are based on...(Reading to the words)... The
 23 choice to deploy econometric techniques has been
 24 motivated by two main objectives. First reducing the
 25 dependency of the results on the merchant's judgments

73

1 and cost nature and (2) treating the heterogeneity of
 2 merchants and trying to perform out of sample
 3 predictions."
 4 Then they go on to say:
 5 "First, econometric techniques are capable of
 6 identifying fixed and variable costs without relying on
 7 the merchants' views."
 8 Do you agree that the use of econometric techniques
 9 reduces the dependency on the merchants on judgments on
 10 whether costs are fixed or variable?
 11 A. It reduces the subjectivity but econometrics is not like
 12 pressing a button and getting the right result. If you
 13 are objectively measuring the wrong thing, and that's my
 14 contention here, then it is garbage in, garbage out.
 15 Q. Can we go back to your second report, D2.1, tab 3,
 16 page 520, paragraph 469 which we have seen you say:
 17 "It is the case that there is some degree of
 18 ...(Reading to the words)... which are themselves
 19 a matter of subjective judgment."
 20 In conducting its own econometric analysis, if
 21 anything, the Commission would have preferred a lower
 22 than a higher MIF, wouldn't it?
 23 A. Sorry, I don't quite understand the link to objectivity.
 24 Q. You say that, fairly, when you are putting together
 25 an econometric model, you have to make certain

74

1 assumptions?
 2 A. That is right.
 3 Q. You have to use your skill?
 4 A. Yes.
 5 Q. So you say, well, econometrics involves a degree of
 6 subjectivity. My point to you is that the econometric
 7 model that the Commission created and carried out is not
 8 one that's created by someone with an incentive to
 9 produce a high MIF. The Commission would either have
 10 been neutral or may even have had a sneaking incentive
 11 to create a lower MIF, because that's what the
 12 Commission has been trying to do for years.
 13 So in terms of exercising subjectivity, it was the
 14 Commission who were being subjective and they had no
 15 interest in a higher MIF, correct?
 16 A. I think we need to get off the idea of subjectivity --
 17 Q. It is you that introduced it. It is 469, I'm dealing
 18 with your report.
 19 A. Okay, then I will explain it in very simple terms, in
 20 terms of what we are trying to measure: what we are
 21 trying to measure is the avoidable cost of going from
 22 cash to cards for a 10% increment over three to four
 23 years. That is a within firm estimation. Now, what
 24 they did econometrically was not that at all.
 25 It was an increment across a wide range of firms, so

75

1 remember what "large" is here, it is 20 to 20 billion.
 2 20 million, 6 to 7, to 200 category, and then above that
 3 are very large firms. You can see there is an inherent
 4 number of different cost functions.
 5 They did it effectively with one year's data.
 6 PROFESSOR JOHN BEATH: I think what you mean is the only
 7 feasible set of data these people could have, because
 8 they have one year of data, is a cross-section?
 9 A. Is a cross-section it is not --
 10 PROFESSOR JOHN BEATH: So the only way you could estimate
 11 a fixed cost and variable cost is by fitting a linear
 12 line through this cross-section. I just make a factual
 13 point, I'm sorry.
 14 MR HOSKINS: No, it is very helpful.
 15 PROFESSOR JOHN BEATH: It is very hard to see how, if you --
 16 with given numbers, you fit a straight line through the
 17 cross-section, you can make any judgments at all about
 18 bias or trying to get particular results, the results
 19 are simply what the data you have -- they are embedded
 20 in the data.
 21 A. Yes, and --
 22 MR HOSKINS: I'm not trying to make submissions but, in
 23 a sense, that's what I was trying to get across because
 24 we have looked at Commission scenario 2, which is based
 25 on the merchant's approach.

76

1 PROFESSOR JOHN BEATH: No, no --
 2 MR HOSKINS: You have my point, and the Commission itself
 3 says econometric analysis reduces the dependency on
 4 subjectivity.
 5 A. It is not about pressing the return button and get the
 6 right -- the thing is, if you are measuring the wrong
 7 thing, if you are thinking about the increment and you
 8 are thinking about all this huge range of firms from
 9 20 million to 200 or 12 -- 20 billion, you are not
 10 actually measuring -- if you don't take full account of,
 11 for example, the admitted variable bias issue,
 12 Professor Beath. So the econometrics, if it is not
 13 correct -- and I will show you why it is probably not
 14 correct -- when it produces certain estimates is
 15 objectively measuring the wrong thing. And, you know,
 16 what I will try to do and I --
 17 PROFESSOR JOHN BEATH: I think we could have a seminar on
 18 this but I don't think --
 19 MR HOSKINS: I think we are having a seven-week seminar.
 20 PROFESSOR JOHN BEATH: I just wanted to make a rigorous
 21 technical point.
 22 A. It was a very good point, sir.
 23 MR SMITH: When you say it is measuring the wrong thing,
 24 what exactly is wrong about it? What is the wrong
 25 thing?

1 A. Well, we have a cross-section of data, we have firms
 2 that go from 20 to Sainsbury's size, 20 million to
 3 Sainsbury's size, in that sample. There are all these
 4 different types of cross function and we are trying to
 5 estimate what the econometric scale across one year's
 6 data, across all these different sizes of firm.
 7 That is not really telling us what happens within
 8 a firm when you change the component of cash to the
 9 component of cards. Ultimately, that's what we are
 10 trying to measure. What changes? The avoidable cost
 11 over an increment. What's the increment? 10%. Is the
 12 10% reasonable or should it be higher, should it be
 13 lower? That's scenario 2.
 14 You know, I appreciate that there are these issues
 15 about DG competition wanting politically to get lower
 16 interchange fees. But my understanding, from living in
 17 Brussels and having been in the Commission, and
 18 understanding these political pressures, is that in this
 19 case, this was the economist team --
 20 MR HOSKINS: I'm not sure this is appropriate evidence, I'm
 21 sorry to interrupt. I don't want to go into what the --
 22 MR JUSTICE BARLING: I wouldn't worry too much about it.
 23 But I would still like to understand the answer better
 24 to Mr Smith's question, you know, about --
 25 MR HOSKINS: Can I see if I can manage it with a question

1 which is: is your main objection to the Commission's
 2 econometric analysis, the fact that it doesn't
 3 sufficiently take account of the heterogeneity of the
 4 merchants in the sample?
 5 A. We can do the heterogeneity --
 6 MR JUSTICE BARLING: Can you not answer yes or no to that
 7 question? It would help us.
 8 A. It is a no, it is more than the heterogeneity.
 9 MR HOSKINS: But is that part of it?
 10 A. It is part of it.
 11 Q. Well, that's a start.
 12 MR SMITH: Okay, apart from heterogeneity then, is it the
 13 fact that one only has one year of data, is that another
 14 issue you have?
 15 A. That is another issue. That is what it is. What we are
 16 trying to get here is the average transaction benefit.
 17 I'm not worried whether it is the average merchant or
 18 not, I'm worried about the average transaction benefit
 19 because I'm trying to get something that is actually
 20 measurable for the purpose of article 101.1. That's
 21 what I'm trying to measure. So I want to know what are
 22 the benefits of swapping cards and cash, and I don't
 23 think I'm getting that via the econometric approach, or
 24 at least there is something going on here -- and I will
 25 show you in practical terms later why I think it is

1 coming up with wrong estimates. Let's leave that for
 2 now.
 3 MR SMITH: Let me just ask you one very simple question,
 4 just this: are you saying that the econometric approach
 5 is a misconceived approach no matter what data you use?
 6 In other words, that it is --
 7 A. No --
 8 MR SMITH: -- simply not the way to do it, you should look
 9 at, as you have done, the actual costs of an enterprise.
 10 A. If we had managed to have ten years' worth of data and
 11 we had managed to account for all those reasons why
 12 costs change in a firm, or between firms, so as you get
 13 the issuers -- as you get larger, you have different
 14 things, you have legal departments coming in, so you
 15 have different fixed costs and all those other things.
 16 If it had taken account of that, you could understand
 17 it. But it is not taking into account that. It is
 18 trying to measure across firms when it is easier in this
 19 case actually to do, within the firm, and measure the --
 20 then the issue is, is that estimate representative?
 21 Then you have to work out whether it represents a fair
 22 share. That is the exam question.
 23 MR SMITH: Right, just identifying the issues you have with
 24 the data, it is period of time and the fact that the
 25 data doesn't sufficiently differentiate between sizes of

1 firm?
 2 A. The data itself goes between 20 and 20 billion, in terms
 3 of size, but we are not actually taking full account
 4 then of how things --
 5 MR SMITH: The cross balance may be different --
 6 A. The reasons why things are changing over time in terms
 7 of the cost function. So we have a large -- the implied
 8 increment in the econometric approach is rather large,
 9 so it is an empirical point, should it be large or
 10 should it be 10%, or should it be some other number?
 11 MR SMITH: Thank you.
 12 MR HOSKINS: Can we go to your annex B, so that is D2.1, at
 13 tab 3A. It is page -- I will ignore the 659A, it is
 14 page 127 in that tab. (Pause)
 15 A. I have 125.
 16 Q. So you don't have 127? It runs out?
 17 MR JUSTICE BARLING: Mr Cook has it. (Handed)
 18 MR HOSKINS: Have you got 126?
 19 A. I don't have 126 either.
 20 MR SMITH: Are you referring to bundle numbering or to the
 21 internal numbering?
 22 MR HOSKINS: The page I'm looking at has the number 659A.127
 23 on it.
 24 A. Sorry.
 25 MR HOSKINS: That's fine. It's not the easiest numbering

81

1 system.
 2 A. So 126 is the DSS cost and cost of equipment.
 3 Q. Yes, and it is the top of 127 I want to look at. So at
 4 8.6:
 5 "Relative use of cash and cards in the UK in the
 6 past 10 years, the number of value and card
 7 transactions ..."
 8 I think it has been cut off. It probably should be
 9 "in the UK".
 10 A. Yes.
 11 Q. "... has been steadily increasing", I think it should
 12 say.
 13 A. Mmm hmm.
 14 Q. Then if we go over the page, 259, you say:
 15 "However, the increase in card transactions cannot
 16 be directly interpreted as a displacement of cash
 17 transactions, as at least a part of this increase may be
 18 due to the general increase in the value and number of
 19 transactions."
 20 What you then go on to do is try to estimate the
 21 cash displacement rate; is that correct?
 22 A. Yes.
 23 Q. Then at 261 you come up with your estimate and your
 24 estimate is for an annual displacement ratio of about
 25 7%; is that correct?

82

1 A. It states there 7% but that's a mistake.
 2 Q. What should it be?
 3 A. If I go to Dr Niels' table, figure 3.1, I think we will
 4 get a ballpark idea of what it should be.
 5 Q. The place I was going to take you to, to see if this was
 6 correct or not, let's see if we can shortcircuit it, was
 7 D3.1, tab 6. This is Dr Niels' second supplemental
 8 report. Then if you go to page 601, it is
 9 paragraphs 339 and 340. He supports what I hope is the
 10 same error that you have said there is, and he says that
 11 because you give an annual figure of 7%, given that we
 12 are dealing with a three to four-year period, what you
 13 should have actually said was a cash displacement rate
 14 of 20 to 25%; is that the error you are referring to?
 15 A. The error I refer to is the 7%. In fact, the next error
 16 is actually in Dr Niels' next sentence. It is not
 17 an error in the sense that if you take cards, that is
 18 debit and credit cards, you would get that figure, but
 19 we are talking about credit cards and, hence, I wanted
 20 to go to figure 3.1 of Dr Niels' first report just to
 21 give you a --
 22 Q. So you agree with his correction there at 340 but you
 23 want to -- he deals with cards and you want to clarify
 24 it further in relation to credit cards; is that correct?
 25 A. Yes, sir.

83

1 Q. Show us what you want to --
 2 A. It is figure 3-1 of Dr Niels' first report. It gives
 3 you an overview of how things have changed in the UK.
 4 Q. 247, Mr Brealey kindly informs me.
 5 MR BREALEY: D3, 247.
 6 A. D3.
 7 MR HOSKINS: D3, tab 3, page 247.
 8 A. So figure 3.1, which is on 247, the point I'm making is
 9 that if you see over -- it is a very nice figure going
 10 from 2000 to 2014, credit cards is the -- can everyone
 11 see the colour at the bottom? It is the very dark one.
 12 That is credit cards. You will see share of the payment
 13 methods, it actually has not moved much. Let's assume
 14 zero.
 15 The displacement of cash, which I assume is the ATM
 16 and cash, which is the light green, so cash is getting
 17 squeezed. What's squeezing it is actually the debit.
 18 So the shift is actually the debit card. That's also,
 19 by the way -- we see that, a similar picture, in
 20 Australia.
 21 Q. So what is the correction you want to make to your
 22 figure, D2.1, tab 3A, page 130, paragraph 261?
 23 A. So the Commission has an increment of 10% but if you
 24 took these figures on face value, the cash displacement
 25 to credit card would be 0.

84

1 Q. You are changing your evidence from annual displacement
2 ratio of about 7% and you want to say it is now 0?
3 A. I'm just looking at this figure saying, look, we have to
4 sort of step back --
5 Q. But what's your evidence, because we have got your
6 evidence at the moment -- let's look at it, it is
7 D2.1 --
8 A. The reason --
9 Q. Please let's look at, this is important.
10 A. Sure.
11 Q. D2.1, tab 3A, page 130, paragraph 261. Now, there is
12 a fair bit of reasoning before that, but the punchline
13 is the last sentence of 261:
14 "This corresponds to an annual displacement ratio of
15 about 7%."
16 What is now evidence now? What's the figure that
17 you want to give?
18 A. Look, I would be quite happy if we keep to the
19 Commission's 10%, as a very conservative figure.
20 MR JUSTICE BARLING: So you change your 7% -- you prefer to
21 have 10% there; is that what you are saying?
22 A. No, the point about this paragraph is to say was the
23 Commission's 10% reasonable? And I made the point,
24 which is erroneous, that it looks like 7%. If you go to
25 the figure, it could be 0 but I'm simply saying, look,

85

1 let's keep to 10%.
2 MR JUSTICE BARLING: You say it doesn't matter what it is?
3 A. It doesn't matter. It doesn't matter, we could actually
4 have said zero.
5 MR JUSTICE BARLING: As a matter of interest why did you say
6 it was 7 again, what was the mistake?
7 A. Because I looked at it and I basically, as Dr Niels has
8 pointed out, I have made an arithmetic error and if
9 Dr Niels' calculation -- he made -- he suggested it was
10 25%, and that was for cards, and I'm making the point
11 that actually the growth or the substitution seems to be
12 debit card and cash, not credit card and cash.
13 MR HOSKINS: To be fair to Dr Niels, he was actually
14 following through the logic of your 7%.
15 A. He did.
16 Q. That was not his own figure, he said on your own
17 analysis of 7% that should have been the correct figure
18 if you followed the logic through.
19 A. If I followed the logic in terms of credit cards but in
20 terms of -- sorry. He followed my logic, my logic was
21 wrong. It should have been on credit cards. I got the
22 arithmetic error. This 25% though is on cards and, as
23 I suggested in figure 3.1, the substitution looks to me
24 on this basis of this evidence from cash to debit, not
25 cash to credit.

86

1 Q. But you are ignoring charge cards, aren't you, in figure
2 3.1? We are dealing here with credit and charge cards
3 as against cash, aren't we? If you include charge
4 cards, then the displacement is more marked, isn't it?
5 A. I can't even read that up there.
6 Q. Well, the charge card is the light blue.
7 A. Yes.
8 Q. You will see that colour, it is -- if you go on the
9 vertical axis, 80%, you will see a little blue block.
10 We have all got different colours. It is a dark grey.
11 The first block between the 80 and 90 on the vertical
12 axis?
13 A. That looks like it has grown by, let's say, 5% over the
14 period.
15 Q. You have to add that in when you are comparing
16 displacement of cash as against credit cards.
17 A. I agree.
18 Q. So you have to put that in as well?
19 A. Yes, we should.
20 Q. In terms of the costs, because we are looking at here
21 costs which vary over time in terms of handling cash, as
22 opposed to accepting cards, and in this specific
23 instance credit cards, but the costs of accepting debit
24 and credit cards, it doesn't matter, you have to look at
25 them altogether, because the infrastructure is the same,

87

1 whether you are accepting a debit or a credit card.
2 A. Mmm hmm.
3 Q. So the distinction you make in saying you have to look
4 at just credit cards isn't correct, is it, because the
5 infrastructure is the same, therefore one is looking at
6 the total costs?
7 A. The infrastructure may be fixed costs which are not
8 contained in the calculation. If they don't vary over
9 time, that's the three to four years. If they do, they
10 are in.
11 Q. For this purpose, there is no utility in the distinction
12 between debit or credit because the infrastructure is
13 the same: yes or no?
14 A. In terms of the actual increment, can I think about it
15 for a few more minutes?
16 Q. We do have to move on. I have one more question on this
17 topic --
18 PROFESSOR JOHN BEATH: Before we move on, and while he is
19 thinking about it, could I be assured that the data set
20 that was used to construct figure 3.1 is exactly the
21 same as the data set that was used to construct figure
22 B6.5?
23 MR HOSKINS: Sir, 3?
24 PROFESSOR JOHN BEATH: In Mr von Hinten Reed's second
25 report, before the phrase we have been looking at about

88

1 displacement ratio, it is based upon a chart.
 2 MR HOSKINS: Sir, can you give me the bundle reference?
 3 PROFESSOR JOHN BEATH: Sorry, D2.1, tab 3, 659A.129, then on
 4 the page before the statement about 7%, the paragraph
 5 says it was based upon this calculation and this figure,
 6 and it covers not quite the same but almost the same
 7 period, has a larger aggregation of units, I just wonder
 8 whether it is the same data set used.
 9 MR HOSKINS: I will ask Dr Niels --
 10 MR JUSTICE BARLING: In that case --
 11 MR HOSKINS: I have one more question on this, otherwise we
 12 will lose the chain. So if you will just let me finish
 13 off.
 14 MR JUSTICE BARLING: Okay, go on.
 15 MR HOSKINS: I need to go back to D3.1, tab 6, page 601. At
 16 paragraph 3.41, he says:
 17 "As I explained above, the Commission's medium-term
 18 approach...(Reading to the words)... over a three to
 19 four-year period."
 20 Then he goes on to say:
 21 "Given that a larger level of cash displacement
 22 ...(Reading to the words)... timeframe ..."
 23 You corrected your error, but if you have a higher
 24 cash displacement rate, that provides evidence that
 25 a greater proportion of fixed costs should be included

89

1 than the medium-term approach considers.
 2 I want to unpack, because that obviously includes
 3 the area you corrected, but is it correct that the
 4 greater the cash displacement, the greater proportion of
 5 fixed costs should be included than the medium-term
 6 approach suggests, ie the greater the cash displacement,
 7 the less costs are fixed?
 8 A. The greater the cash displacement, the costs that are
 9 displaced will increase.
 10 Q. Therefore it should be variable rather than fixed?
 11 A. It should be variable rather than fixed.
 12 MR HOSKINS: Sir, that is a good point to break.
 13 MR JUSTICE BARLING: Good, right, we will have a break.
 14 (3.20 pm)
 15 (A short break)
 16 (3.30 pm)
 17 MR HOSKINS: I'm glad it is Friday. Am I allowed to say
 18 that?
 19 MR JUSTICE BARLING: Yes, you are now.
 20 MR HOSKINS: It's too late.
 21 PROFESSOR JOHN BEATH: Some of us have been away from home
 22 for a while.
 23 MR HOSKINS: There we are.
 24 MR JUSTICE BARLING: Okay.
 25 MR HOSKINS: I have an answer to Professor Beath's question

90

1 on whether these are based on the same data. The answer
 2 is: they are not.
 3 PROFESSOR JOHN BEATH: They are not, okay.
 4 MR HOSKINS: So if we go to Mr von Hinten Reed's figure 6.5,
 5 which is at D2.1, tab 3, 659A.129 --
 6 PROFESSOR JOHN BEATH: Yes.
 7 MR HOSKINS: -- you will see that the source stated there is
 8 the UK Cards Association --
 9 PROFESSOR JOHN BEATH: Yes.
 10 MR HOSKINS: -- and have debit cards credit and charge cards
 11 cash and cheques. Figure 3.1 in Dr Niels' report, so
 12 that is D3, tab 3, 247 came from MasterCard internal
 13 documents.
 14 PROFESSOR JOHN BEATH: Thank you.
 15 MR HOSKINS: Whether they obtained information from the UK
 16 Cards Association, I don't know, but they are not on
 17 their face from the same source.
 18 PROFESSOR JOHN BEATH: Thank you.
 19 MR HOSKINS: Obviously, it is clear, figure 3.1 includes
 20 more types of payment.
 21 PROFESSOR JOHN BEATH: Yes. That's why I mentioned in
 22 relation to Mr von Hinten Reed's -- it seemed to me
 23 aggregating things together.
 24 MR HOSKINS: Yes.
 25 There was a question that Mr von Hinten Reed asked

91

1 for more time to think about, I don't know if he wants
 2 to take up that --
 3 A. Yes, just a small -- in terms of thinking about common
 4 costs and fixed costs, in annex B, 659A.34, so in
 5 effect, we have the first table which is table B2.13 on
 6 debit cards. The second table is overleaf, B2.14 on
 7 credit cards. So I have separately treated the fixed
 8 and variable costs involved in debit and credit card
 9 payments. To the extent that there are common aspects
 10 to them, they are in the cost allocations. In my view,
 11 the increment is not the place to actually change. What
 12 we are trying to ask there is, what is the change that
 13 we observe from cash to a credit, or in charge card, not
 14 a debit card. That's not what we are trying to assess
 15 here.
 16 So I have actually calculated the MIT-MIF separately
 17 for the credit card and the debit card, the debit card
 18 being slightly higher.
 19 Q. Can we go to E3.10, which is the Commission's survey
 20 again.
 21 A. Sure.
 22 Q. Tab 202, page 4315, paragraph 82. So E3.10, tab 202,
 23 page 4315. It is paragraph 81, the Commission says:
 24 "Merchants in this population are likely to be
 25 heterogeneous with respect to the relative cost payments

92

1 ...(Reading to the words)... need to be taken into
 2 account."
 3 A. Mmm.
 4 Q. Skipping the next sentence:
 5 "The size of the merchant may also have an impact
 6 since a larger size may imply different organisation of
 7 the business or a specific payment process and therefore
 8 a different transaction cost."
 9 First of all, do you agree with the Commission that
 10 the relative costs of payment methods may vary between
 11 merchants?
 12 A. Yes.
 13 Q. Do you agree that one of the factors that may have
 14 an impact on costs is the size of the merchant?
 15 A. Yes.
 16 Q. Can we go to E3.14, tab 266. It is the Rysman and
 17 Wright article. If we can go to page 5737. We looked
 18 at this again earlier in another context. It is
 19 a second complete paragraph on the page that begins
 20 "Firstly surveys are often conducted":
 21 "Firstly surveys are often conducted only with large
 22 retail firms, firms that will tend to have lower costs
 23 of accepting cash due to the economies of scale involved
 24 in cash handling, as opposed to cards which are fairly
 25 scale invariant."

93

1 Do you agree that large retail firms will tend to
 2 have lower costs in accepting cash due to economies of
 3 scale?
 4 A. Yes.
 5 Q. Can we go to E3.5, tab 99A. This is the Rochet and
 6 Tirole article from 2008, yes?
 7 A. That is correct.
 8 Q. The numbering is 2194A, it's 0029 that I would like to
 9 go to. You will see the third paragraph on that page
 10 begins "First, in the short run"; do you see that?
 11 A. Yes.
 12 Q. If you skip five lines down, there is a sentence that
 13 begins:
 14 "Third, merchants are heterogeneous and an IF that
 15 properly guides cardholders' decisions must reflect the
 16 ...(Reading to the words)... at the social optimum."
 17 Do you agree with that?
 18 A. In terms of the statement, yes.
 19 Q. Can we go to E3.10, tab 202, so the Commission survey
 20 again. E3.10, tab 202 at 4295. Again, it is something
 21 I think we looked at in another context. The first
 22 paragraph in that page, paragraph 4 continues at the top
 23 of the page. If you go up from the bottom of that
 24 paragraph seven lines, you get to a sentence that
 25 begins:

94

1 "In order to maximise coverage ..."
 2 It begins in the middle of the page.
 3 A. Yes.
 4 Q. The Commission says:
 5 "In order to maximise coverage and to ensure the
 6 best quality data, it was decided to ...(Reading to the
 7 words)... Eventually, this represents a trade off
 8 between precision of data and sample size and
 9 representativeness."
 10 We see from that the Commission study only took
 11 account of large merchants, yes?
 12 A. Large merchants above 20 million.
 13 Q. The Commission believed that that had implications for
 14 the representativeness of the study, correct?
 15 A. In that it didn't actually have small firms in it.
 16 Q. Can we go to paragraph 23 in this document. The
 17 Commission says:
 18 "The report finally explores the possibility to
 19 obtain figures that would describe the whole merchant
 20 population and not only large merchants. This, however,
 21 requires very strong assumptions on the cost functions
 22 of the different payment means for smaller merchants.
 23 Taking this into account and after careful
 24 consideration, the Commission therefore considers that
 25 without further data from small merchants, it is not

95

1 possible to draw reliable conclusions from the study
 2 concerning the level of indifference of all merchants."
 3 Do you agree with the Commission that without
 4 further data from small merchants it is not possible to
 5 draw reliable conclusions from the study concerning the
 6 level of indifference of all merchants?
 7 A. You cannot get the level -- at least you can calculate
 8 what it should be for all merchants but you can't get
 9 the level of indifference for all merchants because we
 10 don't have small firms.
 11 Q. Do you agree it is not possible to draw reliable
 12 conclusions concerning the level of indifference of all
 13 merchants for that reason?
 14 A. The meaning of "indifference" to me is -- in the exam
 15 question is that firms are no worse off, that's the
 16 Article 101.3(b) criterion. So I can tell you that
 17 large firms will be worse off if, for example, they have
 18 to pay a MIF, which is estimated for the category 6
 19 to 7, but what I can't do is tell you whether actually
 20 the small firms are benefiting and offsetting the loss
 21 made by large firms. That's what I can't do.
 22 Q. Do you agree or not with the Commission's own assessment
 23 of its own survey that, without further data from small
 24 merchants it is not possible to draw reliable
 25 conclusions from the study concerning the level of

96

1 indifference of all merchants?
 2 A. In that context which I have just said, yes.
 3 Q. Dr Niels has sought to deal with this problem by relying
 4 on the cost data for the group of smaller merchants
 5 within the Commission's sample of large merchants, which
 6 he has taken as merchants with an annual turnover
 7 between EUR20 million -- sorry, the Commission's sample
 8 is EUR20 million and EUR200 million, but you are aware
 9 of that, aren't you, he relies on a subset of that data?
 10 A. I am and let's be clear it is category 6 to 7 and the
 11 larger merchants than that are category 8. So if
 12 I refer to that --
 13 Q. If we go to your second report, that's D2.1, tab 3, 523.
 14 D2.1, tab 3, at page 523, it is your paragraph 489, this
 15 is where you deal with what Dr Niels has done in terms
 16 of the sample he has taken, and you say:
 17 "I note that excluding the largest merchant
 18 seriously limits the reliability of results and their
 19 applicability to the UK. As 130 merchants out of 256
 20 included in the sample ...(Reading to the words)... as
 21 also shown by lower R2 values."
 22 Your preferred approach is to rely on the cost data
 23 submitted by Sainsbury's to Deloitte which you then
 24 reassess for fixed or variable, correct?
 25 A. That is correct and then I try and do sensitivity tests,

97

1 which kind of replicate what category 6 to 7 would look
 2 like.
 3 Q. But your basic approach, by relying on the cost data
 4 submitted by Sainsbury's, is to rely on a sample of one,
 5 isn't it?
 6 A. It is a sample of 1 and then we conduct sensitivity
 7 tests to try to replicate data for a wider sample.
 8 Q. So you rely on a sample of one with sensitivity analyses
 9 and Dr Niels relies on a sample of 126?
 10 A. He relies on a sample of 126, but by excluding or
 11 focusing on the average merchant you are not actually
 12 focusing on the average transaction benefit, which is
 13 what we get from the literature as being the appropriate
 14 thing to measure.
 15 Q. Let's go to your second report, again. D2.1, tab 3 at
 16 526. Paragraph 505, you say:
 17 "We know, however, that in the UK a typical payment
 18 takes place at a large retailer."
 19 Then at the end of the paragraph you conclude:
 20 "Therefore, it is reasonable to assume that the
 21 MIT-MIF obtained for these retailers would be
 22 representative for the vast majority of the UK sales."
 23 Then at 506 you go on to say:
 24 "As a sensitivity check I consider how the MIT-MIF
 25 ...(Reading to the words)... based on the Eurostat data

98

1 for the UK discussed above.
 2 "As I mentioned earlier, no data is available for
 3 the cost of payments to small merchants ...(Reading to
 4 the words)... being twice as high and three times as
 5 high. I apply the sensitivity test to three MIT-MIF
 6 estimates."
 7 You don't cite any evidential basis for your
 8 assumption that the MIT-MIF for small merchants is twice
 9 or three times as high as for large merchants, why is
 10 that?
 11 A. That is correct, because I do not have any evidence on
 12 the exact costs for cash and cost of payments for small
 13 firms. In 7.7, by the way, large merchants there are
 14 categories 6, 7 and 8.
 15 Q. Can we go back to the Commission's survey. That's E3.10
 16 at tab 202. This time can we go to page 4350, it is
 17 paragraph 185. It is E3.10, tab 202, page 4350. If you
 18 pick it up at paragraph 185:
 19 "As regards the distribution of the MIT MSC levels
 20 of individual merchants, the figures below indicate
 21 heterogeneity among the merchants in the sample. In
 22 particular, where the MIT MSC is between 0 and 0.5 for
 23 the majority of merchants, there is a non-negligible
 24 number of observations resulting in very high or
 25 negative sales."

99

1 Then, over the page, the Commission sets out
 2 figure 11, which is a distribution of estimated MIT MSCs
 3 by number of merchants. We know from paragraph 14 the
 4 number of merchants in the sample is 254, yes?
 5 A. Yes.
 6 Q. The range of MIT MSCs is on the horizontal axis. You
 7 see that below 0, minus 2, minus 2 to minus 1, minus 1
 8 to 0.5 etc, that is the range of MSC MITs, yes?
 9 A. Yes.
 10 Q. Then the number of merchants within each range is on the
 11 vertical axis, yes?
 12 A. Yes.
 13 Q. We see from this graph that most merchants had a MIT MSC
 14 from the 0 to 0.5 range. That's in the middle of this,
 15 yes?
 16 A. Yes.
 17 Q. If you move to the right, we see around 15% had a MIT
 18 MSC in the 0.5 to 1% range, yes?
 19 A. Yes.
 20 Q. If you take the median point of those ranges, so for the
 21 first we are looking at the median of 0 to 0.5 is 0.25,
 22 and the median of the 0.5 to 1 is 0.75, yes?
 23 A. Could you re-do that one?
 24 Q. Of course. I'm looking, first of all, at the most
 25 popular category, 0 to 0.5. The median of that is 0.25.

100

1 I'm just saying half of 0.5 is --
 2 A. I should have said yes.
 3 Q. If you go to the next range, 0.5 to 1, the median is
 4 0.75?
 5 A. Yes.
 6 Q. 0.75 is around three times higher than 0.25?
 7 A. Yes.
 8 Q. So that indicates that around 15% of larger merchants
 9 had a MIT MSC around three times higher than the
 10 majority of large merchants, yes?
 11 A. Yes.
 12 Q. Let's do the same exercise for the 1% to 2%. That's
 13 three in from the right. 1% to 2%.
 14 A. Yes.
 15 Q. Around 6 to 7% of large merchants had a MIT MSC in that
 16 range, yes?
 17 A. Yes.
 18 Q. Take the median of that, that's 1.5%, yes?
 19 A. Yes.
 20 Q. If you compare that again with the most popular range,
 21 the median of which is 0.25, what we see is 6% to 7% of
 22 large merchants had a MIT MSC around 6 times higher than
 23 the majority of large merchants, correct?
 24 A. Yes.
 25 Q. We will do the same again for the 2% to 5%, the median

101

1 of that is 2.5%. There is about 5% in that range, yes?
 2 A. Yes.
 3 Q. That shows therefore that around 5% of large merchants
 4 had a MIT MSC that was 14 times higher than the
 5 majority, yes?
 6 A. Mmm.
 7 Q. Then, finally, if you take the last category on the
 8 right, around 2% of large merchants had a MIT MSC above
 9 5%, and if you do the same exercise that tells us that
 10 around 2% of large merchants had a MIT MSC that was
 11 20 times or more higher than the majority of large
 12 merchants; is that correct?
 13 A. Yes. Remember that you have got MSC, so you have got
 14 the acquirer margin coming in here.
 15 Q. But that's minimal compared to the --
 16 A. It is not so minimal all the time. But your point is
 17 taken.
 18 Q. Of course this survey was based only in large merchants,
 19 we know that, don't we?
 20 A. Yes, above 20 million.
 21 Q. One would expect the disparity to be even greater
 22 between small and large merchants, wouldn't you?
 23 A. Small in terms of small 1 to 5 and 6 or?
 24 Q. I mean small outside this category --
 25 A. So 1 to 5?

102

1 Q. You accept that, the disparity you would expect to be
 2 greater?
 3 A. I don't know what 1 to 5 really is, but I'm just --
 4 I will assume for the purpose of this that it is.
 5 Q. I think you are saying the answer is yes, you would
 6 expect the disparity to be greater.
 7 A. I would expect it to be greater, based on my estimates.
 8 Q. In your evidence yesterday you referred on a number of
 9 occasions to the interest that issuers earned from
 10 cardholders. Just to be clear, are you suggesting that
 11 the interest that is earned in that way is large enough
 12 to cover the whole scheme costs; is that your evidence?
 13 A. The interest earned by issuers?
 14 Q. Yes.
 15 A. For issuing cards is greater than the cost of them
 16 issuing the cards.
 17 Q. Is the logic of that that no MIF is necessary?
 18 A. The logic of that is that lending, which is the process
 19 by which banks are offering credit, for example, would
 20 happen anyway, with or without the MIF.
 21 Q. Is your logic that no MIF is necessary?
 22 A. On that, yes.
 23 Q. How does that tally with what you also said yesterday,
 24 which is that a MIF is necessary to balance the two
 25 sides of a four-party system?

103

1 A. If the revenues and the costs are all on one side, then
 2 the issuers are making more than the costs of actually
 3 providing the service.
 4 Q. So is your evidence that a MIF is necessary or not
 5 necessary?
 6 A. A MIF is necessary for the part which attracts
 7 transaction efficiencies. So the switch between cash
 8 and cards. To that extent, that benefit, I think
 9 a MIT -- a MIT-MIF measures it, also Visa 2 indirectly
 10 measures it and that's the justification for a MIF.
 11 Q. Your MIT-MIF analysis doesn't take account of interest
 12 revenue received by issuers, does it?
 13 A. That is right.
 14 Q. Can we go to E3.14. At 265, it is the Tirole article we
 15 have looked at earlier today.
 16 A. I'm with you.
 17 Q. Page 5696, it is the top of that page, the first
 18 paragraph, Tirole says:
 19 "There is substantial debate as to whether
 20 anti-trust authorities should factor profits into the
 21 computation of social welfare and they rarely do. Take
 22 issuer profits. If the profits associated with
 23 cardholders and...(Reading to the words)... leads to
 24 enhanced cardholder welfare. Ultimately, what fraction
 25 of profits should be factored into the computation of

104

1 interchange fee is an empirical question which we will
 2 not attempt to resolve here but there is no question
 3 that not including any leads to a conservative estimate
 4 of the desirable interchange fee."
 5 Do you accept that it follows from that analysis
 6 that your MIT analysis results in a MIF that is too low?
 7 A. My MIT-MIF is based upon Article 101.3. It is not based
 8 on Rochet/Tirole or Rochet/Wright or Wright and
 9 something else. The issue that Jean Tirole comes up
 10 with here is quite interesting because if we are right
 11 that interest is above the cost of issuing cards, then
 12 what is the exact market failure that necessitates some
 13 subsidy from merchants to achieve that end? I don't
 14 think there is.
 15 Q. Let's assume, leave aside what the legal position is or
 16 isn't --
 17 A. That's your job.
 18 Q. That is right. If one accepts Tirole's analysis of
 19 profits as being capable of driving technological and
 20 pricing innovations as well as new entry, if one accepts
 21 that the test is social welfare, do you agree with his
 22 logic? I know you don't agree with everything but
 23 assume those factors are corrected, do you agree that
 24 failing to take account of them would lead to a MIF that
 25 was too low?

105

1 A. A MIT-MIF could be too low compared with the social
 2 optimum.
 3 Q. Not all credit card holders are revolvers, are they?
 4 A. Transactors.
 5 Q. If a MIF were to take account of the interest that
 6 issuers earned from revolvers, then the MIF would be
 7 lower than it would otherwise be?
 8 A. Yes.
 9 Q. I think you said yesterday, but I want to clarify, would
 10 that, in effect, lead to a degree of cross subsidisation
 11 of revolvers by transactors?
 12 A. Transactors benefit or use the 28-day funding. The
 13 question, again, is the additionality of that particular
 14 funding thing and what benefits that actually derives.
 15 It is not a benefit in terms of transactions. If it is
 16 additional sales, well, a transactor is basically paying
 17 off next month what they have used this month and it is
 18 a fact of financial services that the reason why you
 19 offer a 28-day funding is to actually attract people
 20 into having a card and, eventually, you want to become
 21 revolvers, and that's where the stickiness comes in.
 22 Q. But do you agree that if the MIF were to take account of
 23 interest that issuers earn from revolvers, there would
 24 be a degree of cross-subsidisation of revolvers by
 25 transactors?

106

1 A. Yes.
 2 Q. Some banks are primarily transactor banks, aren't they?
 3 A. Yes.
 4 Q. If a bank is primarily a transactor bank it couldn't
 5 operate without the MIF, could it?
 6 A. The issue is primarily and the issue then is basically
 7 whether that is a statement of truth.
 8 Q. But it is a possibility?
 9 A. It is a possibility. If, for example, their interchange
 10 income went down, they have an option of increasing
 11 cardholder fees. If that was really on the margin of
 12 the decision, but that's not obvious.
 13 Q. Does the MIT-MIF apply to online transactions? Is it
 14 intended to cover them?
 15 A. MIT-MIF was designed for the cash and cards, online is
 16 cards.
 17 Q. So is your MIT-MIF intended to cover online
 18 transactions?
 19 A. My MIF, the 0.15 covers till operations not online.
 20 Q. But a MIT-MIF is for not just for Sainsbury's, it is for
 21 all people who use MasterCard or Visa, isn't it? It has
 22 to be a general application?
 23 A. That's true, that's why I go back to the way in which
 24 I characterise it. What is the benefit we are trying to
 25 measure under Article 101.3. If it is basically the

107

1 substitution of card for card, then there is no
 2 efficiency. Therefore, we don't need to measure it.
 3 Q. But your MIF as you said therefore does not take account
 4 of online transactions?
 5 A. That's true.
 6 Q. Can we go to E3.14 at 265. Back to the Tirole article,
 7 if we can pick it up at 5689. It is the second
 8 paragraph on that page, the first complete one, "Even
 9 for debit cards" it begins. It is page 5689, second
 10 paragraph down begins:
 11 "Even for debit cards ..."
 12 Do you have that?
 13 A. Yes.
 14 Q. At the end of that paragraph Tirole says:
 15 "More importantly still, e-commerce is vastly
 16 facilitated by the use of electronic payments. Cash or
 17 even cheques cannot easily substitute for cards for
 18 online purchases."
 19 Do you agree that cash is not generally suitable for
 20 online transactions?
 21 A. Yes.
 22 Q. Can we go to your second report at D2.1, tab 3,
 23 page 528. You say:
 24 "To assess efficiencies, the first issue to address
 25 is what would happen if the MIFs were not at the level

108

1 obtained by Dr Niels, but at a lower level...(Reading
2 to the words)... by more efficient card transactions."
3 But that statement isn't true, is it, if a consumer
4 has a choice between buying online or going to a shop,
5 because then he does have a choice between a card or
6 cash, correct?
7 A. If he goes to the shop he has a choice between a card or
8 cash.
9 Q. A consumer has a choice between buying online or buying
10 in a shop?
11 A. Yes.
12 Q. Failure to take any account of online transactions will
13 result in a MIT-MIF which is too low won't it, because
14 the MIT-MIF has to be applied generally across all sorts
15 of transactions?
16 A. The MIT-MIF is applied to online transactions. One has
17 to think -- that is a distribution channel. So the
18 benefits are all in terms of the cardholders not having
19 to get out of bed or use their shoes to go down to
20 Sainsbury's, or wherever.
21 So I don't quite get where the efficiencies in terms
22 of transaction on the merchant's side -- and that's what
23 we are measuring -- come in. In fact, the merchants are
24 actually having to build out, imply lots of cost to
25 actually achieve that end. I think that's in John

109

1 Roger's second statement.
2 Q. Are you suggesting that online transactions are a burden
3 for retailers?
4 A. Online transactions are basically another distribution
5 channel, if you are favouring one over another, what is
6 the additional sale you are getting? Well, it may be to
7 the individual. So Amazon may have, for example, a real
8 interest in promoting online sales but that's not
9 necessarily the case for a book store.
10 Q. Retailers set up online stores because they believe it
11 is going to be profitable, don't they?
12 A. They believe that they should actually earn a profit
13 otherwise they wouldn't do it.
14 Q. I'm not sure whether you accept or not that failure to
15 take any account of online transactions will necessarily
16 compromise the accuracy of a MIT-MIF?
17 A. The MIT-MIF is about measuring transaction benefits on
18 the merchant's side, of getting the efficiencies, of
19 transfer of cash to cards. I can't see where the
20 efficiency of card use comes in on its own.
21 Q. Is your evidence then that the MIT-MIF does not need to
22 take any account of online transactions?
23 A. If you come back up to the point of what is the benefit,
24 if you can't see the benefit according to 101.3 then you
25 don't need to measure it.

110

1 Q. So your evidence is MIT MIF does not need to take any
2 account of online transactions?
3 A. That is my evidence, sir.
4 Q. Can we go to E3.14, tab 266. This is the Rysman and
5 Wright article. If we can go to 5736, pick the first
6 paragraph up from the bottom, where it says:
7 "Future work might consider ..."
8 Do you have that?
9 A. Yes.
10 Q. It says:
11 "Future work might consider a broader range of
12 possible...(Reading to the words)... case of internet
13 transactions, in case these make use of only payment
14 cards and no other payment instruments."
15 So Rysman and Wright believe that further work is
16 necessary in order to take account of online
17 transactions, correct?
18 A. They do, they don't consider that in the context of
19 101.3.
20 Q. The Commission's 2015 survey doesn't take any account of
21 online transactions, does it?
22 A. That's true.
23 Q. Amex is a closed platform, isn't it?
24 A. Yes.
25 Q. Looking, again, at what we have just been looking at,

111

1 the Rysman and Wright at 5376, in the section I just
2 read out they said, in relation to future work that
3 might be necessary:
4 "For instance, existing theory does not cover the
5 case in which the relevant alternative to the open
6 platform cards is closed platform cards."
7 They think that further work is necessary to take
8 account of closed platform cards such as Amex, correct?
9 A. They believe that.
10 Q. The Commission's 2015 survey doesn't take account of
11 Amex where it is a relevant alternative to open platform
12 cards, does it?
13 A. It doesn't. I can't talk about the Deloitte or the
14 Commission but, in my view, again, there is no
15 efficiency benefit.
16 Q. Your analysis doesn't take any account of Amex where it
17 is a relevant alternative to an open platform cards,
18 does it?
19 A. That's true.
20 Q. Can we go to your first report, D2, tab 2, at page 263.
21 Paragraph 707, you say:
22 "For face to face payments, the most appropriate
23 comparator to card payments is cash."
24 Do you say that is true for both face-to-face debit
25 and credit card purchasers?

112

1 A. Yes.
 2 Q. Can we go to Dr Niels' first report, that's D3, tab 3 at
 3 page 335. This is Dr Niels' first report, page 335,
 4 paragraph 6.99:
 5 "Cash is a comparator for credit card purchases. In
 6 its implementation of the ...(Reading to the words)...
 7 credit card purchases."
 8 You just told us that's your approach as well,
 9 correct?
 10 A. Yes.
 11 Q. "While cash would be a closer comparator for
 12 face-to-face debit card purchases ...(Reading to the
 13 words)... funds credit purchases."
 14 That's where you and Dr Niels not for the first time
 15 differ, correct?
 16 A. Yes.
 17 Q. Can we go to E3.6, tab 130A. You see that this is the
 18 article by Rochet and Wright. You see that on the
 19 second page of this.
 20 A. Sorry, I have got the wrong bundle. (Pause)
 21 Found it.
 22 Q. Thank you. Again, it is the horribly convoluted
 23 numbering. If you turn over the first page, you will
 24 see the title. You will see it is an article called
 25 "Credit card interchange fees" by Rochet and Wright,

113

1 yes?
 2 A. I do.
 3 Q. Then if we can go to point 6. You will see in the
 4 middle of the page there is a paragraph that begins:
 5 "In our model, credit cards can be used for two
 6 types of transactions: ordinary purchases for regular
 7 convenience usage, for which cash or a debit card will
 8 soon provide identical benefits and for credit purchases
 9 where credit is necessary for purchases to be realised.
 10 Credit purchases include a range of different types of
 11 purchases such as unplanned purchases, impulse purchases
 12 and large purchases for which the consumer does not have
 13 the cash or funds immediately available to complete the
 14 purchase or for purchases to which the deferment of
 15 payment facilities facilitates the transaction. For
 16 ordinary purchases we assume credit cards are
 17 inefficient given that we assume ...(Reading to the
 18 words)... for ordinary purchases."
 19 Then they go on to say:
 20 "Taking into account both types of transactions,
 21 a monopoly card network always sets its interchange fee
 22 too high in our setting. Thus, regulators ...(Reading
 23 to the words)... only likely to give a lower bound of
 24 possible interchange fees that maximise consumer
 25 surplus."

114

1 Now, the view you express in your report is not
 2 consistent with Rochet and Wright's view expressed
 3 there, is it?
 4 A. That is right for, I think, a good reason, that you are
 5 going to ask me.
 6 Q. Well, according to Rochet and Wright, if you accept
 7 their analysis, the MIT test that was developed by
 8 Rochet and Tirole in 2008 is not suitable for credit
 9 cards; that's their view, correct?
 10 A. That's their view. I think Jean Tirole in footnote 13
 11 makes the point, in his paper, that the MIT test has
 12 a few problems in terms of competition law.
 13 Q. Can we go to E3.14?
 14 A. Sure.
 15 Q. Tab 265 is the Tirole article, 5696. You will see
 16 a heading halfway down the page:
 17 "Subsidise competing means of payment."
 18 A. I do.
 19 Q. Tirole says:
 20 "The analysis assumed that alternative payment
 21 methods, cash/cheques, are fairly priced. This,
 22 however, need not be the case. In some countries banks
 23 are not allowed to charge for the costs they incur on
 24 cheques. In this case cheques are subsidised in that
 25 their costs are recovered through cross ...(Reading to

115

1 the words)... cash is then unduly favoured."
 2 What he is doing is identifying that there are
 3 social costs of cash and your MIT analysis doesn't take
 4 account of those social costs of cash, does it?
 5 A. The MIT analysis consistent with Article 101.3 does not
 6 take account of those social costs of cash.
 7 Q. If one accepts Tirole's analysis it will be likely to be
 8 too low.
 9 A. If you view his assumptions as correct then it would be
 10 too low.
 11 MR HOSKINS: It is probably a good time to stop, sir, I'm
 12 about to move on to a new topic.
 13 A. Sir, may I make just one -- two small points about
 14 Rochet and Wright?
 15 MR JUSTICE BARLING: Yes.
 16 A. The existence of a credit card, we establish usually in
 17 terms of the restriction on whether you can actually --
 18 it is an objective necessity. When you get to 101.3,
 19 a credit card exists, so you have to ask yourselves,
 20 what is the benefit that Rochet and Wright are actually
 21 thinking about, that the MIF is actually contributing
 22 to. If I go to Rochet and Wright's model, you can look
 23 through the mathematics but, essentially, it is saying
 24 it aids rivalry between retailers.
 25 So using a credit card has some benefit between

116

1 retailers. That is an additional sales argument at the
 2 retail level but he actually says, explicitly, in his
 3 model that there's no global additional sales to the
 4 totality of merchants which is our test.
 5 The second thing is that I think even -- I'm not
 6 saying even you -- but you have read the mathematics,
 7 but you also note that there is no interest in his
 8 model. So if, actually, as I have said before interest
 9 on the issuer side is greater than the cost, then the
 10 additionality of providing that credit is absent.
 11 I was given the homework last night of reading these
 12 lovely surveys and I really appreciate it because it
 13 brought home to me that we can have as many theories as
 14 possible, but ultimately they have got to be grounded in
 15 the law. I'm the economist, you are the lawyers, that's
 16 the basis.
 17 Q. Before we finish then, is your evidence that you believe
 18 your MIT-MIF complies with 101.3, but the logic, the
 19 result of everything we have seen so far is that what
 20 you are saying is, in order to comply with 101.3, one
 21 has to apply a MIT-MIF which Rochet, Tirole and Wright
 22 all consider would not be appropriate economically
 23 because it would be too low? That's your evidence?
 24 That is the impact of it, isn't it?
 25 A. The impact of Rochet Tirole is: I think we ought to

117

1 measure transaction benefits. Everything apart from
 2 that I do not think is much use in the context of 101.3,
 3 where the central issue is actually fair share. That is
 4 not a straight economics point because you asked me
 5 yesterday: does economics worry about the level? Well,
 6 the law worries about the level and that's fair share.
 7 Q. Let's stick to economics because that's your expertise.
 8 A. Indeed.
 9 Q. Your evidence is that you would prefer a MIT-MIF which,
 10 according to Rochet, Tirole and Wright, would be too
 11 low?
 12 A. Yes.
 13 Q. Thank you.
 14 PROFESSOR JOHN BEATH: Might I ask exactly on that point,
 15 because I think this whole line of questioning arose in
 16 looking at the final sentence of the Rochet paper,
 17 E3.14, page 5696, tab 265.
 18 "The use of this term leads to a conservative
 19 estimate of the desirable IF."
 20 I think we should be careful that the word
 21 "conservative" is being -- as it seems to be being used
 22 is too low. In fact, if you take the range of
 23 theoretical results, the word "conservative" means it
 24 has not accounted for all the relevant factors. It
 25 could be either too low or too high.

118

1 MR HOSKINS: Sir, can I respond to this with the legal
 2 submissions I made in opening, which is remember here we
 3 are in the context of the broad axe.
 4 PROFESSOR JOHN BEATH: Yes.
 5 MR HOSKINS: And the judges have applied the broad axe in
 6 the past and recognised the need to favour the defendant
 7 rather than the claimant. So when one is looking -- the
 8 reason why I'm taking you to all these articles is to
 9 show you there is a series of issues, a series of
 10 factors that would lead to a higher MIF that are not
 11 taken account of. My submission, giving nothing away,
 12 at the end in closing is going to be, if you want to
 13 apply the broad axe you have to be nice to me and you
 14 have got to take account of all these factors that
 15 aren't in the MIT-MIF.
 16 PROFESSOR JOHN BEATH: I take the point and I still believe
 17 I am correct in my use of the term "conservative" to
 18 mean not all factors taken into account. Okay.
 19 MR SMITH: Mr Hoskins, one query that we had. We had some
 20 mention earlier today of the introduction of the
 21 MasterCard World card in 2008/2009.
 22 MR HOSKINS: Yes.
 23 MR SMITH: It may well be in the documents but, if so,
 24 I haven't been able to find it. But did Visa have
 25 an equivalent premier card at any time, no need to

119

1 answer this now.
 2 MR HOSKINS: No.
 3 MR SMITH: And if it did, can you give us a rough date as to
 4 when it was introduced. Thank you.
 5 MR JUSTICE BARLING: Thank you very much.
 6 Mr von Hinten Reed, I have already said to you you have
 7 to be very careful not to talk about your evidence or
 8 the case except in that one respect where you are going
 9 to raise it with the team.
 10 A. I appreciate that. Thank you very much, sir.
 11 MR JUSTICE BARLING: Have a good weekend.
 12 A. And you.
 13 MR JUSTICE BARLING: Thank you very much.
 14 (4.31 pm)
 15 (End of open session)
 16 (The court adjourned until 10.30 am on
 17 Monday, 22nd February 2016)

120

	INDEX	
		PAGE
1		
2		
3	(Open session)	1
4	MR NILS VON HINTEN REED (continued)	2
5	Examination-in-chief by MR HOSKINS	2
	(continued)	
6		
	(End of open session)	7
7		
	(In camera)	7
8		
	(Beginning of open session)	7
9		
	Cross-examination by MR HOSKINS	7
10	(continued)	
11	(End of open session)	120
12		
13		
14		
15		
16		
17		
18		
19		
20		
21		
22		
23		
24		
25		

211 (3) 3:21 8:17,24	4315 (2) 92:22,23	63 (1) 35:7
2194A (1) 94:8	4350 (2) 99:16,17	64 (1) 25:23
220 (1) 40:17	44 (2) 15:1,2	659A (1) 81:13
224 (1) 30:16	440 (6) 3:20,22 4:4,20 6:1,13	659A.10 (1) 71:17
22nd (1) 120:17	441 (9) 3:20,22,22 8:18,24 9:2,3 10:13 10:14	659A.127 (1) 81:22
23 (3) 14:17 35:3 95:16	45 (1) 36:12	659A.129 (2) 89:3 91:5
236 (3) 2:9,19,22	455 (1) 45:17	659A.34 (1) 92:4
23rd (1) 5:3	46 (2) 10:2 14:24	69 (4) 25:19,20,25,25
247 (5) 84:4,5,7,8 91:12	466 (2) 2:9 65:18	7
249 (2) 27:20 36:2	467 (1) 65:18	7 (14) 15:16,19 48:16 50:1 76:2 86:6 96:19 97:10 98:1 99:14 121:6,7,8,9
24th (3) 65:2,5 70:6	468 (1) 69:7	7-6 (1) 64:15
25% (3) 83:14 86:10 86:22	469 (3) 73:7 74:16 75:17	7% (13) 82:25 83:1,11 83:15 85:2,15,20 85:24 86:14,17 89:4 101:15,21
254 (1) 100:4	472 (1) 58:17	7.6 (3) 65:18 66:19 72:12
256 (1) 97:19	473 (1) 59:17	7.7 (1) 99:13
258 (1) 44:22	48 (3) 15:24,25 35:8	70 (3) 25:20 27:7,9
259 (1) 82:14	482 (1) 63:4	707 (1) 112:21
261 (4) 82:23 84:22 85:11,13	489 (1) 97:14	744 (1) 69:15
263 (1) 112:20	49 (1) 15:24	8
265 (5) 24:18 104:14 108:6 115:15 118:17	5	8 (2) 97:11 99:14
266 (4) 52:11 61:1 93:16 111:4	5 (4) 13:17 102:23,25 103:3	8% (3) 11:7 17:14,21
270 (2) 34:9,12	5% (12) 4:1 8:19,22 9:4 10:11,14,17 87:13 101:25 102:1 102:3,9	8.6 (1) 82:4
272 (1) 5:2	5.12 (1) 31:9	80 (1) 87:11
28-day (2) 106:12,19	5.4 (3) 28:19 29:5 30:14	80% (1) 87:9
281 (1) 32:21	50 (1) 15:12	81 (1) 92:23
2nd (1) 35:25	505 (1) 98:16	811 (1) 13:22
3	506 (1) 98:23	82 (1) 92:22
3 (27) 2:8 9:13 14:7 17:11 22:12 31:18 31:21 32:13 44:21 45:17 58:14 62:7 63:3 65:14 70:2 72:13 74:15 84:7 88:23 89:3 91:5,12 97:13,14 98:15 108:22 113:2	520 (3) 65:16 72:13 74:16	9
3-1 (1) 84:2	521 (2) 58:15,17	9 (2) 35:17 37:8
3% (3) 10:17,21 11:16	522 (1) 63:4	90 (1) 87:11
3.1 (8) 83:3,20 84:8 86:23 87:2 88:20 91:11,19	523 (2) 97:13,14	99A (1) 94:5
3.20 (1) 90:14	526 (1) 98:16	
3.30 (1) 90:16	528 (1) 108:23	
3.41 (1) 89:16	5328 (1) 36:7	
3.59 (1) 44:22	5334 (1) 28:3	
30% (1) 30:1	5376 (1) 112:1	
32 (3) 14:22 31:19,21	54% (1) 63:9	
329 (1) 62:8	551 (1) 30:25	
335 (2) 113:3,3	56 (1) 29:5	
339 (1) 83:9	5689 (2) 108:7,9	
340 (2) 83:9,22	5694 (2) 24:23,24	
367 (1) 27:12	5696 (3) 104:17 115:15 118:17	
38 (1) 62:3	570 (1) 13:25	
3A (5) 71:13,14 81:13 84:22 85:11	5701 (3) 55:10,11,24	
4	5703 (1) 55:25	
4 (1) 94:22	5736 (4) 52:15,16,18 111:5	
4% (1) 30:3	5737 (2) 61:4 93:17	
4.31 (1) 120:14	577 (1) 69:16	
40 (3) 9:25 10:2,17	5th (3) 64:24 66:5,12	
40% (1) 10:6	5th/7th (1) 64:6	
41 (2) 31:19,21	6	
419 (5) 39:12 40:19 41:19 42:15 44:9	6 (14) 47:25 57:17 73:12 76:2 83:7 89:15 96:18 97:10 98:1 99:14 101:15 101:22 102:23 114:3	
42 (1) 14:24	6% (5) 11:10,18,19,22 101:21	
420 (1) 44:10	6.3.1 (1) 44:11	
422 (3) 62:17 63:23 70:3	6.5 (1) 91:4	
4294 (1) 56:10	6.75 (1) 62:8	
4295 (2) 47:25 94:20	6.99 (1) 113:4	
4297 (1) 73:16	60% (3) 9:25 10:6,17	
	601 (2) 83:8 89:15	
	6297 (1) 34:17	

