IN THE COMPETITION APPEAL TRIBUNAL Case No: 1517/11//7/22

Salisbury Square House
8 Salisbury Square
London EC4Y 8AP

Wednesday 14 February – Thursday 28 March 2024

Before:

The Honourable Sir Marcus Smith (President)
Ben Tidswell
Professor Michael Waterson

(Sitting as a Tribunal in England and Wales)

MERCHANT INTERCHANGE FEE UMBRELLA PROCEEDINGS

TRIAL 1

A P P E A R A N C E S

Kieron Beal KC, Philip Woolfe, Oliver Jackson & Antonia Fitzpatrick (instructed by Stephenson Harwood LLP and Scott+Scott UK LLP) on behalf of the Stephenson Harwood LLP and Scott+Scott UK LLP Claimants

Brian Kennelly KC, Jason Pobjoy, Isabel Buchanan & Ava Mayer (Instructed by Linklaters LLP and Milbank LLP) on behalf of Visa

Sonia Tolaney KC, Matthew Cook KC, Owain Draper & Veena Srirangam (Instructed by Jones Day) on behalf of Mastercard

Thursday, 7 March 2024

(10.00 am)

THE PRESIDENT: Mr Beal, good morning.

MR BEAL: May it please the Tribunal, may I invite Mr Dryden to come forward and give evidence, he has already been affirmed.

THE PRESIDENT: He has already been affirmed.

MR NEIL ALISTAIR DRYDEN (re-called)

THE PRESIDENT: Mr Dryden, good morning, do sit down and make yourself comfortable. As counsel has just said, your affirmation of yesterday stands; we are not going to reaffirm you.

I am going to say this at the beginning rather than at the first break which is: I am going to impose the usual purdah rules pro tem but I am very sympathetic to any application from counsel -- in this case it will be Mr Beal, but whichever counsel it is -- to the lifting of that regime because, frankly, I know you perform a dual role in terms of giving evidence to assist me and assisting Mr Beal in cross-examining the other experts, I do not want Mr Beal to be disadvantaged to that extent. He will make an application if he needs to. I am signalling that I will almost certainly grant it, subject to whatever is being said. The reason I am willing to do that is because, frankly, we have massive regard for the experts who assist here and the chances I think of any counsel influencing your opinion are so close to zero that I am willing to let you be exposed to the misconceived notions of counsel as to what your evidence should be because I do not think it will change.

That is not a point made against Mr Beal; it is made generally.

MR BEAL: No, it reminds me of an anecdote I heard once from a German lawyer who said that in the relationship between a lawyer and an economist, the German lawyer said to the economist: you know I am going to be driving this case and the economist said: well, it is always nice to have a chauffeur. I will not say about my relationship with Mr Dryden but you will draw your own inferences in due course.

Examination-in-chief by MR BEAL

MR BEAL: Mr Dryden I hope you have a bundle before you.

A. I do.

Q. Can I just confirm: I saw you bring a notepad. Is that empty?

A. It is empty.

Q. It does not have any scribblings on it at the moment. Please look in bundle {RC-H2/1/1}; is that your first report?

A. It is.
Q. Please could you turn to page {RC-H2/1/152}?
A. Yes.
Q. There is an expert declaration there, are you happy to reaffirm that that declaration holds good?
A. I am.
Q. Please could you turn in bundle {RC-H2/2/1}?
A. Yes.
Q. That is your second report; is that right?
A. It is.
Q. Could you please turn to page {H2/2/70}?
A. Yes.
Q. Same question, are you happy to stand by the declaration you have given there?
A. I am.
MR BEAL: I anticipate there will be some questions for you.
THE PRESIDENT: Mr Kennelly.

Cross-examination by MR KENNELLY

MR KENNELLY: Thank you. Good morning, Mr Dryden.
A. Good morning.
Q. Mr Dryden, obviously today I will be asking you questions about four-party payment schemes, but before I do I would like to ask you some questions about some other types of financial transactions that do not settle or might not settle at par.

I want to discuss first factoring with you. So a business might take -- might sell goods or services to lots of customers and instead of taking the payment immediately, it might issue them with an invoice that is payable in, say, 30 days. Now, a business like that might prefer to have the money immediately rather than waiting for the customer to pay after 30 days or 60 days and so it can assign or sell its right to collect those debts to a finance company.

You are nodding, but this is obviously --

A. I am familiar with the concept.

Q. I am grateful. So the finance company pays the money to the business immediately and then takes over the task of collecting the debts from the customer, 30 days later.

Now, there are obviously different costs involved in doing that and I am just going to run through those costs, only discussing factoring at the moment and I appreciate I am sure there are distinctions to be made, just factoring. The costs that are involved, the time value of the money. Do you accept that is a cost involved in the factoring exercise that I am describing?

A. I do.

Q. The risk that the customer does not pay?

A. Yes.

Q. The risk that the whole transaction was a fraud?

A. Yes.
Q. The cost of administering this factoring scheme?
A. Yes.
Q. The cost of making payments to the business. Again, we are not discussing the size of the costs, just the fact of the cost?
A. Yes.
Q. The costs of recording payments from customers and matching them off?
A. Yes.
Q. So you would not expect the finance company to buy that debt at par, would you, to pay the business £1,000 for that £1,000 debt?
A. No, it would have to cover its costs.
Q. It would settle at quite a significant discount, would it not?
A. I would expect so.
Q. In relation to the size of that discount, what do you think would influence the size of the discount in question?
A. I would expect it to be influenced by the costs of factoring, of the competitiveness and of the competitiveness of the factoring market and the alternative options of the -- the merchant who is seeking the service.

Q. That discount would be set at a rate that the finance company would set, either unilaterally or it would be the product of negotiation between the finance company and the business?
A. Yes.
Q. Still factoring?
A. Yes.
Q. So the business selling the debt, does not receive -- I think you have just agreed does not receive the transaction price that it has actually agreed with the customer but the business benefits in other ways, does it not?
A. Yes. By reveal preference if the business is choosing to purchase factoring, it is deriving a benefit.
Q. Let us just think about those benefits. So it can offer its customers an attractive way of paying, so the customers get 30 days to pay even though they get the goods or services immediately; that is attractive from the customer's perspective, is it not?
A. Yes, it is not clear the but for factoring that the customer would also be given 30 days. But if they would not, then it is a benefit to the customer.
Q. If it is a benefit to the customer, offering that benefit helps the business to access those customers who might have purchased from someone else who offered them

this thing that they like?
A. Yes, subject to the caveat, subject to the "if".
Q. Yes.
A. The English "if".
Q. Yes.
A. Sorry, yes.
Q. No, no. The business in this factoring scenario avoids the costs and uncertainty of getting the money from the customer?
A. Yes.
Q. That is why lots of businesses choose to use this kind of scheme?
A. I do not know the extent of it but for those businesses who choose to use it they are clearly judging that the benefits, there is a net benefit to them from doing so.
Q. There is nothing artificial or unnatural about the fact that a business receives less than par in this arrangement?
A. No.
Q. Nothing anti-competitive about it?
A. Not without some complicating factors. There is nothing intrinsically anti-competitive about this, obviously.
Q. Indeed. So I would like to ask some questions about the three-party payment schemes now like Amex and ask some questions about some similarities between three-party

payment schemes and the factoring scheme that we have been discussing. In a three-party payment scheme, it is also the case, is it not, that the business provides a good or service to the customer immediately, the customer does not himself or herself pay the business?
A. That is correct.
Q. Amex pays the business and then Amex collects the transaction price from the customer some time after paying the business?
A. That is correct.
Q. Just like factoring in this arrangement, where Amex pays the merchant immediately and collects the money from the customer later, it involves similar categories of cost to the ones we were discussing in the factoring scenario?
A. I am not sure if every one carries across but at least some of them clearly do.
Q. So time value of money?
A. Yes.
Q. Credit risk?
A. Yes.
Q. Fraud risk?
A. Yes.
Q. The cost?
A. Depending where the fraud lies but --

Q. You are quite right.
A. -- there is some fraud risk.
Q. Well, the card might be fraudulent, a stolen card?
A. Yes.
Q. The cost of administering the system?
A. Yes.
Q. But there is one important difference, is there not, at least one important difference, between a three-party payment scheme and factoring, is that Amex has a pre-existing contractual relationship with both the merchant and the cardholder?
A. Yes.
Q. That is the difference.
Amex's relationship with the cardholder allows it to mitigate some of the risks involved, so it can choose only to issue to creditworthy customers?
A. True. I think the factoring -- I am not sure what to call it, the factoring undertaking can mitigate by deciding what business to take on in the mix of risk in what it chooses to factor, so it has a degree of control.
Q. Indeed. Indeed. But coming back to Amex, other ways in which Amex can mitigate the risks, it can monitor transactions for fraud risk and decline them if they are too risky?

A. Yes.
Q. But the risks cannot be entirely eliminated, can they?
A. Not at some portfolio -- yes, not at some positive level of business.
Q. The relationship with the cardholders gives Amex another potential source of revenue, does it not? It can charge fees to the merchant and it can also charge fees and interest to the cardholder?
A. Correct.
Q. But Amex might want to charge negative fees to the cardholder, by way of rewards?
A. In principle, or indeed in practice. I mean, it is not -- that is not a negative fee overall because there are -- there are positive fees and there are in a sense kind of negative prices in the form of rewards.
Q. Indeed, indeed, and the reason why Amex might do that to offer rewards for example is to encourage customers to take an Amex card and to use an Amex card?
A. Indeed.
Q. The benefit for Amex in doing that is that the more the cardholder uses the card, the more Amex can profit from the fees that it charges the merchant?
A. Yes.
Q. That is an extra dimension that we have in the three-party payment scheme and that ability that Amex

has is an aspect of the two-sidedness of the markets in which Amex is operating?
A. I agree.
Q. You said in your first report when you have a two-sided market it is very common to have -- I think what you said was unbalanced pricing?
A. Yes.
Q. In other words, it is often profitable to charge a higher price on one side of the market than on the other?
A. Yes.
Q. It is often profitable to charge nothing at all on one side of the market or even a negative price as a form of reward to one side of the market?
A. That can happen in some two-sided markets yes.
Q. To that extent it is a normal feature of two-sided markets?
A. It is a feature of two-sided markets.
Q. But the consequence of this unbalanced pricing in the Amex scenario results in bigger deductions from what Amex pays the merchant, bigger deductions from the amount that Amex pays the merchant?
A. Yes. I think that is maybe a tautology, but yes.
Q. Forgive me. But the merchant in this scenario is again Amex is effectively paying the cost of fraud risk and

credit risk and the time value of money and all those costs we described like administration, but the merchant -- please say "yes" when you nod -- if you do --
A. I am sorry, I will. I did not know if you were at the end. The Amex is contributing to those costs. I do not think it is -- I think perhaps you said they were paying for those costs. I do not think they are paying for their costs in the entirety because obviously Amex -- via the implicit transfer from the acquiring side so there is different contributions to the overall cardholder offer.
Q. Sorry, Mr Dryden, perhaps I misspoke. I meant the merchant: the merchant is paying from these costs that Amex is incurring, the credit, time -- well, time value of money, cost of fraud, credit, cost of administration, the merchant is contributing to those costs by the charges that it is paying?
A. Yes, that was my understanding of your question. My answer is indeed they are contributing. I think it was -- it is -- I hesitated to say they were paying if the implication to that is they are paying for everything.
Q. I understand.
A. But they are contributing.

Q. So for these reasons, the costs and negative customer pricing, the rewards, three-party payment schemes do not settle at par, do they?
A. There is an implicit -- my understanding is there is an implicit transfer.
Q. So just like the factoring, the discount that the price they are setting for the merchant is set either unilaterally by Amex or through negotiation with the merchant; that is right, is it not?
A. Yes.
Q. Lots of merchants choose to accept Amex?
A. Some merchants do. There is obviously -- one could be more precise about merchant acceptance with Amex which is less than complete but some do, some do not.
Q. I said lots --
A. Yes.
Q. -- I am not suggesting as many accept Amex as accept Visa and Mastercard.
But the reason these merchants choose to accept Amex is because it allows them a desirable payment option to offer cardholders?
A. Well, I think this is where we run into a -- this is where we run into some of the issues from yesterday. So the merchant may be paying the implicit transfer associated with Amex to some degree because they are

afraid of losing the business if they decline the payment means. So in other words the level, the level of the merchant's contribution may be in excess of the benefits the merchant derives.
Q. Indeed. They are driven to accept Amex by these market forces, I think you described in the hot-tub, where cardholders want to pay by Amex because of rewards that are funded by Amex's implicit, as you described it, interchange fee and so merchants agree to pay these higher fees because they are afraid if they do not, the customers will switch to another merchant that does accept them?
A. That is right, the dynamic that I discussed yesterday to some degree also will apply to Amex.
Q. Coming back to why the cardholders want to pay with Amex, why it is a desirable payment option for them, we mentioned rewards but there is also the fact that they do not always carry cash, so it is convenient to have to pay by card, this is why cardholders choose to use Amex?
A. Yes, I am not sure that is a reason to use Amex rather than choose to have a card.
Q. But it is -- I accept that. But it is one of the reasons why someone would use Amex, to avoid using cash?
A. I think that would depend. If they also had a Visa or a Mastercard card they are protected against the risk of

not having cash by the Visa or the Mastercard so there would be another reason for having the Amex. If they were single homing and they only had an Amex, then part of the reason for having the Amex would be against the contingency of not having cash.

Q. From the cardholder's perspective, Mr Dryden, I am looking here from the cardholder's perspective, the benefits they perceive from using a card, not just the Visa and Mastercard but an Amex card also, it is not -- it may be more convenient than cash if they have not got cash. They get, if it is 30 days, up to in fact up to 56 days interest free with an Amex card?

A. Yes, I mean, I am at risk of repeating my previous answer. The benefits of Amex are different in your scenario depending whether the person already has a Visa or a Mastercard and they are multi-homing, in which case there is some kind of incremental reason to have the Amex. Or if they are single-homing, in which case all of the benefits of having a card accrued from having the Amex.

Q. Of course. But even if they are multi-homing, do you accept that these are benefits from the cardholder's perspective that the Amex card shares with the Visa and Mastercards?

A. Yes.

Q. Except, as you said, Amex may have a further benefit from their perspective which is the greater rewards?
A. I agree.
Q. So all of these reasons make Amex cardholders happier about buying goods and services from merchants who accept Amex?
A. Happier than ...
Q. It makes them --
A. Well --
Q. Sorry.
A. Yes.
Q. Makes them -- well, they enjoy receiving the benefits we have just described and that encourages them to use their Amex card?
A. Yes, I think again it is true by reveal preference that if some cardholders carry an Amex it must be because on some occasions they find that it is beneficial to have it and to use it.
Q. Coming then to the merchants who choose to accept Amex. I think you accepted a moment ago a major reason they choose to do so is because they want to win the business of these customers that want to pay with Amex?
A. Yes, that is the "must take" point applied, which is not binary, that is the "must take" point applied to Amex.
Q. I am sorry?

A. That is applying the "must take" point to Amex.
Q. Yes. The merchant also, even when Amex is used, does avoid the costs of dealing with cash?
A. By definition they avoid the cost of cash. The problem with I alluded to yesterday, is they may be paying through the Merchant Service Charge a cost much in excess of their benefit of avoiding cash. That is the market failure point that I described yesterday.
Q. Indeed. We will come back to that, Mr Dryden, I am not suggesting that it satisfies the merchant difference test or anything like that, but just dealing with the merchant perceptions and merchant benefits.
So for those reasons we have just been describing the merchant is willing to accept a deal involving Amex where it does not receive the full transaction price paid by the customer?
A. By reveal -- I have been asked a number of questions about whether a cardholder perceives the benefit of having a card and whether the merchant perceives the benefit of, for example, accepting Amex. I mean, by virtue of observing that there are cardholders with Amex who use it and merchants who accept Amex, we can tell that both sides judge that they have a benefit in either using or accept Amex; that follows. If they did not, then they would not.

THE PRESIDENT: Mr Dryden, there is a problem when one talks about why people use certain things and the relevance of cost because we have an entirely understandable absence of data, so Mr Kennelly and you have been discussing costs of cash to a merchant. To what extent is that a sort of theoretical cost in the sense that one knows that there is a cost involved and to what extent is that a granular figure because one can understand that there must be huge diversity of different merchants to whom the cost of cash and the cost of cards are different, I mean to take, say, a corner shop might very well have a very different attitude to relative costs of different payment methods. But equally one might have extraneous events pushing merchants and their customers into different forms of payment.

I mean, one of them is technology as we have discussed. Another -- and it is not relevant save as an example -- is something like Covid where you have an extraneous event regardless of costs pushing everyone into the use of cards rather than money and so really what I am trying to get an idea of is the extent to which when one is talking about these costs that are associated with different payment systems how far this is a kind of theoretical discussion and how far there is helpful data that would enable us to crystallise those costs and if there is, how reliable you think that is or whether we are actually going to be confined to a discussion of these things at a theoretical level?

A. So since the Rochet and Tirole developments that I described yesterday, there has been a focus on the cost of cash because it is central to applying the merchant indifference test. It has, because of its conceptual importance, gone beyond the conceptual into measurement. The European Commission did a study to try to measure the cost of cash and various -- even parties to this litigation have commissioned surveys on the -- to look at the cost of cash.

Part of the reason it was a lot of work is that, as you rightly say, sir, the cost of cash varies for example between large and small merchants. So the European Commission study focused on larger merchants and there was a need to go and estimate the costs for smaller merchants and that resulted in significant bits -- significant projects that were done a decade ago, I do not know if they have been refreshed, to look at the cost of smaller merchants.

In the -- in the previous interchange litigations that I have done, the Article 101(3) stage of the analysis was highly dominated by this measurement issue. So there were sort of hundreds, if not thousands, of pages of expert reports measuring the cost of cash in order to then apply the merchant indifference test framework, in order to determine the efficient level of the interchange fee.

So it has gone far beyond the conceptual into measurement and, you know, it is difficult, it is resource intensive etc but, you know, that has been -- that has been done.

On the other part of your question, which is the idea that cardholders, which is that buyers may choose to use cards regardless, as you put it, because of technological developments etc, that also was a very important part of the Article 101(3) analysis when I was involved previously, embodied in the phrase or the idea of switching, switching customers, and there is -- there -- with the -- with the MIFs at their factual level used card, but with MIFs at zero would not use card.

So looked at the other way round, the switchers are the ones who with no MIF would be using cash but the MIF causes them to switch to card. Then the observation precisely in line with what you said, sir, is that the number of switchers may not be too great, if one is reaching a stage of development of cards where people are inclined to use card anyway the MIF is not flipping them from cash to card. In those circumstances the rationale for the interchange fee to cure the externality that I described yesterday is reduced so it is harder to justify an IF at all or certainly at a higher level. So these issues of the measurement of the cost of cash and the measurement of the question of people who use cards regardless are key issues but at least in past cases have been part of the 101(3) framework.

THE PRESIDENT: I understand. Thank you.

Mr Kennelly, I apologise for interrupting you but it seems to us important that we at least get a sense when you are debating these perfectly correct theoretical questions that we have some sense of the detail that may lie behind them, because if, of course, these measures matter, we are going to have to write a judgment which is more than just based on the theoretical. So we will try and get a feel for what there is. I am not expecting you to cross-examine on it, but we need to get a sense of what is --

MR KENNELLY: Indeed, sir. As I explained to Mr Dryden, we are not discussing here specifics. When we come -- and we will come -- to specific figures, the costs of alternative means of payment, and I will discuss those with Mr Dryden, for the moment we are not discussing figures at all.

THE PRESIDENT: No, I am merely trying to locate myself in the course of evidence that is there may or may not be.

MR KENNELLY: Never fear, sir, we will be coming to numbers in due course. But for the moment we are really looking at Amex and the way Amex works and Mr Dryden had accepted, as you heard, that -- as he said it is a statement of the obvious, these reveal preferences merchants who choose to accept Amex are willing to accept something less than the full transaction price.

My next question was: there is nothing unnatural or artificial about the fact that in that scenario the merchant receives less than the full transaction price?

A. There may be something unnatural about it and that is -- and that is reflected in the difference between the factoring example and the three-party example. So Mr Kennelly rightly identified some things in common between factoring and Amex but I -- in the case of factoring, the merchant is only going to use the factoring service if the benefits of the factoring service to the merchant exceed the costs of using them at the factoring service and there is no market failure that is distorting the merchant's choice. It can be efficient to offload this collection on to the factoring party.

In the case of Amex, the problem can exist perhaps to a lesser extent than for Visa and Mastercard but the problem can exist of the merchant being -- can exist, I would emphasise that -- of the merchant being willing to pay in excess of the transactional benefits they get from accepting Amex because of the risk that if they do not accept Amex, they lose the whole transaction. That is the business stealing effect that we described yesterday.

So merchants are collectively worse off but they individually agree to it because each merchant is afraid to lose the sale to another merchant.

Q. Are you suggesting, Mr Dryden, that that is a competition problem?

A. That is a -- that is a market failure, and it can give rise to a or has given, when fed through the competition law framework, has given, has given rise to a competition law problem.

Q. In the context of Amex?

A. Not -- in the context of four-party schemes.

Q. Not in the context of Amex?

A. Not in the context of Amex. There have been not in the context of Amex as far as I am aware but I -- I may be missing something there.

Q. But in terms of the fact that Amex is not settling at par just on that point alone, I appreciate there may be a market connection to merchants paying for more than they would like to pay for that covers cost, but just the simple fact that they are not settling at par with Amex, there is nothing anti-competitive about that fact, is there?

A. It -- it is -- I think we need to disentangle two things. One is: is it economically efficient, does it reflect -- and the answer to that is, no, it is not economically efficient, is it? Does it reflect the exercise of some market power? Yes. So there is -- from an economics point of view there is a degree of competition problem there that may be less severe than with other schemes or it may be more severe, but there is a degree of a competition problem there. That competition problem may be out of the reach of competition law because it is a three-party scheme under the 101 rubric.

Q. So you are saying the simple fact that they are not settling at par Amex does give rise to a market failure which competition law may not be able to fix, but you say there is a market failure by are virtue of the simple fact that Amex is not settling at par?

A. No, it is not by virtue of that simple fact. You have to look at the conditions on the acquiring side of the

market about whether there is single or multi-homing, about whether there is surcharging or no surcharging. As I had tried to describe yesterday under certain conditions that can produce a situation where settlement is not at par and part of the discount is attributable to a market inefficiency or a competition problem.
Q. Part of it may not be attributable to a market inefficiency or competition problem.
A. It is possible that part of it may not be.
Q. Sometimes Amex operates a slightly different model, does it not, this is the three-and-a-half party scheme, I think GNS was its name?
A. Yes.
Q. That allowed other financial institutions -- let us say Barclaycard -- to issue Amex cards.
So in that scenario, Mr Dryden, Amex has the relationship with the market but Barclaycard has a relationship with the cardholder in this example?
A. Yes.
Q. So it is Barclaycard in this scenario that is incurring the cost of the time value of the money, credit risk, fraud risk, administration and rewards potentially?
A. It is, it is -- those costs are falling directly on Barclaycard in this example.
Q. So some of the money that Amex withholds from the

merchant on every transaction is paid to Barclaycard?
A. Yes.
Q. That money has been paid to them for the purpose among other things of funding those costs?
A. Well, we -- I am not sure that is the ultimate purpose. I mean, I think the ultimate purpose is Amex is seeking to be competitive on the issuing side and the degree to which Amex can make its issuing side competitive in this example depends on how much it can extract from merchants and how much it can extract from merchants depend on the conditions on the acquiring side of the market and the extent of single or multi-homing and whether there is surcharging or not in the way that I described yesterday.
Q. But this payment by Amex to Barclaycard could be used to fund Barclaycard's costs?
A. No, I think it -- it is used by Barclaycard to contribute to its costs.
Q. Even though Barclay -- sorry, Mr Dryden?
A. But I think the first way you put the question was that was sort of the ultimate purpose --
Q. No, sorry --
A. -- on the part of Amex so I think Amex is not doing -- I do not think Amex is doing this ultimately from an accounting view of funding various people's costs; it is

doing it from a competitive standpoint of how can Amex be competitive and the upshot of that is in the equilibrium that we are in, that it has an incentive to extract what it can on the merchant's side and pass that across to the issuing side. It is rather different to what I described yesterday for Visa and Mastercard because Amex seeks to be competitive but at the same time occupy a sort of niche of the market, have a specialist role in the market rather than be a -- a sort of universal scheme.
Q. So, Mr Dryden, you say that even though it is not the ultimate purpose, this money transferred to Barclaycard is being used to fund their costs even though Barclaycard could obviously charge fees and interest to its cardholders as well, could it not?
A. Yes. Yes, I mean, it is -- in the same way that I described yesterday, these costs that flow across to the issuing side contribute to the issuers' costs. If you double the amount that flows across to the issuing side, the issuer's costs will probably double because they will dissipate the additional transfer they are getting in the form of a more costly offer and some of it may be -- some of it may be retained as profit, some of it may be dissipated as advertising. But some of the extra transfer would go into a more costly offer to

cardholders. So it is essentially always going to be that whatever level of the MIF or implicit MIF in the case of Amex that we are at, it is almost going to be universally true that it can be said to be contributing to whatever corresponding level of costs of issuer then has.

Q. But from the merchant's perspective, looking at the perspective of the merchant, what we are describing now three-and-a-half party scheme is the same as the pure three-party scheme from the merchant's perspective?

A. Sorry, I did not understand.

Q. Sorry. So we have been describing how the three-and-a-half party scheme works but from the merchant's perspective it is the same as facing the three-party scheme; it is an Amex card that is presented to it?

A. I -- I think so. I mean, the merchant would, in some sense recognise that there are more Amex -- there are more and slightly different Amex cards being issued if Barclaycard had been recruited, unless Barclaycard is sort of substituting for Amex but essentially from the merchant's standpoint vantage point on their side of the market, they are just seeing people carrying Amex cards, they are not so interested in the exact composition of the issuing side.

Q. So this three-and-a-half party scheme still involves Amex paying some percentage of the transaction to the merchant immediately and again, turning to my old theme, the merchant does not have to worry about how that money is eventually collected from the cardholder?
A. That is correct.
Q. The discount at par -- the discount to par, sorry, that the merchant receives, it is either set unilaterally by Amex or it is negotiated between the merchant and Amex?
A. I think that is correct.
Q. That reflects in some way the amount that Amex has to pay to the issuer in this three-and-a-half party scheme the discount to par?
A. Yes. Except I think the implied causation there is somehow a bit in the wrong direction. I think the Amex is extracting what it can from the merchant and that is then funding the issuing side.

I would actually make, if I may, a slight -- a slight qualification in that regard which is the position is somewhat different I think for Visa and Mastercard to Amex, which is Visa and Mastercard seem to be committed to a strategy of having nearly universal acceptance, so they want to push their MIFs up as far as they can but subject to the -- subject to still being universally accepted.

So they are kind of -- the pinch point comes when the MIFs would be so high that the universal acceptance started to be eroded and the reason they want to have universal acceptance is that is extremely attractive on the cardholder side and allows them to get a very high market share.

So the Visa or Mastercard problem to solve is how far could we push MIFs up, but still having universal acceptance and then that funds the issuing side to whatever extent that it does. Amex has got more of a trade-off because it has less than complete acceptance so if it pushes its MIF -- if it pushes its implicit MIF up further, it will be less accepted; if it brings it down, it will be more accepted. So somehow their findings sweet spot from their point of view in which they are a specialist scheme and many merchants choose not to accept them. That is giving a level of -- that is giving a level of MSC on the merchant side and it is funding a certain amount on the issuing side.

Q. Thank you, Mr Dryden.

Just coming back, though, to this much more basic question about settlement at par and Amex and Amex only for the moment. I have described how Amex has a deal with the merchant but also in this three-and-a-half party scheme Amex pays to the issuer and what Amex pays to the issuer is set unilaterally by Amex or negotiated between Amex and the issuer?

A. Yes.

Q. The fact that Amex's transaction with the issuer settles at a discount to par is not unnatural or artificial either, is it?

A. Well, it is the same answer I gave a short while ago. It is -- I am not sure economists really distinguish between the natural and the unnatural. We distinguish situations of market power and no market power, of efficiency and inefficiency, of a market distortion or no market distortion.

The conditions that I have described as existing on the acquiring side of the market are ones that mean payment card systems are prone to set a MIF or a Merchant Service Charge that is higher than the official level for reasons I have given and that I will not repeat. Then that flows across to the issuer -- and they do that because it flows across to the issuing side and allows them to compete on the issuing side.

So the level of that charge that you are inviting me to call natural is better understood as or what we have to be concerned about as economists is whether it is efficient or not. I have tried to explain why the market -- features of the market mean that it is prone

to be too high.
Q. As you said a moment ago, efficiency may be a question really for 101(3). Looking at just the market power question, Mr Dryden, which may well be a 101(1) issue, is that how you distinguish between the two scenarios; you say that whether Amex settling at par is a market failure or not -- sorry, whether Amex's failure to settle at par is a market failure or not, it depends on market power --
A. Yes.
Q. -- in the first instance?
A. Yes. Sorry, could you repeat the question just to make sure.
Q. No, no, you were -- I asked you was there anything artificial or unnatural about Amex not settling at par with issuers actually in this scenario. You said whether it is unnatural or not really is not literate from an economist's point of view. The question is: in the first instance, is there market failure -- sorry, in the first instance is there market power? Then there is a second question about efficiency. I said -- I asked you just to confirm that the distinction you make between a problem and the lack of a problem in Amex not settling at par is the question of market power?
A. I agree.

Q. Now, you do know, do you not, that this type of arrangement is now regulated by the IFR, the three-and-a-half party scheme?
A. Yes.
Q. So the implicit interchange fee we have been discussing is also capped at 0.2 and 0.3 as well.
    Now, I want to move on, Mr Dryden, to four-party schemes. So these are just like Amex's three-and-a-half party scheme except now we have multiple independent acquirers as well. That is the structure I am describing; is that correct?
A. Yes.
Q. So the acquirer has the relationship with the merchant and the issuer has a relationship with the cardholder.
    Again, from the merchant's perspective, there is nothing fundamentally different about this type of scheme from the Amex schemes, in terms of the cards that are being presented to him and his motivation?
A. In a -- I am not quite sure what you mean by "fundamental". I mean, at a fundamental level, the merchant is facing somebody presenting a card to them and they are deciding whether to accept it or not, so that far it is the same. One does get into differences that might even be fundamental differences to do with single homing and multi-homing so it may be that a much

higher and indeed I would expect that a much higher share of the buyers presenting a Visa or a Mastercard card to a merchant are single homing than the other way round; it is asymmetric. Not everybody who has a Visa or a Mastercard will have an Amex but the high proportion of people who have an Amex may have a Visa or Mastercard. I am talking about consumer, not commercial.

Q. Indeed. My question is again a very basic one. In the very basic sense from the merchant's perspective whether they are receiving an Amex card or a Visa Mastercard, they are paying an MSC so they are receiving less than par and that money is contributing to the costs on the issuer side?

A. I agree with that.

Q. But the merchant is willing to do that, and again this is going over old ground, because it is equally true in the four-party scheme because the acquirer is allowing the merchant's customer to pay in a way that is desirable to the customer?

A. I -- yes, I think that is -- I am sorry, could you repeat the question? Should I have -- perhaps the answer is no, should I have the screen?

Q. The screen, yes, you ought to believe able to see what I am saying, could Mr Dryden have the -- he means

realtime, he is not getting realtime. I do not think the witnesses normally get --
THE PRESIDENT: No, but I can see its usefulness.
MR KENNELLY: I am happy to repeat the question.
A. I may need to ask you once or twice.
MR KENNELLY: Please.
THE PRESIDENT: Perhaps during the short adjournment, I cannot see any reason why --
MR KENNELLY: Not at all.
THE PRESIDENT: -- It would not make life easier so if it can be done.
MR KENNELLY: I am sure that can be arranged.
Again the question is a very basic one. This is about why the merchant is willing to pay that MSC and settle at less than par?
A. Yes.
Q. Because it is something that the customer wants to do, it is -- to pay with the four-party card is a desirable option for the customer, which is why the merchant is willing to take that payment and pay the MSC?
A. Yes, so I think obviously if the use of the card was unattractive to the customer, the merchant would have no interest in paying the MSC because they would be paying him an MSC to facilitate something that is not attractive to the buyer.

Q. So again the point I made earlier, Mr Dryden, this helps the merchant win the business that might otherwise be lost to him?
A. Yes, and this is the root of the problem that I described yesterday.
Q. Yes.
A. But indeed the -- part of the merchant's incentive to accept the card and of course the merchant's decision to accept the card is not -- is one that is linked to the price of accepting the card, in other words it is linked to the MSC so the merchant's willingness to pay relatively high MSCs is connected to the fact that if it declines the card it risks the buyer going to another merchant.
Q. Indeed and we will come back to that in detail.
PROFESSOR WATERSON: Can I just interject here. Are we talking all the time about credit cards here?
MR KENNELLY: Yes.
PROFESSOR WATERSON: Are we talking about debit cards as well?
MR KENNELLY: Well, we have just moved on to four-party schemes and we are describing credit cards at the moment in the context.
PROFESSOR WATERSON: Okay, I just wanted to be clear you are talking about credit cards at the moment.

MR KENNELLY: Well, I am describing credit cards right now. From now on, because we are such a high level and since MIFs and MSCs are paid both in context of debit and credit, I will -- I will make sure Mr Dryden understands I am covering both. The last question was about credit but, Mr Dryden, the basic point remains the same, does it not, for debit and credit cards?

A. Yes.

Q. Both involve an MSC, the merchant chooses to accept those cards, both debit and credit cards, because that is what the cardholder wants to use?

A. Yes, most of what I have said this morning would apply equally to debit.

THE PRESIDENT: That is helpful. I think let us adopt the convention that unless Mr Kennelly says otherwise, he is referring to credit and debit cards.

MR KENNELLY: Yes, thank you.

THE PRESIDENT: If you answer in that way and of course, Mr Dryden, if you need to qualify your answer by reference to credit or debit cards, then please do say so and Mr Kennelly will then question in a bifurcated way. But let us proceed on the basis that one size fits all for the moment.

MR KENNELLY: Yes, I am obliged. Again, looking at the merchant's perspective, as you say, Mr Dryden, the main reasons he is taking these cards is to win the business but he is also avoiding some costs of alternative means of payment, is he not, the merchant, by taking the four-party scheme's card?

A. Yes, when Mr Kennelly says that the merchant's main reason for taking the card is to win the business that is saying that the main reason is the -- the merchant predicament is the problem, it is the "must take" issue that has been identified by Vickers, by Rochet and Tirole etc, that is underlying the market, that is underlying the -- the need for intervention. If it was the other way round and their main or overwhelming reason was the transaction benefit of the card compared to alternative payment means, we would not or I would not be here saying that there is a competition problem.

Q. But in certain contexts, Mr Dryden, it may not be the main reason. It may be because the card is better from the merchant's perspective than some alternative means of payment?

A. Yes, but that is just saying there may be an efficient -- that is just saying there may be an Article 101(3) defence of a MIF up to some level that is unlikely to be as high as the factual level for various reasons because you have these -- these two components of why it is as high as it is.

Q. Coming back, Mr Dryden, to the basic question of why the merchant is taking the card and paying the MSC and I mentioned costs again without going into numbers. In this four-party payment scheme we are describing, the acquirer is not doing all of the work that involves these benefits going to the merchant, is it, such as they are, the benefits that accrue to the merchant?
A. Well, such as they are. That is what has to be demonstrated and what has to be proven. So, for example, if -- if card does not offer a transactional benefit compared to cash, then the acquirer is doing all of the work that confers a benefit on the merchant. The merchant is not getting value added from the issuing activity.
Q. Well, again not going to whether -- whether the --
A. Sorry, if I may correct my last answer, it is not clear that it is either the acquirer or the issuer who is assisting the merchant.
Q. But without again discussing whether the MIF is too high just in terms of the kinds of benefits which we described and the costs that are involved in those, such as the time value of the money, credit risk, fraud risk, administration of the scheme, those kinds of costs, the acquirer is not incurring those costs, is it?
A. I -- I think that is correct.

Q. Those costs are being incurred by the issuer?
A. Correct.
Q. So just like Amex does not settle transactions at par, the issuer does not want to settle at par either, it wants to get some contribution towards those costs; that is part of the rationale?
A. Yes, the issuer no doubt wants as much contribution as anyone is willing to give it.
Q. But you accept that cost recovery is part of what the issuer wants in settling at less than par?
A. It is -- it is circular because the costs that Mr Kennelly says the issuer wants to be covered are at the level that they are because of the level of the interchange fee that is coming across to them.

So in other words, the issuer wants to be if -- imagine we start in a world of no interchange fee. The issuer who is in the business of issuing will issue cards to cardholders, there will be some cost of issuing cards to cardholders and there will be some revenue stream from doing so which is the fees paid by the cardholders from having and using the cards and there is also a benefit to the issuer of -- of the contribution that makes to the portfolio of their banking activities.

So the issuer with no subsidy or no contribution will make an offer to cardholders that will entail incurring some costs, but where it recovers those costs through fees and charges and other benefits and it will do so in competition with other issuers. That is essentially describing any market, that could be the market for widgets or blodgets, if I am a blodget supplier competing with other blodget suppliers then I incur costs to produce blodgets and hope that someone is willing to pay a price for blodgets more than the cost of me producing them. If the answer to that is yes, then I have a business.

I can then start funding the issuing activity with more and more interchange fee and the issuers who are sitting in a fairly competitive issuing market will dissipate that greater and greater interchange fee in the form of -partly in the form of more and more costs, they will make their -- they will make their card more and more attractive to cardholders by giving lower fees more reward points, more frills, etc.

So at that point when you then face that, if we then come along and that is the factual, we can look at the factual and say ah, they need the interchange fee to fund their costs but their costs are what they are because of the interchange fee.

THE PRESIDENT: Can I play that back to you, Mr Dryden, and you can tell me whether I have correctly understood what you are saying. In some businesses, but emphatically not this one, there is an extraordinarily close nexus between cost and price. You have got a sort of hypothecation situation where you can literally map costs onto price or costs plus form of pricing where there is this nexus but that is quite uncommon and not the case here?

A. I would put it slightly differently. I would say that the --

THE PRESIDENT: I am not trying to capture what you have just said; I am going through a sort of series of relationships between price and cost.

A. Okay.

THE PRESIDENT: I mean, the common situation, if I can just take it further, is where one has got a cost stream and a revenue stream and they are not necessarily related but in order to carry on an effective business the revenue needs to exceed the costs, but there is --

A. Yes.

THE PRESIDENT: -- no broader relationship than that. I mean, common costs would be an example where you have got costs of, say, running headquarters that you need to cover somehow and it is the blodgets you sell that covers them but there is no particularly close nexus between one blodget and those costs and that is probably true of many costs.

Now, what you are saying here is that there is a peculiar relationship between some costs and the revenue comprising the interchange fee in that the costs actually go up correlative to the interchange fee and that is what I am understanding but my question sharpened -- do comment on everything I have said -- is that that is true of some costs of, let us say, the issuer but not all. I mean, it is obviously I think you are saying true of cardholder benefits but it probably would not be true of things like anti-fraud where there is an intrinsic need to make fraud as low as possible because you do not want to pay out in regard to fraudulent transactions, so investment there would likely to be unrelated to levels of interchange fee because you want the anti-fraud measures to be as effective as possible and as cheap as possible, whereas cardholder benefits, you -- you want a to scale them according to the amount of revenue you are getting in. Have I got that right, it was a rather long question, I am afraid?

A. I mostly agree with that. On your first proposition about nexus, I broadly agree with that, the nexus between costs and revenues may be more or less close but the critical point which you made is that to have a business the revenues, whatever relationship they bear to the costs have to be borne in the costs, if yes, I have a business, if no, you know, I do not. Hence society generally wants businesses to exist where they can provide something that is valued by consumers by more than it costs the business to make it and generally we do not want businesses to be producing something that is more costly to produce than consumers value it.

So that is the basic set-up and we want -- we want productive activity where revenues are more than costs and we do not when it is the other way round.

On the -- and then you made the correlative point which I think is what I am saying, it is that the costs that we see on the issuing side are not independent of the interchange fee.

Then you made the point that some costs may be more or less sort of elastic to the level of the interchange fee and I think I agree with that as well. One could imagine there is some basic costs that are fixed costs of having a card business at all and then other costs go more to the nature of the offer and etc.

One point, although I think it is a little bit of a sort of sub-point about fraud, is I think the -- is I think you made a point about essentially fraud there is an intrinsic need for that to be minimised. I mean, I think actually what I --

THE PRESIDENT: I think more to be efficient in the sense that the correlation between cost and interchange fee breaks down or is not as clear in that case as it would be in the cardholder case, that is I think the point I am making, but do tell me I am wrong.

A. Not as clear as in which case?

THE PRESIDENT: As in the cardholder benefit case where I think you are saying there is perhaps quite a tight correlation.

A. Yes, so I can see that on benefit there could be quite a tight correlation. On fraud, there is a few things that one could say about fraud so I do not want to make it dominate too much.

THE PRESIDENT: I mean, by all means, pick another example of something where the correlation breaks down if fraud is not a good example.

A. The interesting thing with fraud is whether there is or is not a correlation to the interchange fee. The PSR says there is not, they looked at this and they said they were not essentially persuaded that the level of fraud prevention had anything to do with the level of the interchange fee. Mr Knupp, if I remember correctly, said that the level of fraud prevention has to do with the interchange fee or at least maybe it is a slightly different point, the level of the optimal decline rate varies with the interchange fee and one can see in principle how that could be the case.

Because if I am an issuer and I am making sort of a probabilistic assessment of whether a transaction is fraudulent or not and without an interchange fee I think it is only very slightly -- I think it is -- I think the transaction is -- my expected value of the transaction is profitable because I think there is a certain chance that it will have fraud -- sorry, it is not a good -- let me start again.

The PSR did not see the relationship between fraud and the level of fraud prevention. I think Mr Knupp's evidence was that as the interchange fee goes up, an issuer might decline fewer and fewer transactions because essentially they are more willing to tolerate fraudulent transactions because transactions are being subsidised at the rate of the interchange fee.

We can have a little bit of a debate about where between where in the spectrum of those things the right answer is, but I think that is a little bit of a --

THE PRESIDENT: I see, I think what you are saying and what I entirely understand is that fraud is perhaps not a nice clean example of where the correlation that you are saying exists in relation to cardholder benefit breaks down, so can I give you a different example. Let us take the cost of simply producing a physical card. Now, there is in one sense going to be some sort of correlation between interchange fee and number of cards because the more cards you get, the likelihood is the more transactions you get and so the more interchange you get because that is triggered by volume of transactions. But more fundamentally, the issuer is going to be concerned to push down the costs of card production, irrespective of what the interchange fee level is because that way they get more money; in other words --

A. Yes.

THE PRESIDENT: -- efficiency will drive in regard to that particular cost centre the price down. I think what you are saying is about cardholder benefits is that that efficiency incentive does not exist because what you are doing is you are being as efficient, you are just providing more as the interchange fee goes up because that is what you can do.

A. Yes. I agree, I agree with that, with the small caveat that there are some very flashy cards, gold laminated etc so --

THE PRESIDENT: Titanium card, yes, I --

A. So this may be funded by the interchange fee.

However, so I agree, I am with you on all of that analysis.

The point, however, is whether or not the costs are correlated with the interchange fee. It is -- subject to a caveat I will give in a second, the starting point is that it is only efficient for the card -- for the issuer to provide the card and all the associated services to the cardholder if the cardholder is willing to pay the costs the issuer incurs in providing that service. The caveat is if there is an externality exerted from the issuing side on to the other side of the market, for example, going back to what I said yesterday, if there is an externality because merchants prefer people to use cards rather than cash, because cards are cheaper than cash and yet they are not able to signal in the shop through surcharging or discounts to steer people towards the more efficient payments means from the merchant perspective, then there is an externality and the externality can give a reason to have a MIF to flow across from the acquiring side to the issuing side to subsidise the issuing side, but only to the extent of that externality.

MR TIDSWELL: Mr Dryden, the transcript records that you said "the point however is whether or not the costs are correlated with the interchange fee", did you mean to say "not" whether they are?

A. Not, thank you.

MR TIDSWELL: Thank you.

THE PRESIDENT: Thank you, sorry, do you have more to say?

A. No, that is really the key point in terms of covering costs on the issuing side, maybe to put it in slightly different words the issuing side should stand on its own two feet, if I can put it that way, the cardholders should be willing to pay through a combination of fees and other things. They should be willing and -- they should be willing to and actually paying for -- to such an extent that it covers the costs of the issuer's activities and if cardholders are not willing to pay that amount, then the issuer should stop or scale back their activities, remove some of the frills, or whatever it is. That is the starting point, the issuing side standing on its own two feet. The rationale for subsidising that side of the market comes in if the issuing activity is creating a positive externality for merchants and then you want to subsidise the issuing side to the extent of that externality.

THE PRESIDENT: I think we are now trespassing into the questions of Mr Kennelly, but thank you very much, that has made much clearer your earlier answer and I apologise, Mr Kennelly, I am just trying to understand exactly what is being said.

MR KENNELLY: Not at all. At lunchtime we can take stock of how we are doing for time and I will update the Tribunal, but we are making good progress, Mr Dryden, and I am grateful for your answers.

Again just coming back to more basic questions on 101(1) and we are discussing settlement at par, that is really what I have been going back to again and again.

So in this context, I was talking about the interchange fee contributing to costs and, Mr Dryden, you made a point about there is going to be debate not least on 101(3) about the level of costs, justifiability of those costs and so forth. But have you seen the evidence -- the issuer's evidence and the evidence from Visa that under the IFR, the MIF at 0.3% does not cover the costs of credit cards? Have you seen that evidence?

A. Yes.

Q. Do I need to take you to, I will give you the reference, actually I will take you to it, if I may, just so we are clear. It is Mr Steel's evidence {RC-F4/13/15}. That should be on your screen, paragraph 34. I am showing you this, Mr Dryden, just because we are discussing costs in the abstract but now I am bringing this back to what is in issue in Issue 3 which is the post IFR period and the MIFs at 0.2 and 0.3 in the UK and 0.1 for debit in Ireland.

To show you the next piece of evidence this is confidential, so I would ask it just to be brought up on the screen, I am not going to read out the words. I would ask you, Mr Dryden, not to do so, simply to read it. It is the transcript from Day 7, page 71, lines 18-21, this was debit and credit it was of the evidence of Ms Dooney for an issuer. {Day 7/71:18-21} (Pause)

Do you see that?

A. Yes.

Q. I entirely understand the points you have about efficiencies and the points you made to the President a moment ago about 101(3) but do you see here that for credit issuers, they are losing money on transactions and that is in circumstances where merchants are still receiving value, again not about whether the value is commensurate, but the merchants are receiving value from receiving card payments from Visa and Mastercard; do you see that?

A. Yes. So I -- first of all, just to get it out of the way, the merchants are receiving value and the value may not be commensurate. I agree.

Going back to what I said earlier, there is no -- there is no reason from my perspective to -- to have as a goal in -- as a goal in terms of an outcome, from an intervention point of view, that we can preserve the schemes' ability to fund their historic levels of costs for all of the reasons that I have been giving.

On the first evidence that you gave Mr -- that was Mr --

Q. Steel.

A. -- Steel, the judgment there of the issuers would seem to be that it is overall a profitable activity to continue to issue credit cards, overall.

Q. In the sense of cross-subsidising it from other parts of the business?

A. Yes, and note here he gives the phrase cross-subsidy and we should note that the cross-subsidy has flipped here. The cross-subsidy with the interchange fee is a cross-subsidy obtained from the acquiring side where the cards are "must take" and the merchants have no negotiating power. So the interchange fee is extracted from merchants who are unable to resist it and that is subsidising the issuing side. That is a different thing from the issuer deciding of its own free will to cross-subsidise its card issuing activities from other parts of its business. They are -- they are two different things.

Then on the second piece of evidence from Ms Dooney --

Q. Yes, again please do not mention any figures.
A. No numbers. All I would observe is that the number in line 19 I think is a cost; number, is that correct?
Q. Yes.
A. The number in line 21 is an interchange fee number?
Q. In broad terms, yes.
A. So there is a cost number and there is a revenue number in the form of interchange. But there is no other revenue numbers. So in other words there is going to be lots of other sources of value to the issuer from this activity which are not measured in the second number.
Q. Mr Dryden, coming back again to the question of settlement at par and the basic point about whether there was any -- whether there was any market failure or anything anti-competitive in the mere fact of settling at less than par, and putting to one side the question of how interchange fees are set, and we will debate that in a moment, there is nothing anti-competitive in itself in issuers settling transactions at less than par subject to the market power point you made, it is fully understood but this mere fact of settling at less than par is not anti-competitive in itself?
A. No. But I find, I find it an almost -- I -- I do not find it a very enlightening statement because to say that something is not anti-competitive, setting aside

all considerations of market power, is always going to be true. We have -- we have competition concerns because of market power. So once I take market power off the table, once I take market context off the table and strip all of that out of the problem and say is there anything intrinsically anti-competitive with what is left, the answer is always going to be: no.

Q. We will come to the separate factors but the question was simply about the fact of paying at less than par. The reason why putting to one side questions of market power, the reason why settlement at par may involve no anti-competitive problem or market failure is because like in the factoring example there is the time value of getting the money early, the cost which the finance house incurs, credit risk, fraud risk and so forth?

A. I -- I would refer to my previous answers. I think it is a question I have answered.

Q. In fact four-party schemes, compared to three-party schemes that we discussed in detail, there are in fact competition benefits in a four-party scheme compared to a three-party scheme because there is at least competition between acquirers in a four-party scheme whereas there is an acquiring monopoly in a three-party scheme?

A. Yes, the competition concern here in my opinion is not

one that denies the value that four-party card schemes add to the economy and the benefit you have mentioned may be one of them. The problem is with the -- or may be that we have to look at is with the interchange fee.
Q. Again, compared to a three-party scheme, a competition benefit -- sorry, the scope for competition is greater in a four-party scheme because issuers compete with one another?
A. Yes, it is a different business model to a three-party scheme and it has pluses and in some sense it has pluses and minuses.
Q. That gives rise to pressure on acquirer and issuer margins?
A. It -- it is -- it gives -- it does, yes. I mean, if you have lots of issuers and lots of acquirers recruited to the scheme then they ought to be competing among each other.
Q. Again comparing to Amex in a four-party scheme there is greater opportunity for issuers and acquirers competing to offer a wider range of benefits and services to their own customers: cardholders for issuers, merchants for acquirers?
A. That is true. But the counterfactual implicit in the question is four-party scheme compared to no four-party scheme, is not four-party scheme with a factual level of

interchange fee compared to four-party scheme with a lower level of interchange fee.
Q. I am not comparing it to Amex, Mr Dryden.
A. Neither was I, sorry. I was saying that the comparison seemed to be between four-party scheme and no four-party scheme or maybe between four and three --
Q. Four and three, Mr Dryden, was the comparison.
A. Yes, but I think I answered on that basis. What it is not, is a comparison between a four-party scheme with actual IFs and a four-party scheme with lower interchange fees.
Q. Of course. But again comparing four-party schemes with Amex, the greater opportunities to innovate in a four-party scheme, for example Barclays might find a more innovative way to invest the interchange revenue to improve their cardholder offer as opposed to a different issuer like Lloyds, that is something that does not happen in a three-party scheme?
A. That instruction is true. But if the question was making a linkage between interchange fee and innovation, that again is a different question. That is: do you get more or less innovation with a four-party scheme with the interchange fees or without?
Q. On that subject, Mr Dryden, whether you get more innovation in a four-party scheme with interchange, did

you see the evidence from Mr Peterson on that on Eftpos.
A. I -- it rings a faint bell. I cannot say I am familiar with that.
Q. May I show you that before the transcriber break. It was on Day 6, I think, page 175. {Day 6/175}:10-17.
The point was being made to Mr Peterson that there is no interchange fee in New Zealand for Eftpos and Mr Peterson from line 10 made this point about what had happened to Eftpos in New Zealand.
A. I see that.
Q. So the evidence about Eftpos, for example, is that it has not innovated and the reason that the evidence records is that it is for lack of investment and that investment in the four-party schemes has been made by reference to interchange, that is a natural experiment, is it not?
A. Well, the President asked me some time ago about costs and I said that was a big issue in the 101(3) stage of my previous interchange cases. The linkage between interchange fees and innovation was also a big topic in the 101(3) stage of the two previous interchange cases that I was involved in and it cannot be settled on the basis of this. One example, that in itself is a big topic and there was a lot of evidence around whether interchange fees have promoted innovation or harmed

innovation.

Dr Frankel gave an example yesterday in the concurrent session, if I remember correctly, about how the particular structure of interchange fees in the United States may have been an inhibitor there to moving away from the old-fashioned approach of signing because that was more profitable for the issuers. So interchange fees can -- it is an open question and I think in past cases it has been a 101(3) question about whether there is a linkage there and what direction it goes in.

Q. You are not suggesting, Mr Dryden, that in the United Kingdom and Ireland for the claim period that concerns us there is any evidence that the schemes encouraged or delayed innovation in order to drive up interchange in this trial?

A. No. I am not suggesting that at all. But I am making the point that the linkage between interchange and innovation is --

THE PRESIDENT: Complex.

A. Complex.

THE PRESIDENT: I think the witness' position was not in opposition to the point that you were making but that it was a rather bigger topic than he was able to fairly respond to in answer to your perfectly proper question and that there was a whole myriad of evidence arising in other 101(3) cases which he would want to have at least referenced in his answer.

MR KENNELLY: The word "innovation" was a trigger, sir, I am afraid I should not have gone down that road.

THE PRESIDENT: No, you are quite right to raise it, but it does, I think, raise something which I said we had in mind yesterday and we do have in mind, namely that there is a very delicate line between the perfectly proper points you are making regarding 101(3), light points if I can call them that in this litigation, and the full fat 101(3) points that will be made in the future and we very much do not want to traverse those lines but you are quite right to raise these points and the witness is quite right to make clear there is a broader picture.

MR KENNELLY: Indeed and I am moving on to my next topic.

I think Mr Tidswell has a question before I do?

MR TIDSWELL: Before we do, I might ask a question of Mr Dryden, if the transcriber will forgive me a little longer because it relates to the question of business stealing and before we get too far from that, I would like to ask you about it.

When we are talking about business stealing, am I right in thinking that we are talking about a merchant being worried that, for example, a Mastercard cardholder might come in and if the card was not taken, go next door --

A. Precisely.

MR TIDSWELL: -- with the commerce.

You have talked about creating a market distortion and inefficiency, does that distortion come because the merchant is unable to assess the value of the business stealing, so it is just opaque and therefore it is not something that could be taken account of or actually -- and perhaps there is a sort of the real point of the question is: is there any way in which if you could calculate that benefit, it was something that could properly be taken into account as an internal transfer without creating a distortion?

A. Thank you for the question. It does not -- it does not arise -- the problem does not arise because it a PAIG, the problem would arise if the merchant knew to the last penny what its vulnerability to business stealing was. So if the merchant could do a calculation and say: if I did not accept Mastercard how many of the transactions that I have now would I lose and what is the associated gross margin, and they could estimate that to the last penny, we would have exactly the same problem.

MR TIDSWELL: That is because it arises from the "must take" obligation and that creates market power which creates a distortion, is that the chain of logic?

A. Exactly and the "must take" as I explained yesterday comes from two things, it is anything less than complete multi-homing because if you imagine that if every Mastercard -- if every person entering this merchant's shop had a Mastercard and a Visa, the merchant -- and was at all times equally happy to use them, the merchant could turn down the Mastercard and would not lose anyone to the next door shop because they could all pull out their Visa card, but once you have single homing that creates the problem.

The other thing is the surcharge, is the lack of surcharging, because if they were surcharging they could afford to accept the Mastercard but send a price signal in the form of a surcharge to -- that would then create competition between Visa and Mastercard. That would push MIFs down it is because there is no price signal operating combined with the "must take" point that the pressure on the interchange is up and that creates the "must take" problem.

MR TIDSWELL: Yes, thank you, Mr Dryden. Thank you.

MR KENNELLY: I am happy to take a break now, sir.

THE PRESIDENT: I am very grateful, Mr Kennelly. We will rise for 10 minutes.

(11.34 pm)

(A short break)

(11.46 am)

THE PRESIDENT: Mr Kennelly.

MR KENNELLY: Now, I should say, Mr Dryden you should have the realtime transcript on your screen. When I show you a document that will occupy the screen and you will no longer see the transcript but if you want to check what I have said or go over the transcript in any way just tell me and we will stop and switch over and back.

THE PRESIDENT: Do not get too distracted by the transcript, use it as you wish, but it can be disconcerting to see your words come up in realtime. So use it as you wish.

A. Thank you.

THE PRESIDENT: We can equally take it down if it becomes too much of a distraction.

A. Thank you.

MR KENNELLY: Mr Dryden, I am moving on now to the UIFM. In the UIFM, as you know, the amount to discount to par is zero by default and it can only be a positive discount if the issuer chooses to send a positive discount unilaterally, or if one is agreed bilaterally between the issuer and the acquirer. That is its form, at least.

A. Okay.

Q. So that fact, just the fact of agreeing a discount from

par is indistinguishable economically, is it not, from the situation where Amex agrees discounted settlement rates with Barclaycard?
A. Yes and as it is from the MIFs that have previously been found to be infringing.
Q. Your main objection to the UIFM is that Visa's rules are still a collective agreement under which positive interchange fees are set and the only reason why Visa would adopt the UIFM is because issuers are very likely to choose to set positive interchange fees?
A. Yes, I recognise that is ultimately a legal issue as everything is. But that is the substantive point that I put forward.
Q. Now, you accept, do you not, that a four-party payment scheme is not inherently anti-competitive in itself?
A. I think I have said that already.
Q. So there is no restriction you say as long as there is settlement at par?
A. I think that is correct.
Q. So you are then claiming that any other framework within the four-party payment scheme that leads to positive MIFs is a restriction of competition?
A. No. That is precisely the wrong conclusion to draw from my report.
Q. I am not asking about whether a MIF could be justified

under 101(3); I am only asking about restriction of competition?
A. Yes, and I answered on that basis.
Q. So you are saying it is possible in a four-party payment scheme to have positive MIFs and no restriction of competition?
A. Yes, because it might still be economically undesirable but I could see that that could occur and the agreement limb of 101 may not be satisfied.
Q. Sorry, Mr Dryden, the agreement limb may not be satisfied. But for the purposes of the facts in the actual, are you saying that a four-party payment scheme has to require settlement at par?
A. No.
Q. In your counterfactual, you are positing a settlement at par counterfactual, are you not?
A. I am, if you take UIFM off the table, then I think you are back to settlement and bilaterals, you are back to settlement at par.
Q. But for --
A. In other words, you are back to the counterfactual that has been used in the previous cases.
Q. When you say settlement at par in a four-party payment scheme, you mean, do you not, a rule that requires settlement at par in the scheme?

A. I do not think it has to require settlement at par, I think it is achieved by having a default MIF of zero, which the acquirer would always choose rather than accept a higher one. So it does not require zero, it is a default of zero.
Q. But you accept that there is no economic difference between settlement at par and a zero MIF?
A. No economic difference.
Q. If settlement at par is to be secured or a zero MIF is to be secured, it will require a rule within the scheme, some -- a rule in a broad sense, some rule structure, which requires that outcome?
A. I agree.
Q. So logically, a four-party payment scheme in your counterfactual has to require settlement at par?
A. I do not quite understand that question, it does not ... I do not quite understand the question. Let me just put it slightly differently.
I think the appropriate counterfactual is one of settlement at par.
Q. Yes.
A. That can be expressed in a few different ways, I think: settlement at par, prohibition on ex post pricing, zero default MIF. From my perspective, they amount substantively to the same thing.

Q. For any of those to work, it has to be required by the scheme, does it not?
A. Yes on any of those things which may be identical or at least are very similar to each other, for that to be the counterfactual we are envisaging that the scheme would have that as the scheme rule.
Q. If we --
A. Sorry, the reason perhaps we are slightly at cross-purposes is that those rules are not required -- not all of those rules are requiring the MIF to be zero but they are providing a set of rules in which the MIF ends up being zero.
Q. But one way or the other, in order to avoid a restriction competition on your analysis, the schemes have to ensure that there is settlement at par, or zero MIF, whatever label you want to give it, the scheme has to require that?
A. No, that is not generally true, I think Mr Kennelly does not -- I think the point that I have made in my report has not necessarily been fully, fully understood because also in openings I think the arguments were made about what I said that were -- were not correct.
    The schemes have put forward, or at least Visa has put forward UIFM as an alternative counterfactual which they say is a counterfactual that becomes relevant after

the IFR is in place. So the idea there is they are saying: well, instead of having a positive default MIF, let us instead have a rule that says to the issuers you can choose the level of interchange fee that you set and then the assumption is the issuers abide by the law so if the IFR is there and it is saying that the maximum interchange fee can be 10 that they will unilaterally seek a MIF of 10, the IFR level. Then the argument of the schemes is that that is a unilateral act on the part of the issuers so it cannot -- because it is unilateral, it is not an agreement, and because it is not an agreement, it is a legitimate counterfactual.

So in other words, the factual of a positive default MIF can be replicated by a counterfactual arrangement, the UIFM, that does not involvement an agreement and because it does not involve an agreement, it is legitimate.

What I have said in my report is that we need to distinguish between two situations. One is one in which the schemes only adopt the UIFM framework because of its effect in producing positive MIFs from another world in which they would choose to adopt it irrespective of the -- of the positive IFs that result from it. If it is the first scenario, they are only choosing to do it because of the positive IFs that it produces, I say that in substantive terms it seems to me that that is an agreement. The agreement has shifted forward, it is not -- the agreement does not lie at the moment that the issuers are unilaterally deciding the IFs; the agreement lies at the earlier stage when the scheme participants are deciding to operate in a scheme with the UIFM framework. There is a nexus between the agreement to operate the UIFM model and the IFs because they are choosing the UIFM framework only because of the positive interchange fees that result from it and I think all of the evidence suggests that that is the case.

If it were the case that the schemes would choose the UIFM irrespective of its producing positive IFs, then I would accept that it is a legitimate counterfactual and if it then produced positive IFs, I would say that those are legitimate counterfactual IFs.

THE PRESIDENT: Again -- sorry, did I interrupt you?

A. If I may just one final sentence. So when Mr Kennelly put it to me that I am requiring interchange fees to be zero in the counterfactual, that is not correct.

THE PRESIDENT: Again can I repackage what I think you are saying and do, please, push back if I have got it wrong.

You cannot have a state of affairs where money is moving from the acquirers to the issuers, however it happens, without some form of contractual basis which justifies it. Now, where that contractual basis arises and at what point in time it arises may vary. But the fact is all of these payments or deductions from revenue streams however you want to characterise them, need to have their foundation somewhere in the overall contractual scheme that exists between the various participants, however many there are in the scheme, and is that essentially the reason why you are saying that there is some form of arrangement however you choose to structure the route by which the payment is made?

A. Yes, I agree with all of that. I essentially make life slightly more difficult for myself for my argument because I say that what needs to be demonstrated is not just that there is a scheme arrangement that produces the positive MIFs or IFs but that the scheme arrangement that is put forward -- I say that what is necessary for it not to be a legitimate counterfactual is that this -- that the scheme arrangement that is put forward would only be adopted because of its effect in producing the positive IFs.

THE PRESIDENT: Well, indeed, I mean that goes to the questions that we have been having in relation to bilaterals which is: whenever one starts talking about bilaterals in the context of the interchange fee, one never seems to be talking about a genuinely negotiated bilateral where one party or the other is free to walk away. One always seems to be vaulting on some form of compulsion to the bilateral where the acquirer is instead of being told you are free to choose, they are being told that there is some form of fac/oblig functionality where the issuer or the issuer's -- someone in place of the issuer of the scheme is saying: well, you cannot disagree to this extent, you have to have an imposition. It may be packaged in many different ways and what I am saying is there is I think inherent in your view of the world, that sort of forcing in this case also?

A. I broadly agree with that. Yes.

THE PRESIDENT: Okay.

MR KENNELLY: Mr Dryden, just coming back to what you said, and I apologise if I misrepresented your evidence in opening but just to be clear: you are saying I think that the UIFM would be a legitimate counterfactual even if it went on to produce positive interchange fees provided Visa's motivation in promoting it or adopting it was not because it knew it was very likely to produce positive interchange fees.

A. Yes. That is -- that may be unduly restrictive but it seems -- but I have not taken -- I have not taken that question on. What I am saying is that when the model or the scheme rules or the packaging, as the President put it, has been chosen, because of -- precisely because of a desire to re-establish the interchange fees at the factual level, then not speaking as a lawyer but in substantive terms it seems to me you then have a nexus between the agreement to run the scheme in a certain way and the IFs that is produces and they can be said to have been agreed to.

Q. So I think you agree with me then that it is not right that the only valid counterfactual is one which requires the scheme to ensure settlement at par, a rule which ensures zero MIF or settlement at par?

A. Yes, there is, there is --

Q. It must follow, from what you have just said?

A. Yes. I mean, in broad terms I am with you. I am slightly focused on the exact way you said it. In broad terms, I agree with you. On your first proposition it is not right that the only valid counterfactual is one that requires settlement at par. I mean, in this case I am saying that is the only valid counterfactual, but you get thereafter doing the kind of analysis of why the UIFM would be adopted. So a priori on my approach the UIFM is not objectionable.

You have to then look at why is the UIFM put forward

as the alternative scheme rules? If the reason is that it is put forward precisely because it replicates the factual IFs, or at least produces higher interchange fees, that is the point at which it becomes an invalid counterfactual on my analysis.
Q. Thank you.
A. Then I will just return to the point I made before which is I do not think the settlement at par counterfactual is requiring settlement at par. I think at least versions of it are providing for a default of settlement at par. But there may be versions that require settlement at par and versions that just give that as a default.
Q. But you accept, do you not --
A. The economic consequence is going to be settlement at par, I agree.
Q. Exactly. Your other objection to the UIFM is the HACR, the Honour All Cards Rule. You say this is giving issuers the power to set interchange fees up to the level of the cap?
A. Yes, I say that may be the case, yes.
Q. Because you say that with the UIFM, or without the Honour All Cards Rule, it is likely that issuers would set their fees below the level of the IFR caps?
A. Yes, I think that is an evidential question. I do not

think one gets there from theory. But I think it is -- I think it is a possibility and I think at least some of the factual witnesses at some moments have come close to suggesting or actually suggested that that is the case and I can see scenarios whereby it could arise. The extent to which it would arise, you know, I do not know.

Q. So you accept that your proposition that with the UIFM but without the HACR the proposition that that would cause issuers to set their fees below the IFR cap cannot be demonstrated by theory alone; you say it is an evidential question?

A. It is an evidential question. If I can perhaps just, because it may just be helpful to locate us --

Q. Of course --

A. -- all in this branch of the argument.

So the Honour All Cards Rule has two elements: the Honour All Product Rule and the Honour All Issuer Rule. The bit that we are talking about here is the second of those, the Honour All Issuer Rule. As I am sure we all know, the Honour All Issuer Rule says that if a merchant accepts any one -- the cards issued by any one issuer of the scheme, it has to accept the cards issued by all issuers of the scheme.

So the effect of the Honour All Issuer Rule is effectively to unionise all the issuers; it means they are collectively bargaining, because any one issuer by threatening not to deal with a merchant is essentially threatening that the entire scheme does not deal with that merchant. So it is a very -- it is a very -- it is a very significant rule. It is -- it is turning the issuers instead of being individual into a collective for bargaining purposes.

Q. Let us, Mr Dryden, focus on that very point about the effect of the Honour All Cards Rule and this effect that you describe. I will discuss now with you, if I may, what would happen if Visa adopted the UIFM but with the Honour All Cards Rule. I think you would agree with me that in that scenario with the Honour All Cards Rule the issuers would all set their interchange fees at the level of the cap?

A. I agree. I have agreed.

Q. I would like to go through the reasons why we agree carefully. The first is a point you have made now several times that issuers compete with each other to win the business of cardholders. These are the reasons why they will set at the cap?

A. Yes.

Q. If an issuer charges a higher interchange fee, as you said before, that does not directly affect the cardholder one way or the other, does it, directly?

A. Well, they -- the cardholder may get more benefits, yes.
Q. Indeed, quite right but apart from that the cardholder does not see it directly because it is paid by the acquirer to the issuer?
A. No, that is true, they do not see the inner workings of the machine but they -- they see the benefits that flow to them from it.
Q. So the direct effect of the interchange fee is just that the issuer receives more revenue for every transaction?
A. Yes.
Q. Which is obviously a good thing from the perspective of the issuer?
A. Yes, it is a good -- it is a good thing on one side and an equal or opposite bad thing on the other side.
Q. If that direct effect was the only effect, the issuer -- again we are just talking about the perspective of the issuer -- would charge the highest possible interchange fee?
A. If that was the only effect, yes.
Q. But let us look at the indirect effects. One indirect effect is because the issuer received this additional revenue per transaction, again just the perspective of the issuer, the issuer then has the ability and incentive to spend money on activities that encourage cardholders to use their cards?

A. I agree.
Q. Higher interchange fees are likely to result in issuers making their cards more attractive to cardholders, again a point you have made previously?
A. I agree.
Q. That helps them to win market share among cardholders?
A. I agree.
Q. That is another reason why issuers want to set their interchange fees as high as they can?
A. I agree.
Q. Now, I want to look at the downsides for an issuer in setting high interchange fees. One possibility is that acquirers or merchants might decide the cost is too high and they decide not to accept the issuer's cards?
A. In principle, yes.
Q. But I think we agree that, remember assuming here the HACR, the Honour All Cards Rule, is present, with interchange fees at 0.2 and 0.3%, that is just not a realistic outcome, is it?
A. Well, I think it is not a realistic outcome even independent of the level of the interchange fees. It is not a realistic outcome because -- because of the situation that I described, which is that when you have the Honour All Issuer Rule, the issuer here who is in this thought experiment negotiating with the other --

with the other side of the market, they -- they have immense bargaining power because the other side of the market has to deal with them in order to deal with the scheme at all. That is the effect of the Honour All Issuer Rule.

So the issuer has in that situation immense power to push up the interchange fee.

Q. So from a merchant's perspective -- I think again it is a point you just made for an acquirer's perspective, the question of whether to accept cards under the UIFM with the Honour All Cards Rule with issuers choosing the maximum interchange fee is the current situation, is it not?

A. It is -- that is -- well, it is not the current situation because we do not have the UIFM but economically it is in terms of the issuer bargaining power, it is the current situation.

Q. Bearing in mind the Honour All Cards Rule is here, is in play, that they wanted to reject one issuer they would have to reject the whole Visa scheme?

A. Yes, this bargaining power that I am describing is a feature of the factual and it is a feature of the counterfactual -- the UIFM counterfactual where that UIFM counterfactual maintains the Honour All Issuer Rule.

Q. So they would not -- so -- well, in the actual, nobody is doing that at the moment, are they? No one is rejecting one issuer and then being forced to reject the whole Visa scheme?
A. No, because that would be suicide, I think.
Q. They would not do that under the UIFM either if the HACR is part of the UIFM?
A. Yes, and that is what my report suggests in different words, but that is the economic idea.
Q. Now, one concern that was raised by the Tribunal in argument that you may have seen in my opening since I know now you have read it carefully, is that might cardholders choose issuers with lower -- we are in the UIFM now. Would cardholders choose issuers with lower interchange fees because they expect that merchants will charge them lower retail prices if they use a card that has a lower interchange fee? Did you see that exchange that I --
A. I do not recall that exchange.
Q. Are you with me in at least in what I am describing to you?
A. I am with you on this scenario.
Q. So just to looking at the relation between interchange and retail prices, for what I am about to put to you I am assuming full acquirer pass-on and I want to assume

full merchant pass-on as well.

I will start with the merchants that do not surcharge, they charge -- and again, Mr Dryden, I am sure you are wondering why I am asking you things, I think you may have said yourself in the hot-tub, but I will go through it to be absolutely clear.

Starting with merchants that do not surcharge. They charge the same price to all customers whether they pay by cash or card, whether they pay by Visa or Mastercard or Amex.

A. Yes.

Q. Suppose all issuers in the UIFM choose the maximum interchange fee except for one issuer who chooses to zero interchange fee, settlement at par, the question that was discussed in opening was: as a cardholder, should I choose the issuer with the low interchange fee offering zero interchange fee in order to decrease the prices that I and other consumers pay at the till? The answer is that my individual decision as a cardholder to choose the issuer with the very low interchange fee will make really zero difference to the price at the till?

A. Yes, I think it would be magnanimous and heroic.

Q. Ultimately pointless?

A. Ultimately pointless.

Q. Because the price at the till reflects the average cost --

A. Yes.

Q. -- of a transaction for the merchant.

Moving on, then, to just some points on surcharging.

A. So far we are on the same page, as far as my report is concerned?

Q. Yes.

A. Yes.

Q. Surcharging, Mr Dryden. You know it is now impossible to surcharge the types of cards that we are talking about because of the implementation of the Payment Services Directive in the UK, so since January 2018 it has not been lawful to surcharge?

A. I understand that is the case.

Q. But there was a period of time between 2009 and 2018 when it was possible, in theory, to surcharge categories of cards?

A. Yes, I -- I confess I get a bit lost on the exact periods when these things are or not possible, but I am happy to accept that.

Q. I will not assume any concessions from you in relation to periods, but there was a time when, for Visa cards at least, it was theoretically possible for merchants to apply different surcharges to different categories of cards depending on the costs of having to accept a card payment?

A. I mean, there is two things that have to be true. I think one is there has to not be legislation that prohibits surcharging what you described as now applying.

Q. Yes.

A. There has to be no scheme rule that prohibits surcharging.

Q. But if the scheme rule is expressly subject to legislation saying otherwise and the legislation positively permits surcharging --

A. Yes.

Q. -- you accept in that situation there is no prohibition on surcharging?

A. Yes, yes. The -- I mean, I do not think we disagree here. I mean, there is two things to distinguish I think perhaps, although I am straying into territory here that is maybe better for others, but there is -- and I think I am repeating myself, there is a legislative layer about whether surcharging is allowed or not and there is a scheme rule there about whether issuers are allowed to surcharge or not. So there is a world in which it is legal, but the scheme prevents it.

Q. Let us assume that there is a law that expressly permits

surcharging and overrides any contracts that say otherwise.
A. Understood.
Q. In that scenario -- and I want to put to you that was the scenario for the period 2009 to 2018 for certain categories of cards -- merchants overwhelmingly did not choose to surcharge even when they could?
A. That is my understanding.
Q. They declined to surcharge even when MIFs were much higher than the current levels under the IFR?
A. That is my understanding.
Q. Do you recall how much higher the MIFs were during that period when they declined to surcharge?
A. No -- not precisely.
Q. May I just show you, to jog your memory. I will take you to two references from your report of the 2016 cases. They will hopefully come up. The first is {RC-H2/7/609}, these are the --I think they are the Visa credit card -- it is just an example of how much higher they were then. That is not it. There should be a table. Maybe it is -- scroll down, please, on the same page. There we are. 610, forgive me. {RC-H2/7/610}
The totals, these are credit cards UK domestic MIFs as set. There is no need to go back, you can take from

me, unless you want to, this is the 2016 expert report you did in the Visa case. You see the total MIFs at the bottom --
A. Yes.
Q. -- averaged out and for the period from 2007 to 2014, do you see that and can I show you the Mastercard MIFs, again your report {RC-H2/4/225}, UK credit MIFs. This is a supplemental report that you made and you see them there. There are ranges given for various Mastercard credit cards. Do you see that, Mr Dryden?
A. I do.
Q. So they were not surcharging, even though -- in fact even between Visa and Mastercard even though you can see the difference between Visa and Mastercard credit card MIFs was substantial, was it not?
A. The level of both is high, the -- I am not sure I can comment on the difference.
Q. Even though differential between Visa and Mastercard on the one hand and Amex was high, there is evidence again about a reluctance to surcharge even on Amex?
A. Yes.
Q. Do you recall -- I mean, you know in these proceedings where you have estimated the Amex level, do you recall that figure?
A. The Amex level of the MSC?

Q. Yes. I will show you the reference?
A. I think, I think it is either 3.125% or 3.25%.
Q. 3.25 is the ...
So just turning to the period since the IFRs were capped, it is just not realistic -- and I think again you said this in the hot-tub -- that merchants in the UK would surcharge, even if they could, to any material extent to avoid interchange fees at 0.2 and 0.3%
A. That is correct. I think we remain on the same page, because this is entirely consistent with everything that I have said. The -- as I explained yesterday in the concurrent session and a few times this morning the lack of surcharging is at the root of the problem on the market failure, on the acquiring side, which is why we get high interchange fees. The lack of surcharging need not emanate from a scheme rule that prohibits surcharging, it can also emanate from consumers' reaction to surcharging that is sufficiently severe that the merchant does not want to surcharge.
So the "must take" problem stems from either of those -- sorry, the competition problem stems irrespective of whether the surcharging is not there because of the scheme rule or it is not there because it is something that merchants choose not to do, even in the face of very high MSCs.

THE PRESIDENT: It is a hilus --

A. Yes, and precisely a hilus point tying into the business stealing effect of the next door merchant that we were discussing earlier.

PROFESSOR WATERSON: Can I just check, I do not think no surcharging was universal, it was common but not universal in this period.

MR KENNELLY: No, no -- well, this is a matter for submission but the -- the evidence of surcharging in this period was that it was rare for surcharging to take place.

PROFESSOR WATERSON: I mean, I recall for example Ryanair surcharging.

MR KENNELLY: They did. Of course they did.

PROFESSOR WATERSON: Yes.

MR KENNELLY: They are not typical, sir.

PROFESSOR WATERSON: No, not typical in many ways.

MR KENNELLY: But the evidence is clear on the propensity to surcharge and I think Mr Dryden accepts for the reasons and this is part of his case, not his case, his evidence, that surcharging was rare for the reasons that Mr Dryden has been giving and rare even when MIFs were very high.

A. But if I may, the fact that it is rare even when MIFs are as high as they were underscores the depth of the merchant predicament because it is not as if -- it is not as if even when the MIFs and the MSCs become very high they start to surcharge, even at that point the business stealing threat is so strong that they do not, so that is a proof point an evidence point for the "must take" predicament.

Q. That is important for a point I will come to on the relevance of the Honour All Cards Rule.

So I am looking at your argument now, the UIFM with the HACR is anti-competitive because without the Honour All Cards Rule issuers would choose lower interchange fees and your basic point is that the Honour All Cards Rule improves the bargaining position for issuers by making the outside option of the acquirers worse?

A. Yes.

Q. To be clear, when you say outside option, you mean what happens to each party in the negotiation if that negotiation fails to reach an agreement?

A. Yes.

Q. In fact, can I just show your reports on this where you discuss the effect of the Honour All Cards Rule on the bargaining position of issuers and acquirers?

A. Yes.

Q. Your first report, please, {RC-H2/1/64}. Paragraph 7.65 at the top, do you see that, it should be on the screen as well?

A. Yes.

Q. It is really just the -- it is the last sentence on 7.65?

A. Yes.

Q. "If one party to a negotiation has more to lose than the other if no agreement is reached, they are in a weaker bargaining position and are likely to agree to worse terms."

A. Yes.

Q. In your second report, {RC-H2/2/18}, I am looking at paragraph 5.21, four lines from the bottom you say.

"I explained in my first report that there is no reason to expect that issuers, absent an Honour All Cards Rule, would have greater bargaining power than acquirers and therefore acquirers would not have to accept the highest possible interchange fees".

So it is that HACR that gives them the greater bargaining power than acquirers.

Now, your point here is that if an acquirer tries to negotiate with an issuer and fails to agree on an interchange fee then under the Honour All Cards Rule the acquirer has to reject the whole Visa scheme, whereas without the Honour All Cards Rule, it can reject the one issuer with which it has failed to agree an interchange fee and continue accepting cards from the others?

A. Yes.

Q. That is why the acquirer in a worse negotiating position with the Honour All Cards Rule than without it.

A. Yes.

Q. Now, just to see where that argument goes. I want to ask you about a different scenario. I want to explore the relationship between the Honour All Cards Rule and the IFR. Suppose we have the UIFM and the Honour All Cards Rule but no IFR. So I am asking you to imagine there is no caps on (inaudible).

Now, you have been very clear, Mr Dryden, that issuers acting unilaterally would set extremely high interchange fees and that is the hold up problem that we have been describing?

A. Yes.

Q. You say the Honour All Cards Rule strengthens the issuer's bargaining power. So in your argument, without the Honour All Cards Rule issuers would set interchange fees that are lower than those hold up or hold out high interchange fees?

A. Yes.

Q. But that theory does not prove that issuers without the Honour All Cards Rule would set interchange fees that are so much lower that they would be below 0.2 and 0.3, does it?

A. No, and as you correctly stated at the beginning of this section, I have not said that this is resolved by theory, you have to go to the evidence.

Q. So let us go through the thought experiment that you posit where you say that it is the Honour All Cards Rule that gives equal bargaining power to issuers and acquirers in the UIFM.

Let us start by assuming that in the UIFM all the issuers choose 0.2 and 0.3 and all the acquirers except for one go along with that and accept all the cards and pay those MIFs at the cap. One acquirer tries to pick off one issuer and force them into agreeing a lower bilateral interchange fee or lowering, reducing their rate. Are you with me so far?

A. I am with you.

Q. Just pausing there. As a matter of economics that is the right way to test Visa's case, is it not?

A. Sorry, if Visa's case is that even if the absence of the Honour All Issuer rule the IFs would be at the IFR level.

Q. No, it is the Nash bargaining point that I have seen in the papers where we say, Visa says the equilibrium outcome is every issuer choosing 0.2 and 0.3 and every acquirer accepting all cards and to test that you have

to ask if every other player in the game chooses to go along with that candidate equilibrium there might be one player who can properly deviate from the candidate equilibrium?
A. I think I am with you.
Q. If we cannot find any one player who can properly deviate then it is indeed an equilibrium?
A. I think that is generally true.
Q. So the only thing that this one acquirer can do to that one issuer is say: unless you give me a lower rate, I will refuse to accept your cards.
A. That is the threat.
Q. Yes, that is the outside option. So let us think about how that no deal scenario would go for the acquirer. The first immediate consequence would be a loss of profit for the acquirer because there would be fewer transactions; right?
A. Unless it managed to extract the lower interchange fee.
Q. Yes, but this is -- we are discussing outside option here. This is a no deal scenario.
A. No deal. It would -- it would lose the profits from that issuer, I think that is correct -- on dealing.
Q. But the reason we are looking at no deal is that that is what you told us to look at, you said outside options. Outside options is the no deal scenario?

A. Mm-hm.
Q. But the inability to process even a single issuer's cards would also have a material impact on what the acquirer can offer their merchant clients and prospective clients; is that not right?
A. It may do. But if the merchant is multi-homing with acquirers, then the merchant may not be too concerned in case the other acquirer can acquire the transaction of that issuer.
Q. If the merchant is not multi-homing with acquirers, Mr Dryden, let us assume the merchant is not multi-homing, so we are speaking now to the offer about acquirers are making to single -- to merchants that are single homing with acquirers, a merchant who wants a single acquirer, and here we have an acquirer who has failed to do a deal with a single issuer so he cannot take their cards. In offering the acquirer services to merchants that acquirer will not be able to process all of the merchant's transactions, will it?
A. It will not be able to process the transactions of the issuer who it is not acquiring.
Q. So the acquirer's pitch to merchants in that scenario would be: I can process all of your transactions at the same price that every other acquirer is offering, which is the interchange fee at 0.2 and 0.3, except I cannot

process your transaction with that issuer at all.
A. That would be the consequence of not having reached terms with one issuer.
Q. Which is exactly where you tell us to look, Mr Dryden, that is the outside option we are describing?
A. Yes, this is part of the analysis. I mean in due course we can come to the fact that I think there are scenarios that are fairly conceivable of where the interchange fee would be below the IFR level and we can come to the factual witnesses who I think -- also think that is -- that is a conceivable, if not likely, scenario.
Q. We will come to those factual witnesses, Mr Dryden. But I am dealing here with the thought experiment that you set and you told us and the Tribunal to look at outside options, which is the no deal scenario between an acquirer and an issuer, and the acquirer is now, having failed to do a deal, the outside option, is going to merchants and saying: I can process all your transactions at the same price that all of my competing acquirers are offering, 0.2 and 0.3, but sadly I cannot process your transactions with one issuer at all; are you with me so far?
A. Yes, in this -- in this scenario, I am with you.
Q. But that is not a very attractive proposition, is it, for an acquirer to make to a merchant?

A. Yes, but the outside option is never attractive. I mean, the acquirer is not sort of entering into the negotiation with the issuer premised on the outside option being the outcome of the negotiation. They are premising it on the outcome of the negotiation achieving a lower level of interchange fee.
Q. Of course.
A. Which at that moment makes the acquirer more attractive than the other acquirers.
Q. You are quite right, Mr Dryden, the outside options are attractive for no one but it is a question of relative attractiveness when discussing bargaining power between issuers and acquirers?
A. That is where it comes in. It is not because we envisage that it is the scenario -- it is not because we envisage there will be a failure to trade with each other, it is because it is the threat points that determine the price.
Q. Indeed, indeed. As you said, we are looking at outside options to assess whether they have equal bargaining power minus the Honour All Cards Rule. Moving on now to merchants, whether they would encourage an acquirer to threaten not to accept a particular issuer, whether they might have an interest in pushing the acquirer to threaten not take a particular issuer?

A. Well, I think they would have an -- I think a merchant would have an interest in pushing their acquirer to try to get a lower interchange fee from an issuer if that was possible.
Q. Again --
A. The merchant as I suspect you are about to point out to me has an interest in ensuring -- has an interest in the transactions of buyers have that issuer's card ultimately being acquired.
Q. Yes.
A. So if it is not too attractive, then they are left in a position where those transactions can be acquired. They could be acquired -- if they are multi-homing with two acquirers, those transactions could be acquired by a different acquirer, which sort of de-risks the negotiation from --
Q. We are only talking about merchants single homing with acquirers?
A. But that is -- to some extent I am not sure that fits your equilibrium concept because I am not sure that is what the merchants would do.
Q. We can look at separately the extent to which merchants multi-home with acquirers. But I am following the thought experiment, Mr Dryden, that you set us and you said that it is the Honour All Cards Rule that makes the

outside options equal for merchants and acquirers -- sorry, removing the Honour All Cards Rule makes the outside options equal for merchants -- sorry, for acquirers and issuers and in order to understand the acquirers must look at the merchants, which is my next question because --

A. I think, to be precise, they make them more equal. So when you move away -- so when you have the Honour All Issuers Rule, as I tried to describe earlier, the issuing side is fully unionised so any one issuer can hold up -- a failure to deal on the part of any one issuer holds up not just trade of that issuer but trade with the entire scheme. So the Honour All Issuer Rule puts the issuers in an extremely powerful position.

On the other side of the market, the merchants and the -- well, let us say the acquirers are not a collective in the same sense. Without the Honour All Issuer Rule, both sides become un-unionised; neither side can hold up the issuing side, any one issuer cannot hold up entirely the whole scheme on the acquiring side, any one acquirer cannot hold up the entire merchant population.

So moving away from the Honour All Issuer Rule on the issuing side creates in a sense, which I must stress, an equality of arms in the sense that both sides

now become -- neither side is now unionised. So it is
more -- the structure of the negotiation is more equal.
That is not quite the same thing as saying that they
have precisely the same monetary outside options.
Q. We will just develop how equal they are in this
scenario.
A. Yes.
Q. Because we are looking at the match and again the
merchant's perspective of the outside option, we are
only looking at the outside option, Mr Dryden, because
that is how you said you test the relative bargaining
power in the negotiation. From the merchant's
perspective we know and you said that they are generally
willing to accept card payments even if the cost of the
card payment is higher than alternatives like cash?
A. Yes.
Q. We already know, faced with accepting cards at 0.2 or
0.3% or not accepting them, merchants would rather
accept them for all the reasons you have given in the
concurrent session as well?
A. Yes.
Q. Just to make your own point good, Mr Dryden you are
aware, are you not, now that over 90% of retail payments
are by card?
A. I did not know the exact figure, it sounds right, it

sounds correct.
Q. In the United Kingdom 70% of cards are issued by only six issuers?
A. I do not know the exact figure.
Q. Does that sound right to you?
A. Yes, I have no reason to disagree with it.
Q. If a merchant cannot accept the cards of an issuer there will be at least some consumers who will go and make their purchases from another merchant?
A. Yes, that is true.
Q. If they cannot accept these cards, the merchants would lose the sale; right?
A. Yes.
Q. They would lose the entire gross profit margin on that transaction?
A. Indeed, that is the point. We are on the same page on this.
Q. Exactly. As I think Professor Franklin said yesterday, the gross profit margin for most merchants is likely to be much higher than the interchange fee at 0.2 and 0.3%.
A. Yes, there is going to be a distribution of gross margins but many of them will be well above this.
Q. Many of them could be to orders of magnitude?
A. Orders of magnitude above, I agree.
Q. So you do not need to lose very many sales and merchants

to realise that choosing an acquirer who cannot accept one issuer's cards was a terrible decision?

A. That is the "must take" point.

Q. Indeed. But it is also right, is it not?

A. Yes. Well, is likely to be quite commercially damaging to a merchant not to take an issue -- sorry, let me start again.

For all the reasons we have been over quite a few times, a merchant is likely to lose out by not accepting the cards of a particular issuer in proportion to two things, mainly, one is how many out of all its customers how many have that card, but also importantly of the customers who have that card, how many are multi-homing with other cards.

So if there is a card that is being issued by a small issuer where there is a high degree of multi-homing with other cards turning that card down is not going to be such a bad decision for the merchant; if there is a card that is not multi-homing, then that is going to be a worse, a worse decision.

Q. Mr Dryden, you have seen the factual witness evidence from the Claimants about the importance of avoiding customer friction and inconvenience in relation to payment methods, you have seen that, have you not?

A. I have.

Q. The Claimants, many of them accept payment methods much more expensive than Visa and Mastercard in order to avoid customer friction and facilitate customers?
A. I agree.
Q. It is not just a minor bump in the road for a merchant, a single homing acquirer merchant, not to be able to accept payments from a single issuer cards; it is potentially catastrophic for a merchant?
A. Well, it is -- it is -- I mean, catastrophic -- it is on a spectrum between -- it is on a spectrum where catastrophic is the top end of the spectrum. I can -- I can only emphasise that there is a theoretical framework for thinking about this and then we can look at the -- as I did, at the evidence and we can think of some hypothetical -- some hypothetical examples that I think suggest that the kind of phenomenon that Mr Kennelly suggests will not happen could -- it is reasonably foreseeable that it could occur.
    But I am a little bit worried because I did not finish my introduction at the beginning about just framing this overall issue and I wonder if that is helpful.
THE PRESIDENT: Can I just ask you this: you said at the beginning of the section that it is fact dependent?
A. Mm-hm.

THE PRESIDENT: I think that ties in with my suggestion earlier with which you agreed, that elasticities at various levels play a role. So there are a number of factors it seems to me that underpin the correctness of the generality of the point that is being put and let us take, say, a temporal question where you have got a much less convenient form of card payment, in other words you do not have your phone or chip and pin -- sorry, or contactless way of payment and you, say, are a running a sandwich shop where the payment is a couple of pounds and you need fast turnover of business.

Now, if you have got slow card transactions, you do not have contactless, because that is the time in which you are operating and you have got a whole queue of people wanting to buy their sandwiches at lunchtime and you need to transact very quickly, chances are you are going to be quite hostile to cards even if elsewhere in, say, your shoe shop where you are selling shoes at a far lower rate of turnover but at a higher margin, if you do not have card available but are saying "cash only", there may be effects.

Now, I think what you are saying is you can quite see how it could be catastrophic to a merchant if certain facts pertain but I think you are bridling a little bit at that label being extended to each and every merchant for all time. You are saying it is dependent upon the facts and how ubiquitous the facts are in any given case depends on the adjective you are going to assess, whether it is catastrophic in the given case or just generally a bad thing. So it is more nuanced I think than simply a single label being attached.

Have I articulated your difficulty in accepting a generic phrase catastrophic?

A. Yes. So I think it is more nuanced and I think the -- I mean, maybe just to tie it a little bit back into my introductory remarks on this section, I think it may be uncontroversial that the Honour All Issuers Rule which is which as I have said a few times means that issuers are effectively negotiating en masse rather than individually. I think it is uncontroversial that that in any negotiation creates upward pressure on interchange fees.

The reason we are having the debate now about this is that in the UIFM counterfactual on the Visa's version of the UIFM counterfactual it comes with an Honour All Issuer Rule and -- and under this counterfactual the interchange fees would be at the IFR level 0.2 or 0.3. Then the question is: even if it is generally accepted that the Honour All Issuer Rule is creating upward pressure on interchange fees, is all the action, as it were, above the IFR level, because if all the action is above the IFR level so without -- with the Honour All Issuer Rule the IFs are up here, but without it, they are here, but in either case they are above the IFR level, then the presence or absence of the Honour All Issuer Rule is not making any difference to the MIFs -- the IFs that would result under the UIFM counterfactual.

Where it gets interesting is if in the absence of an Honour All Issuers Rule some IFs under the UIFM model could be below the IFR and that becomes interesting because it means that the UIFM counterfactual that has been put forward that embodies the Honour All Issuer Rule embodies an agreement in the form of the Honour All Issuer Rule which has the effect of increasing IFs so it brings us back in -- it is another way of identifying a restriction of competition.

Then I think what Mr Kennelly is keen to establish is that without the Honour All -- even if it is true that the Honour All Issuer Rule pushes IFs up, he is keen to establish that even without the Honour All Issuer Rule, the IFs would still be being pushed up above the level of the IFR. So we never get into the scenario of what about the UIFM model although without the Honour All Issuer Rule and could that create lower

IFs and therefore be a source of a restriction of competition?

What I am saying is that cannot be resolved -- I have given a theoretical framework but I am saying it cannot be resolved by theory. It has -- you have to look at the evidence and there is evidence from the -- some of the schemes' witnesses and I can also think of some fairly intuitive examples, some fairly intuitive examples of where the interchange fee could be below the IFR level, but there are more -- they are less abstract than what has been put to me.

MR KENNELLY: I am taking it in stages. I am starting with a theory, because Mr Dryden started with a theory, and I am going to the evidence and to the facts and to the numbers as well because, Mr Dryden, you quite properly posited a negotiation because if -- if -- the IFs in the UIFM without the Honour All Cards Rule -- sorry, in the UIFM but with the Honour All Cards Rule are -- I am sorry, so sorry, in the UIFM without the Honour All Cards Rule, if the IFs are still going to be at 0.2 and 0.3 then it makes no difference. We have to ask then in a negotiation in the UIFM, absent the Honour All Cards Rule, whether this bilateral negotiation between the issuer and acquirer realistically would end up with an interchange fee below 0.2 and 0.3 and as you said, Mr Dryden, we do that by asking about the relative bargaining power of issuers and acquirers.

So I have been testing with you the relative bargaining power of issuers and acquirers and now merchants because merchants are pushing the acquirers?

A. Yes.

Q. We have discussed the scenario where a merchant's outside option involves losing potentially a significant number of current sales, the gross margin of which may be orders of magnitude higher than the interchange fees or once the negotiation was taking place.

My next point is the point that the President raised about inconvenience. In this outside option scenario that the merchant is thinking about, whether or not he pushes his acquirer to do this negotiation, the customer and this merchant which has backed the acquirer, who has no deal and can no longer accept one issuer's cards, that merchant may have a queue of customers and the customers may not realise that their cards cannot be accepted until they have come to the end of the queue. So you have potentially got a lot of very annoyed customers. That is what the merchant is thinking, right?

Of course it is not just the current sale that the merchant risks losing, if the customers are annoyed, the merchant may lose future sales and the gross profit margin involved with them.

THE PRESIDENT: You are nodding, do you --

A. I am following, I think we are still under the thought experiment of the merchant only having one acquirer?

MR KENNELLY: Of course, all of my questions are on that basis.

THE PRESIDENT: I think it probably would help if at each stage of Mr Kennelly's thought experiment, you indicated agreement or disagreement so that we know where the point breaks down otherwise we get a long thought experiment without witness buy-in, as it were.

So you are happy so far?

A. So far.

MR KENNELLY: So even if -- this is the other payment method point, even if a cardholder whose card has been refused because the issuer is not accepted by the acquirer has some other means of payment -- again from the merchant's perspective, this is the outside option the merchant is considering -- there is no reason to believe that it would be better for the merchant, that this alternative payment means would be cheaper or better for the merchant than the cards of the declined issuer.

A. There is no -- there is no particular reason to believe that.

Q. In fact, lots of other payment methods are more expensive than Visa or Mastercard, when we think about what that customer might pull out of his wallet or phone in the event that his card has been declined, because the issuer is not accepted by the acquirer.

A. Yes, that is -- I mean for the purposes of the thought experiment we can assume that is the case, it is of course a huge topic, the extent to which alternatives are more or less costly as we discussed earlier.

Q. This question of fact, these numbers are material, Mr Dryden, so I will ask you to look at them because this goes to your equal bargaining power model, or more equal bargaining power, and we will come back to precisely what you said later we will start with the average MSC on Visa and Mastercard consumer cards. This is not necessarily straightforward to pull out of the papers, but I would ask you to bear with me.

Could we go to your first report {RC-H2/1/266}. It is table 24.

It is table 24.

A. I do not think I have the right page.

Q. I am so sorry?

A. I do not think I have the right page.

Q. Sorry, I have given you the wrong reference.

PROFESSOR WATERSON: We have page 26 here. I think it should be 266.

MR KENNELLY: No, I have the -- it is table 24 if -- am I in the wrong report?

MR TIDSWELL: 226 I think.

MR KENNELLY: Forgive me, 226. {RC-H2/1/226} -- no.

MR TIDSWELL: 225. {RC-H2/1/225}

MR KENNELLY: 225. Let us see now. Yes, I see the time. I think, Mr Beal, of all of us, has been correct and he gets the prize but I am happy to stop now and take it up. It has been a long morning.

THE PRESIDENT: Very good, it has and thank you. You have had a lot of intervention from the Tribunal. How are you doing for time? It is not a complaint at all.

MR KENNELLY: I am doing pretty well for time. I will be finished well before the end of the day. Ms Tolaney though has a considerable amount of material to cover on issues 4 and 5 and she is going after me. Then I have to do the rules.

THE PRESIDENT: Yes.

MR KENNELLY: So I think, having spoken to Ms Tolaney before today, we were concerned we would not finish by lunchtime tomorrow and we would need to go into the weekend and I think that is -- go over the weekend, I should say -- and that is I think still on the cards and I should say, sir, in view of your indication this morning about purdah I am sure we could have a constructive discussion with my learned friends about where that would leave Mr Dryden over the weekend.

THE PRESIDENT: Why do you not have that discussion -- it does not have to be over the short adjournment but after court today. We will resume at 25 to, if that is all right with the transcriber, is that all right? Thank you very much. We are much obliged. That will give you a few more minutes. So 25 to.

MR KENNELLY: Thank you.

(12.56 pm)

(The short adjournment)

(1.37 pm)

THE PRESIDENT: Mr Kennelly.

MR KENNELLY: Mr Dryden, we were exploring your evidence on the relative bargaining power between issuers and acquirers in view of their outside options in a no deal scenario and I was exploring with you the outside options for merchants if an acquirer could not accept an issuer's cards.

I wanted to explore with you the fact that even if the cardholder was willing and able to pay by some other means, that might not necessarily be better for the merchant in question, better than accepting the Visa card or Mastercard card and I wanted to again with an estimate of the average MSC paid on Visa and Mastercard consumer cards. That is not something which you had to estimate in this case, so I am going to your estimate for commercial cards on that page that I struggled to find before we broke {RC-H2/1/226} and it is table 24 where you estimate -- and it is all confidential so I will not say any numbers out loud -- the factual MSC and you see a combined Visa Mastercard factual MSC there for commercial cards and the percentage is there in the middle of the table.

I want to use that to try to work out what the consumer card MSC is by using your analysis in note 2.

Note 2, it is the second sentence where you say:

"For 2022, the corresponding weighted average MIF for commercial Visa and Mastercard card is [that number] For ease, I apply this figure equally to Visa and Mastercard. To estimate, I also need information on the weighted average acquirer margin and scheme fee."

That is what I want to use to try to work out the consumer card MIF.

"For this I use the information provided in the PSR report ... which shows that in 2018, the average scheme fee and acquirer net revenue was ...

Slightly above that number and you assume the number you have there immediately after it and that suggests an

MSC for Visa and Mastercard in the commercial card scenario of that number, circa that number in the factual situation.

So what I want to do is take your average scheme fee and acquirer net revenue estimate and add that to the 0.2 and 0.3 MIFs which apply in the context that we are describing. Does that make sense?

A. It does.

Q. So the Tribunal then has an estimate of again just an estimate, of the Visa and Mastercard consumer MSC that we are comparing to the alternative payment methods that may be presented to a merchant when it is contemplating its outside options. So instead of that MSC, what might --

A. I think my calculation -- I am sorry to interrupt, I think that calculation depends on assuming that the acquiring margin and the scheme fee is the same for commercial and consumer.

Q. It may not be?

A. But for present purposes, we are operating on that basis.

Q. Indeed, indeed. In the merchant's mind, considering its outside options, something like that is the MSC that it envisages paying on Visa Mastercard consumer cards. Then what alternatives might be offered to it if that cardholder whose issuer's card cannot be used pulls out or uses a different payment method.

I will begin with Amex and you said a moment ago, well, it was earlier today at least, that you are using an estimate of 3.25% for Amex's MSC payment?

A. Yes.

Q. That is significantly above the MSC we have just been roughly estimating from Visa and Mastercard?

A. Yes.

Q. Then moving on to PayPal to look at their charge to merchants. Could you look, please, at {RC-J4/90/2}. This is PayPal merchant fees and you see card funded payment from a user of our terms for payments and there is a percentage on the right, this is the second line, second row, and then there is a range of rates suggested and then we see quite a high one beside all other commercial transactions; do you see that, Mr Dryden?

A. I do.

Q. Just to note how commercial transactions are defined, could you go back, please, to page 1. {RC-J4/90/1} Lower part of the page, please. Yes "Commercial transaction rates" and that is defined when you buy or sell goods or services receive payments with QR codes, make any other commercial type of transaction or receive a payment when you request money.

So you see "commercial" here appears to be defined more broadly than we have been using it in the context of these proceedings, do you see that, Mr Dryden?

A. I -- I do.

Q. Moving on then to Clearpay for domestic payments in the United Kingdom?

A. Sorry to interrupt, the implication of that is that a PayPal transaction in a shop is a commercial transaction?

Q. Yes.

A. Yes.

Q. Yes, and then Clearpay {RC-J5/77/1}. These are figures provided by Adyen, the rates they are offering for Afterpay and Clearpay and for Clearpay United Kingdom, you see "Domestic Payments United Kingdom" you see the rate that they offer in the bottom right-hand corner of the page. Do you see that, Mr Dryden?

A. I do.

Q. That is again very, very significantly higher than the MSC charged by Visa and Mastercard for consumer transactions?

A. It is higher, how comparable it is I do not know because I do not know anything essentially about Clearpay.

Q. If you go, please, to {RC-J2/99.1/21}, I am so sorry -- yes. I am looking at -- this is some evidence that we

saw with Mr Hirst when we were looking at Dr Martens-- have you seen this document before, Mr Dryden?
A. Fleetingly, I think.
Q. I would just ask you to look at the text at the very top of the page in that little rectangular box below the heading "E-com payment methods share of wallet". This is describing the e-commerce payments which have a different mix and then it says "Visa and Mastercard", do you see this, it is confidential so I will not read it out, but you see what is said about Visa and Mastercard?
A. I see that.
Q. Relative to digital wallets, PayPal, Buy Now Pay Later. The percentage charges is given there.
Next, please, could you be shown {RC-J2/104.2/21}. Also a document we explored with Mr Hirst for Dr Martens.
It contains on the right-hand side under the heading "EMEA e-commerce payments volume and fees". I should say straight away, Mr Dryden, have you seen this document before?
A. I do not recall this one.
Q. Take your time to look at it if you need. What I was going to ask you about was the grey line that runs through that chart, "Payment method fee". The document

is comparing volume of transactions between different payment methods and the payment method fee is tracked in the grey line; do you see that?
A. I see that.
Q. Can you see the cost in terms of the payment method fee between Mastercard, Visa, PayPal, Klarna --
A. I see that.
Q. -- Clearpay and so forth. Then {RC-J2/101.1/20}. Again, a document we explored with Mr Hirst and I am asking you to look at the left-hand side. They are describing 2023 and a shift in payments share of wallet, that is the third paragraph down on the left-hand side?
A. Mm-hm.
Q. Again I am asking you to just note the difference in the level between average debit card payments and then credit cards?
A. I see that.
Q. Then Buy Now Pay Later methods; do you see that?
A. I see that.
Q. If we go to {RC-J5/83/1}. Again the rates that are offered by Klarna it is another Buy Now Pay Later. For United Kingdom, you see the rate that is offered?
A. I see.
Q. Paid by merchants, you see that?
A. I see that.

Q. Very good. Amazon Pay we have at {RC-J5/88/2}. There is the processing fee making payments through Amazon Pay payable by merchants; do you see that, Mr Dryden?
A. I do.
Q. Go cardless, another alternative payment method, {RC-J5/80/1}.
A. I see that.
Q. There is the standard charge per transaction.
These are all alternative payment methods. There is of course cash and the IFR itself. Could I ask you just to briefly look at that?
A. I think they are not all alternatives. I mean, a number of these are wrappers to the card transaction. So assuming we are still in the world of talking about the outside option in the -- negotiation in the absence of Honour All Issuer Rule, if a merchant was to not be accepting the cards of a particular issuer, my assumption is they would not be accepting transactions of that issuer's card where it is subject to a wrapper, be that PayPal or Klarna or something else.
Q. I am not sure that is right, Mr Dryden, I will wait to be told otherwise. Do you mean where the acquirer can see that the payment method is riding on the rails of a particular card and therefore knows whether it has a bilateral deal with that issuer or not?

A. I am not sure if the -- yes, I am not sure if I am right either, incidentally, it is just there is a consideration there which is these alternatives, a number of them are a wrapper around the card. I am now hesitating because I think I may be wrong because if -- if the situation we are dealing with is the acquirer is not acquiring the cards of issuer X, but if you bear with me, just if a may just a second.

Q. Of course.

A. So if the scenario that we are dealing with is that the acquirer in this negotiation, their outside option is that they are not dealing with issuer X and therefore the merchant cannot have cards of issuer X acquired by that acquirer, the question is what happens when somebody turns up in the shop with PayPal as a wrapper to issuer X. Maybe that still can -- I am not sure if that transaction goes through or not maybe it does.

Q. I understand, Mr Dryden, although I have nothing to show you for this, that, that for the Buy Now Pay Later transactions they do not ride on the card rails and even if there was no bilateral deal between the issuer and acquirer, those Buy Now Pay Later options would be available to the cardholder if they wished to use them in the merchant. But either way, Mr Dryden, we are concerned here with the merchant's outside option in the event that its acquirer has failed to do a deal with one issuer.

Now, think about it from the merchant's perspective, that is our focus. If -- if none of these other payment methods are available to the cardholder because they ride on card rails the issuer's card rails, that is even worse for the merchant because its customer cannot only not pay with the card but also not use these other payment methods the customer would want to use?

A. It may be better or worse, it depends if the customer as a consequence of not using these diverts to -- stays with the merchant but diverts to a cheaper form of payment or as a consequence of not being able to use these goes to a different merchant.

Q. Mr Dryden, I am sorry, you have accepted that the merchant is concerned with avoiding customer friction. Yes? Yes?

A. I agree.

Q. Also ensuring that the customer is allowed to use the method of payment that he or she wants to use?

A. Yes, the merchant in general wants to offer the payment that the customer wants to use, but subject to consideration of cost.

Q. So in this scenario, in this scenario the cardholder has been told that he cannot use the issuer's card?

A. Mm-hm.

Q. But they say okay, I will use one of these other payment methods Buy Now Pay Later, and they are potentially told they cannot use that either, that is what I am positing. Your answer was, well, maybe the customer will not mind because they will then be diverted to a cheaper method of the payment for them, for the merchant.

A. Yes.

Q. But this is a scenario where the customer has been told he or she cannot use a payment method that they want to use?

A. Yes, I still think it is ambiguous. I am only saying that it is ambiguous.

If you are in a scenario where the card the customer's bankcard has been declined because it is with issuer X, whether in that scenario the merchant is better or worse off offering PayPal, I do not know. They are better off offering it in the sense that they -- in the sense that that may be the next best option of the customer. They may be worse off because it is higher cost than if they had offered cash.

Q. We are concerned here, Mr Dryden, with something you pointed out accurately which is business stealing and the merchant's concern to keep the sale with the cardholder?

A. Yes.
Q. We are imagining a scenario where the customer first of all cannot use his or her bank card, Visa credit card or Mastercard because the acquirer failed to do a deal with an issuer. Then they say: I have my phone here, I will use some other payment method and they are told again: no, sorry, that does not work either. In no conceivable sense can this be good for the cardholder, can it?
A. No, the cardholder would prefer to have the option.
Q. Yes.
A. All I am saying -- and I think it is correct -- but it is not a particularly strong statement because I am just saying it is ambiguous. Imagine one of these options you point to is extremely expensive.
Q. For?
A. The merchant.
Q. Yes.
A. The merchant turns down issuer X's cards.
Q. Yes.
A. Issuer X accounts for all of the merchant's customers. It is not clear to me in those circumstances whether the merchant prefers to have this very expensive alternative or not. Having the very expensive alternative is a plus because it will help them retain more customers in the shop and avoid business stealing and it is a minus

because it is expensive. If they did not have it and they only had cash they would lose some more customers to other shops but for those customers they retained they would pay less.

Q. But Mr Dryden, that is completely unreal.

You are positing a situation where all the customers in the shop hold cards from that single issuer. But that is not a real scenario?

A. No, nothing what I say -- that was -- that was to simplify the example.

Q. But simplify to the point of being of no use because it is not even conceivable, is it, that you would have a merchant where all the customers hold cards from the same issuer?

A. My point did not depend on that. That was just simplifying. All I am saying is that logically it has to be the case that there is a level of cost of the alternative at which in a world where the merchant has declined issuer X's cards, the merchant would rather not continue to offer this alternative because, at that point, too many other people were using it and it is too expensive and they would rather just have cash or other cheaper alternatives.

I do not think that is fanciful. I think that is possible and, you know, it depends, it depends on the numbers.

Q. Mr Dryden, I will ask one more question on this because I think we may be operating on a false premise. But in this scenario, because we are concerned here with the merchant's outside option, the merchant is thinking: will I press my acquirer to run the risk of losing the issuer? The customer is being told they cannot use their payment card and although the shop otherwise is happy to take Klarna and Clearpay, the merchant has made that distribution and has six stickers up saying "we take Clearpay", "we love Klarna" but, sorry, customer, you cannot use that payment method either you want to use and that the shop was otherwise happy to use, is that -- that is a commercially sub optimal outcome for the merchant, is it not?

A. I still think it is ambiguous. However, I think it is -- I -- yes, I still think it is ambiguous but I think we are going down a route which obviously Mr Kennelly is quite entitled to follow. But I am not denying his fundamental premise that it may be very expensive for a shop to turn down a card of a particular issuer. How that expense manifests, whether it is in losing shop customers to the neighbouring shop or whether it is customers diverting to more expensive ways of paying, I do not know. The central premise that it is expensive to -- it may be expensive, there is some nuances on that that we may come to, but the central premise that it may be very expensive for a merchant to turn down the cards of a particular issuer I do not disagree with.

THE PRESIDENT: Is that enough for your purposes?

MR KENNELLY: Yes, it is.

I want to move on to the IFR. I want to show Mr Dryden the IFR because of course there is also cash. {RC-Q1/14/1}, recital 20. Do you need to read this, Mr Dryden? I am sure you are familiar. The point I want to put to you is that the EU legislature is here saying that the caps in the regulation, the IFR, were based on the merchant indifference test and what that means is then summarised in the rest of recital 20. Do you see that?

A. Yes, I see that.

Q. {RC-Q1/14/4}. Just let me know when you have finished reading it.

A. I have read that.

Q. So this explains, as I said, the caps were set by reference to the merchant indifference test and that was a measure championed, as you are aware, by Professor Jean Tirole and as the recital says:

"The caps identify the fee level a merchant would be willing to pay if the merchant were to compare the cost of the customer's use of a payment card with those of non-card cash payments."

The caps were designed to simulate the use of efficient payment instruments and to provide benefits for merchants -- merchants and consumers. Please say yes, Mr Dryden.

A. Yes.

Q. So if the EU was right about the number they picked, then the merchants should be indifferent as to whether they pay MSCs that these interchange fees feed into or cash?

A. Under some assumptions I think that is true but one gets into -- the efficient level of the interchange fee being at the MIT -- i.e. merchant indifference test -- level or the cost of cash, there is quite special assumptions for that to be the efficient level. If those assumptions hold, I think what you said is correct.

Q. In Ireland, Mr Dryden, are you aware that the domestic debit MIF is set at half that of the IFR cap, 0.1%?

A. I -- I was unaware of that.

Q. So by the logic of the EU legislature the Irish merchant should not just be indifferent to cards as replacement for cash; they should be eager to accept them even before you consider all of the other benefits that may

come from card acceptance?
A. Well, it depends why it is lower in Ireland. If the cost of cash has been assessed as lower, then that does not follow.
PROFESSOR WATERSON: Can I -- I am just wondering about this merchant indifference test. Is this based entirely on 101(1) or does it also combine 101(3)?
MR KENNELLY: It combines both, 101(3), yes, and I am not making a legal point about 101(1 --
PROFESSOR WATERSON: Right.
MR KENNELLY: -- at all. I am simply again asking --
PROFESSOR WATERSON: I just wanted to be clear on what it was based.
MR BEAL: Can I just clarify for the transcript my learned friend is making a legal submission that 101(1) has traditionally incorporated the merchant indifference test?
MR KENNELLY: No, that is the opposite of what I said.
THE PRESIDENT: No, I think what Mr Kennelly is doing --
MR BEAL: I am sorry I must have misheard.
THE PRESIDENT: -- is he is using an economic test that has evolved principally in 101(3) to test the factual reactions of actors in the market on the various hypotheses, and there is no legal magic in whether it is 101(1) or 101(3). That is not for today and certainly

not, Mr Dryden, for you.

What he is doing is he has tried to quantify the cost of moving away from cards or moving away from cash on certain assumptions. I think that is --

MR KENNELLY: I am grateful. It is exactly what I am trying to do. I am trying to explore the appetite of merchants to push their acquirers to run the risk of losing an issuer in this negotiation that Mr Dryden has described.

THE PRESIDENT: Just to assist, I think, both of you in terms of absolute versus what is likely to be the case in most instances, you are, Mr Kennelly, quite rightly talking in generalities and we do want to assess how far away from the absolute that you are putting to Mr Dryden, Mr Dryden is prepared to go, but for our purposes it is helpful to know just how much wiggle room there is between the "it is very likely to happen" to "it is always going to happen" because that will assist us in our judgment. It seems to me that you do not need to get acceptance from Mr Dryden of the absolute case in order for your point to hold good and so for that reason I am quite happy to allow Mr Dryden his "there is an exceptional case which I may not be able to quantify", provided he is in agreement with your general thrust and that may make your cross-examination a little easier.

MR KENNELLY: In fact -- indeed, sir, and that is why

Mr Dryden says there may be exceptions. I am not following up on those because that is not the point I am seeking to --

THE PRESIDENT: No, indeed.

MR KENNELLY: -- explore with him.

THE PRESIDENT: I want you both to know that we are on that page as well so that neither of you need to be worried that you are, either of you, making a concession when you are not; you are just articulating what is generally the case and you are not going into the "it is always the case".

MR KENNELLY: Indeed. In fairness to Mr Dryden, Mr Dryden, and we will come back to your evidence, you were speaking in general terms about the likely outcome of a negotiation between merchants and acquirers and how the Honour All Cards Rule/Honour All Issuers Rule features in that, but I want to --

A. No, I do not think that is -- I do not think that is quite right and I think the President's distinction between "always" and "sometimes" is extremely helpful. But I think it may be that we have my position sort of the wrong way round.

So am I saying that absent -- well, first of all, to repeat myself, as a matter of -- sorry, to go even one step back, the exam question here -- it is a little bit easy to lose sight of it -- is under the UIFM without the Honour All Issuers Rule might it be the case that the interchange fees end up being below the IFR level such that you then get a gap between the factual and the counterfactual that might amount to a restriction of competition?

I say that it is theoretically indeterminate. I then say we should have a look at the evidence and maybe think about some slightly more practical examples. Where the evidence and thinking about some practical examples leads me is to the view that it seems to me more likely than not that over a period of time there would be some instances where the interchange fee could end up below the IFR, not that that would be true as a generality.

So therefore what I am saying is that the Honour All Issuer Rule is extinguishing that amount of negotiated interchange fee that would be below the IFR cap. I think there are some realistic scenarios whereby that could happen. You know, with enough issuers on one side, some acquirers on the other and a long time period, one could end up with a situation of the interchange fee sometimes being below the IFR cap.

MR KENNELLY: We are exploring, Mr Dryden, real world scenarios where merchants and acquirers -- an acquirer

and an issuer are negotiating, and I am drawing your attention to the dynamics that affect that negotiation in general terms. The next point I wanted to make to you is, again, the claims --
A. I am sorry, I do not think we are -- I do not think we have looked at a real world scenario.
Q. How about this for a real world scenario: the Claimants' own evidence about the fact that they prefer to accept as many payment methods as possible in order to avoid losing a sale; you have seen that evidence, have you not?
A. Yes, but that does not help answer -- that does not give an answer to the question I have just posed and it is -- it is -- I mean, it is generally going to be true. There is nothing there that contradicts -- contradicts how I am analysing this market.
Q. You have asked us to look at the outside options for acquirers.
A. No, I have asked to look at the outside options on both sides.
Q. Of course, and we will come to the issuers, do not worry, but we have to look at the outside options for acquirers too and that involves also the considerations that merchants have in their minds if they can no longer receive cards from the particular issuer with whom

a deal has not been done. Am I right so far?
A. No. It also involves consideration on the issuer's part of the consequence of it not being accepted.
Q. Mr Dryden, we will come to the issuers. Am I right so far as regards the acquirers and the merchants?
THE PRESIDENT: Mr Dryden, you are being asked, and forensically it is rather difficult to do it at the same time -- you are being asked to look at one side and then at the other side.
A. I understand.
THE PRESIDENT: We will bear in mind, because you have put a marker down very clearly, that when we come to consider this point we cannot disaggregate the two sides. So we will not let Mr Kennelly say what your answers are on the acquirer side means disregarding the issuer side. So we will come to that, but I think, in order to have the questions just comprehensible, we are going to have to do it side by side.
So we now have, as it were, your marker that everything you are saying now is subject to what is going on on the other side, and if you would answer Mr Kennelly's questions on that basis, the position is clear on the transcript and we will bear that in mind.
A. Yes.
THE PRESIDENT: But I do not think there is any other way of

actually getting your answers on the record to Mr Kennelly's questions --
A. That is clear.
THE PRESIDENT: -- if that assists.
A. Thank you.
MR KENNELLY: So returning then to the claimant's evidence and the question about whether merchants and how merchants regard the outside option of not being able to take a card from an issuer in the event of the negotiation failing, have you seen the fact that the Claimants in this trial have confirmed in their evidence that they are willing and they prefer in fact to accept as many methods as possible for payment in order to avoid losing a sale?
A. In general terms, I agree.
Q. I mean, do you accept that that is what the Claimants' evidence has shown or shall I take you to the witness statements and the evidence given in the proceedings?
A. I think in general terms it is true. I mean, the literal statement here is they prefer to accept as many methods as possible. I mean, that would imply that every merchant was accepting every method that is possible, which I think is maybe slightly extreme, but the general notion that merchants are keen to accept a lot of methods, and in particular the ones that its

customers want to pay with, I agree with.
Q. Again, in general terms, what the Claimants' evidence has shown is that in general terms they prefer to accept payment methods, even more expensive methods than Visa and Mastercard, in order to avoid losing a sale?
A. Yes. We have to come back to those costs, but yes.
Q. From the Claimants' witness evidence do you accept that they do not indicate that these businesses would want to decline one issuer's Visa or Mastercard even if they could?
A. Correct. They would be costly to do so. I mean, that is why it is an outside option.
Q. So with that in mind, Mr Dryden, putting yourself in the position of the merchant and recalling, Mr Dryden, that this is about a negotiation over something between 0 and 0.2, 0.1, 0.15; that is the negotiation we have in mind that is going on in theory.
A. Mm-hm.
Q. For what benefit would a merchant want to take the risk of this outside option happening, not being able to receive an issuer's card?
A. It is for -- it is for the benefit of lower MSCs.
Q. But is it really realistic, in view of what you have seen from the Claimants' own evidence, that in view of the gain, the potential gain, that they would take the

risk of not being able to take one issuer's cards and losing all the business that you have described -- well, the gross profit margin that you have noted?

A. I do not disagree that that is normally going to be quite costly to them. There is the caveat that if they have a second acquirer who is acquiring -- acquiring the cards of the issuer in question it is potentially not going to be costly. But I really -- I mean, I have no disagreement with the general proposition that for the merchant losing sales relative to the value of the MSC is -- is very costly and it follows as well from that that negotiating a somewhat lower MSC is not going to be attractive if it is at the expense of losing sales.

So the outside option for the merchant is undoubtedly still quite costly except in some particular circumstances -- some particular circumstances that maybe take us away from the average to some particular circumstances where I can more readily see that it could happen.

Q. You say more costly, Mr Dryden. Just to be clear, in general do you accept that it would be very bad commercially for a merchant not to be able to receive the cards of an issuer?

A. I -- on average I think it would be very bad, yes.

Q. That very bad outcome would weigh more heavily in the balance for an average merchant than the prospect of receiving a small discount on interchange fees below 0.2 and 0.3?

A. It would weigh heavily. The question is whether in a negotiation where the negotiation presumably would not be by the merchant but by the acquirer, in a negotiation between an acquirer and an issuer, can you envisage a scenario where the acquirer would manage to negotiate interchange fees below 0.2 and 0.3? I think one can imagine some circumstances in which that would happen.

Q. But, Mr Dryden, as you have made very clear, we are concerned with outside options because you said in order to understand bargaining power you need to know the walkaway consequences for both sides and you said what about the perspective of the acquirer. We have discussed merchants, but from an acquirer's perspective, if the acquirer cannot do a deal with the issuer and then has to face the merchant market saying, "I cannot give you better terms than any other rival acquirer, and by the way you will not be able to take cards from this issuer either", that is potentially -- that is potentially catastrophic for an acquirer.

A. It -- well, two things. One is it depends on whether the merchant is multi-homing with other acquirers and then, secondly, we have to look -- there is the

President's steer that we are not there yet but in due course one needs to look at whether -- how bad it is for the issuer because these are outside options. We do not -- if there is a negotiation breakdown, then the outside options materialise, but if the negotiation does not break down they just determine the price and the outside option never happens. We never have the issuer card not being accepted by the acquirer and the merchant. These are the threat points that end up not being -- not actually being exercised if the -- if a price is settled on. The question is whether the price that is settled on in some circumstances might be below the IFR level.

Q. Mr Dryden, again, the outside option is what you tell us to look at. The acquirers cannot credibly threaten issuers with non-acceptance unless they consider their outside option; is that right?

A. Yes, I am being asked to do this sequentially. So it is a little bit hard to talk about a credible threat when we are doing it sequentially because it depends on the position of the issuer.

Q. Based on just what you have seen so far in terms of the merchant perspective and the commercial outcome for an acquirer if he fails to do a deal with the issuer -- we will come to the issuer's incentives in a moment, but we are assuming, as you have told us to, that a no deal -- so the issuer has failed to agree a reduction in the interchange fee, so it is a no deal scenario. Is that something that the acquirer can live with?

A. I -- I -- no, but then -- and I am not meant to jump ahead, but an issuer may well not be able to live without being accepted.

Q. We are assuming, as you told us to assume, an outside option of no deal. You said very fairly that the acquirer could not live with that, and because the acquirer could not live with it, he cannot credibly threaten with it?

A. I think the -- the acquirer may be able to live with it in a world where the merchants -- in two scenarios. One is where the merchants are multi-homing with more than one acquirer and the other is where, due to particular circumstances, the merchant does not find it too costly to decline the cards of one particular issuer. Even if in general it is true that it is very costly to turn down the cards of an issuer, if there are some circumstances where a particular issuer's cards can be turned down without it being too costly, then the merchant can live with it and the acquirer could live with it because the acquirer's demand is the derived demand from the merchant.

Q. Moving on to the perspective of the issuers, Mr Dryden.
You have mentioned multi-homing a few times. Just to make sure I understand what that is, by "multi-homing" do you mean a situation where the merchant has a number of acquirers?
A. Yes.
Q. So the issuer's card, even if he has failed to do a deal with one acquirer, will still work because it will be taken by one of the other acquirers?
A. That is the possibility that I am identifying.
Q. So in a negotiation between one acquirer and one issuer where the acquirer is saying to the issuer, "You had better reduce your interchange fee, issuer, otherwise I am going to lose my business", in a multi-homing scenario is it not true that the issuer will say, "I do not care because for multi-homing customers, well, my cards will still work"?
A. That is a good point, I agree.
Q. So the multi-homing does not help, does it, Mr Dryden?
A. Yes, I think you are correct.
Q. So coming back to single homing, if -- if the issuer refused to agree a price with an acquirer, they too -- this is in a single homing scenario -- would not be able to process transactions from that acquirer's merchant clients. This is the -- these are the bad things for

issuers in a single homing.
A. Yes.
Q. That reduction in transactions would mean a reduction in MIF revenue to the issuer?
A. Yes.
Q. It would also mean a reduction in issuer costs though as well, would it not?
A. Mm-hm.
Q. Is that "yes", Mr Dryden?
A. I am sorry. Yes.
Q. You have my point that at least from the issuer's perspective they are processing credit card transactions at a loss since the IFR came into force?
A. Well, they must -- it must be -- unless we are in a sort of transitional stage, it must -- they must assess that it is profitable overall, taking into account the knock-on benefits for their overall -- their overall sales.
Q. Mr Dryden, again, doing the relative comparison exercise that you ask us to do, any small profit margin that an issuer loses -- and we are discussing only now profits and costs -- whatever profit margin the issuer loses as a result of losing an acquirer, that would pale into comparison to the merchant's losses from lost sales where it cannot receive card payments from that issuer?

A. Yes, maybe in -- on average in absolute terms, but if the -- if the issuer's card is not accepted by the merchant and the merchant loses the sale, the merchant loses essentially 100% of their business and the issuer loses essentially 100% of their business. So neither side monetises from -- the merchant does not monetise their sale of the product or service and the issuer does not monetise the transaction from that -- their transaction.
Q. But I am asking you, Mr Dryden, about the relative harm of that scenario. The issuer loses the small profit margin, if he makes one at all, on the transaction and we have seen the figures in question.
A. Yes.
Q. The merchant loses everything, the whole sale, and potentially future sales if the customer is annoyed.
A. Yes, I think the -- the -- the merchant loses the whole sale if the sale leaves the shop and the issuer loses the whole sale if the sale stays in the shop and goes to a different payment means or goes to a different shop and uses a different payment means.
Q. My question, Mr Dryden, was about the relative harm of that outcome to the issuer's loss of that profit margin on the transaction, if he gets any profit at all, and the merchant's loss of the whole sale and the gross

profit margin. Would you agree the merchant's loss is greater and of more significance to the merchant than what the issuer loses in that transaction, assuming that the transaction does not take place in the shop?
A. Yes. So if we are talking about one transaction, then the monetary loss to the merchant may well on average be greater or even a lot greater than the monetary loss to the issuer --
Q. In general?
A. -- from that transaction.
Q. Mr Dryden, again in the real world, in general, based on what you have already said about gross profit margins, it is likely -- likely, in general, to be much worse for the merchant?
A. Yes.
Q. Is that right?
A. But I think I just said that.
Q. Okay. So the cost of fewer transactions for issuers will be offset and this impact, this loss of profit on the transaction for the issuer will only last as long as merchants do not switch acquirers; that is correct, is it not?
A. That is correct. That would be correct.
Q. Because once merchants have switched acquirer, the issuer will be able to process all of their transactions

again?

A. Yes.

Q. It is likely, is it not, that merchants would switch acquirers relatively quickly in order to continue to process transactions, all transactions in their shops?

A. Yes, I think if they were single homing they would -- there would be a strong incentive to switch.

Q. It is also possible, is it not, again if it is single homing, that the issuer would be less competitive with cardholders if its cards were not accepted by every merchant?

A. That is true.

Q. I think this is the point you were hoping to come to, Mr Dryden, because cardholders want their cards to be accepted everywhere, do they not?

A. Yes.

Q. But again that concern would evaporate once merchants switched acquirers, would it not?

A. Yes.

Q. It is also true, again from the perspective of the cardholder, that there is likely to be quite a lot of inertia on the part of them, particularly for debit transactions, where switching involves changing a current account?

A. Sorry, where is the inertia here?

Q. The inertia on the part of cardholders.
A. Sticking with their issuer?
Q. Yes. They may be slow to switch despite the inconvenience that their card cannot be used through that one acquirer that has failed to do a deal with their issuer.
A. That is less clear to me. I can imagine quite a big reaction.
Q. Would you accept that there is a degree of inertia on the part of cardholders switching because of the other services that their bank may offer them?
A. Yes, there is clearly some degree of inertia.
Q. They may have other reasons to stay with their issuer?
A. Clearly.
Q. The affected merchants, again from the issuer's -- the issuer's bargaining perspective, the affected merchants may not be significant in number. So again the failure to do a deal with the acquirer may not affect significant numbers of merchants such that an inability to use the card in those shops will not materially impact the cardholder because it is the inconvenience to the cardholder that we are concerned with now.
A. Yes. That -- that is a little bit to do with the reaction to non-ubiquity. So even a small degree of non-acceptance could produce quite a big reaction from

cardholders. That is -- that is an empirical question. I could see that that could be the case.
Q. It is also relevant, is it not, to consider competition among merchants because if the cardholder has other options apart from the merchants whose acquirer cannot take their cards, it may be easier for the cardholder to avoid the merchants who cannot take their card?
A. To some degree. Again, there is a -- I mean, as we are building this up, yes, there is a lot of things to measure here. But, I mean, to some degree that is true.
Q. Even large merchants, because they compete very strongly, can be relatively easily avoided. Even Tesco could be avoided. If you had to avoid Tesco you could shop at one of its competitors; is that not right?
A. That is true.
Q. Whereas some issuers' cards -- issuers' cards could be up to 20% of a merchant's turnover, like Lloyds for example. One issuer's card could be up to 20% of the whole turnover for a merchant.
A. That is -- that may well be true.
Q. So the reality is that an acquirer who chooses to refuse an issuer's card is facing potentially very, very damaging commercial outcomes whereas the issuer is facing for sure some cardholder inconvenience but nothing like the very severe commercial harm that the

acquirer faces in the outside option of a no deal?

A. Yes, in -- that may well be the dynamic in a lot of negotiations. But the question for me is whether over the period that we are interested in, if one thinks of the schemes having operated with a UIFM and with no Honour All Issuer Rule, might -- despite this even being the average position, might there have been some circumstances in which some acquirers may have managed to extract lower interchange fees than the IFR level from some issuers?

I think that that -- that that cannot be resolved by theory and I think there is a suggestion in the evidence that that could have happened or even is likely to have happened and I think one can think of scenarios where it could happen.

So if I can now give an example. So if we have an acquirer dealing with a small -- with an issuer, potentially quite a small issuer who has -- whose cards tend to be multi-homed with the cards of other issuers, so if we think of an entrant like Monzo or something like that, and if generally people are holding that card alongside a more kind of traditional issuer's banking card, there may be scope for an acquirer to negotiate an interchange fee below the IFR level with that issuer. It is less costly than the average situation that

Mr Kennelly has been discussing because of the multi-homing. So it does not seem to me to be such an unlikely possibility as he is portraying here.

Another situation is, in the absence of an Honour All Issuer Rule, can we rule out that, for example, you could have a kind of buying group of merchants, not only Tesco but say all of the supermarkets, going to an acquirer and the acquirer negotiating on their behalf for an interchange fee below the IFR level.

I am not sure I articulated that perfectly, but it seems to me that it is hard to rule out negotiations either perhaps because of a small issuer who is multi-homing, whose cards are typically multi-homing with other issuers, or because of essentially an aggregation of buyer power on the merchant's side to rule out a situation where lower than IFR -- IFs might not be the outcome notwithstanding the costs on each side.

Q. Mr Dryden, just to be clear, one of the situations you posited there where a large group of merchants could combine to negotiate collectively, you would see the cartel risk there if they were combining to jointly purchase or to negotiate a better deal between themselves?

A. Yes, but that is an ironic statement because that is

exactly what the issuer are doing.
Q. Well --
A. So what you are doing is you are -- if it is okay to be -- if it is okay to have a world where you have the Honour All Issuer Rule in place on the issuing side but for the merchants or the acquirers to be somewhat fragmented on their side, then to say that the other situation cannot be countenanced, especially when the market power problem lies on the merchant's side, is -- it does not seem to me to be so obvious because you are saying the thing that cannot be countenanced is almost exactly what is happening on the issuing side.
Q. Mr Dryden --
A. Now, I -- I agree that if you had that kind of negotiation the -- with a buying group they would need to be 101(1) compliant. But it does not strike me, for the reasons that I have given, as -- as so easily dismissed as Mr Kennelly suggests.
MR TIDSWELL: There is a form of unionisation on the acquirer side anyway, is there not, because the acquirer is actually representing usually a large number of merchants. I do not know how that plays out in your analysis because of course on the one hand, in order to use that effective unionisation, they have to be able to represent them and therefore they have to agree to it,

whereas on the other hand of course if they do, then it carries a certain amount of negotiating weight presumably.

A. Yes, I think the point that Mr Kennelly is pointing to is that if -- and forgive me if I am missing your point, but if the acquirers are aggregating merchant demand to some extent so -- you have that effect, but Mr Kennelly's point is it is hard for the acquirer to exercise that because the risk is that the merchants can just go to a different acquirer if the negotiation breaks down. So the acquirer is a bit hamstrung.

It is a different situation to imagine a group of large merchants being a buyer group to get better interchange fees because then you do not have that problem.

MR TIDSWELL: Yes, I understand.

MR KENNELLY: Mr Dryden, there are points there, I think, about appreciability and we will come back it that, the outcome of that scenario before I leave you, but I am just coming back to that point about the relative bargaining power of the acquirer and the issuer and you have there outside options.

What I think you have accepted is the issuer's bargaining position in this scenario, absent the Honour All Issuers Rule, is still extremely powerful vis-à-vis the acquirer in general?

A. It is -- the issuer clearly has some -- on average, in general as you put it, the issuer is going to have some significant bargaining power.

Q. So when you say that in your report there is no reason to expect that issuers, absent an Honour All Cards Rule, would have greater bargaining power than acquirers, that is just not right, is it, Mr Dryden?

A. No, I -- I think that is -- I think it is fair to say that that statement is maybe slightly too simplistic. I think what happens when you remove the Honour All Issuer Rule is you create more of a symmetry in the bargaining positions between the two sides, not in the sense of their absolute power but in the sense that you go from a situation of one side being fully unionised and the other not to a situation where there is parity in the sense that both sides are not fully unionised.

I do not think that translates into strictly equal bargaining power and indeed I can see that on average the issuer may still have considerable bargaining power compared to the merchant. But what I have done is point to I think some -- because this has been quite general, to some examples that seem to me plausible examples of what over a period of time in the absence of the Honour All Issuer Rule could materialise, and over a long enough period if something is possible there is a likelihood it will materialise. I think we also see the -- some of the witnesses of the schemes recognising this at least possibility, if not likelihood.

Q. This -- just to be clear, and I think again very fairly, Mr Dryden, you are not suggesting that on average the issuers and acquirers are nearly equal. On average in this bargaining scenario the issuers are in a much more powerful position than the acquirers.

A. I am not suggesting they are nearly equal. I think somewhere in my report when I was describing the equality between them I used sort of single inverted commas and said "more equal" or -- I cannot remember where I put the single inverted commas. Somebody can maybe find that. But the argument has not been one of strict equality; it has been one of greater structural equality because you have taken away the unionisation on one side, creating the possibility, which I do not think is there with the HAIR in place, of a negotiated outcome below the level of the interchange fee, and then I -- sorry to be repetitive -- I say it is then helpful to look at the evidence to get a -- to get a sense of whether that is likely -- is likely to happen.

Q. We will come to that, Mr Dryden. So just looking at this from the other end of the telescope, think about a scenario where all the issuers except one choose a zero or lower MIF, and then we ask ourselves whether any one issuer would profit from increasing the interchange fee to the maximum. So one issuer decides to go for the maximum even if all the other issuers are setting their interchange fees at zero or lower MIF. If that one issuer increased its interchange fee to the maximum and any one acquirer thought about rejecting that issuer, would it not find itself in exactly the same boat as in the scenario that we have been debating for the last few hours, with all the other issuers charging the maximum?

The first scenario is all the other issuers charge the maximum, but even if the issuers apart from one all charged zero and one charged the maximum, again, in terms of bargaining, the acquirer is constrained in its ability to reject that one --

A. Oh, I see.

Q. -- issuer?

A. It is still -- it is still constrained.

Q. Because --

A. You still have to look at the exact situation and, as I have described, the exact type of issuer we are talking about, what is happening exactly on the acquiring side between merchants. But the --

Q. But in general terms, Mr Dryden, the scenario is the same. The acquirer has to go to the merchants and say: you can take payment from every other acquirer but sadly not from this one with whom I failed to do a deal -- sorry, issuer. You can take business from -- you can take payments from every other issuer but not this one, and the offer that it is making is exactly the same as the offer every other acquirer is making but minus an issuer?
A. Yes, I think that is just describing the scenario.
Q. Again, that is a terrible offer for the acquirer to make to its merchants?
A. Well, I think that is a -- I think I can agree. You are essentially asking the same question that we have already had.
Q. Okay. So, Mr Dryden, you have said several times that you have based your opinion on the evidence, factual evidence, including evidence from the schemes?
A. Yes.
Q. I would ask you to turn up your report just to see where your reliance is on that evidence. {RC-H2/1/64}. It is paragraph 7.73. Have I given the right reference? Sorry, next page, page 65, 7.73 {RC-H2/1/65}.

I am so sorry, can we go back to {RC-H2/1/64}, paragraph 7.69. You refer there to evidence from the schemes' witnesses which confirms that the -- or acknowledges that the Honour All Cards Rule -- I am now reading from 7.70, second line:

"... [the Honour All Cards Rule] allows issuers to demand higher MIFs than they otherwise might."

A. Yes.

Q. You rely, first, in paragraph 70a on the evidence of Mr Korn.

A. Yes.

Q. We see that in footnote 175. Let us turn that up. {RC-F4/16/1} and the relevant passage begins on page 16 {RC-F4/16/16}, titled "The impact of the [Honour All Cards Rule]"?

A. Yes.

Q. Now, you have referred in your evidence to Mr Korn's statement at paragraph 50.

A. Yes.

Q. But I would like you to look through this section of his evidence in full, beginning at paragraph 48. Do you see that?

A. Yes.

Q. Take your time with it, please.

(Pause)

Let me know when you have read 48 to 50 Mr Dryden and then I will ask you some questions about it.

A. Okay.
(Pause)
Yes.
Q. So you see --
A. Sorry, I am just starting para 50. It is on the second page. {RC-F4/16/17}
Q. No, take your time, Mr Dryden.
(Pause)
A. Yes.
Q. In paragraph 48 in the second sentence Mr Korn confirms what we have been discussing. If the Honour All Cards Rule had been removed at any point after around 2000 it would not have made much difference to merchant acceptance, right?
A. Yes. It says "on merchant practice", but yes.
Q. Because merchants do not want to turn down business?
A. Yes.
Q. Because in a mature market such as the UK and Ireland much of that business, a very large part of that business, will be by way of card transactions as you have said?
A. Agree. I mean, this is a validation of the must take point.
Q. Yes, indeed.
A. I think we are about to come on to the more critical

part, but the -- just to emphasise, the outside option is an outside option because the merchant does not want to take it. So even if the merchant can negotiate -- even if the merchant can negotiate a lower interchange -- what one would expect is the merchant to be able to negotiate a lower interchange fee and then still see the card being accepted.
Q. Yes, but that is not what Mr Korn is saying here, is he?
A. Well, I am not sure he is yet dealing with the negotiation point.
Q. Well, he is dealing with --
A. I think what he is dealing with is that there is a strong motive, which you have spent time on and I in general agree with it, on merchants to accept the cards of all issuers once the scheme is mature.
Q. Then at 49 he says he has been asked whether he thinks the Honour All Cards Rule has prevented merchants from steering cardholders away from Visa products and he says, "I do not think so".
A. Yes.
Q. He says he has seen no evidence of the Honour All Cards Rule actually changing merchant acceptance. It is no doubt because for the very point you make, Mr Dryden; because we do not accept the "must take" argument but on your own argument about must take --

A. Yes.
Q. -- it strongly suggests that, whether the Honour All Cards Rule is here or not now, merchants feel constrained to accept all cards from all issuers.
A. In general terms that is what he is saying. I mean, he could not -- I think you said he had not seen evidence. Obviously it is not a thing that you see because we are dealing here with a counterfactual of what would have happened if there was no HAIR. But he is saying that merchants would want to accept the cards even in the absence of the -- of the HACR.
Q. I am looking at this closely, Mr Dryden, because you referred many times during evidence that you have an evidential basis for the theory you have advanced. You have promised us evidential support for what you have been saying, and now we look at it and we see it at paragraph 50, and having said what he said, Mr Korn says --
A. Yes.
Q. "I suppose, absent the [Honour All Cards Rule], a situation could, in theory, arise where an acquirer could pressure its merchant not to accept certain issuers' cards with a view to using this as a bargaining tool ..."

He goes on to explain how that could go the other

way round. Do you see that?
A. Yes.
Q. But you accept that in theory issuers and acquirers could also agree higher fees even without the Honour All Cards Rule?
A. Yes.
Q. So what is important is not what is theoretically possible, and I think again the point you have been making yourself, Mr Dryden, but what issuers and acquirers are likely to do, bearing in mind their economic incentives?
A. Yes.
Q. They are -- issuers and acquirers are very unlikely in general to agree lower rates even if theoretically they could, lower than the IFR caps?
A. Yes. I mean I think the nub issue with Mr Korn is whether it -- it is pure theory or there is a degree of belief there that in the absence of the Honour All Issuer Rule you could have some situations of a negotiated interchange fee below the IFR.
So I think if we -- and I completely accept that this paragraph is framed as -- at least at the beginning as theory, it is less clear to me that Mr Korn is dismissing this possibility in the way that you have as something that just cannot arise if you read the

totality of the paragraph and his other evidence.

So if I can just go through what he says here:

"I suppose, absent the HACR, a situation could, in theory, arise where an acquirer could pressure its merchant not to accept certain issuers' cards with a view to using this as a bargaining tool to negotiate reduced bilateral interchange fees with issuers."

So that is what we have been talking about for the last while and he is saying he can see it in theory, and I take Mr Kennelly's point that that is just a statement of theory.

The next sentence is imagining the negotiation. Then the next sentence is saying it could have happened the other way round. Then he is saying still I think sort of in the -- as a theory, the issuer would have to agree particularly if the acquirer -- it is the acquirer for a big merchant or their cards will not work. So that is envisaging the possibility. So their cards are accepted but they get less money.

Then he says:

"It would be a very unlevel playing field and it would have made life very complicated. I expect that regulators may have become involved as there would have been a lot of consumer dissatisfaction ... The Honour All Issuers element stops the possibility of acquirers taking advantage of an unlevel playing field."

By "unlevel playing field" here it means negotiation whereby some issuers get less than the IFR cap, and then he says:

"As I explain at paragraph 24 above, without it, the whole four-party ... model could be distorted ..."

"Distortion" there means you would end up with some issuers getting a lower IF than other ones as a consequence of this negotiation and you would end up with a series of three-party models which is his way of characterising what happens when you have some deviation from the IFR cap.

Then if we -- if I -- if I may, if we go to paragraph 24, which is the one he is cross referring to, {RC-F4/16/7}:

"Without the HACR, the four-party model would be distorted. If there were a material number of merchants who accept some, but not other, issuers' cards ..."

Then he gives an example:

"... you could end up with a series of three-party models."

Again, that is the characterisation when you have the negotiation:

"The HACR ensures that it is the brand of the scheme, rather than the identity of the issuer, that determines where a card can be used."

So my reading of this is that it has an element of the theoretical but I also read it as being concerned about the real possibility that in the counterfactual of no HAIR there could be a degree of negotiation in some circumstances between an issuer and an acquirer producing an IF lower than the cap.

Q. Mr Dryden, looking back at that first sentence of paragraph 50, in terms of the express language addressing whether in a negotiation and UIFM absent the Honour All Issuers Rule an acquirer could exercise some bargaining power, that is described by Mr Korn as something in theory?

A. I see that.

Q. You are aware, are you not, that Mr Korn was cross-examined?

A. I am.

Q. Have you read his evidence that he gave in cross-examination?

A. I tried to watch most of his evidence.

Q. Did you see anything that suggested any evidence behind that theory that would substantiate the acquirers having bargaining power in the post-IFR world to negotiate IFs, interchange fees, below 0.2 or 0.3?

A. I do not think this point was tested, so I do not think he elaborated one way or the other.

Q. So what we are left with then from Mr Korn is this sentence and then the other parts you say might potentially provide something at the back of his mind which is not articulated?

A. Yes.

Q. That is quite a thin basis, is it not, for finding what you are suggesting; that acquirers could have sufficient bargaining power to negotiate interchange fees below 0.2 and 0.3 in view of all the other incentives particularly those facing the issuers that we have discussed so far today?

A. It is not the only piece of evidence. I completely take the point that his starting premise is theory. I think that it can be read 50 and 24 and this is clearly ultimately not a matter for me, I think this can be read as going beyond pure theory into a degree of actual concern about a long level playing field. That is clearly an issue for -- for others to assess. Other witnesses touch on this as well.

I mean, there is also -- I mean if -- if it was sufficiently unlikely there would not be a need for -- there would not be a need for the rule.

Q. On the subject of mature markets, Mr Dryden, did you see the report of the Ministry for Business and Enterprise

in New Zealand 2016?
A. I did not.
Q. Could I ask you to turn that up, please, {RC-J3/85/37}. It is paragraph 132. Again, this deals with the relative bargaining power, economic incentives of issuers and acquirers and merchants; do you see this?
A. Yes.
Q. Take your time to read 132. (Pause)
A. Yes.
Q. So the New Zealand Ministry is not attributing these outcomes to the Honour All Cards Rule, is it?
A. Not in these bullet points. In the same way that -- in the same way that yesterday in the concurrent session, I am not attributing the merchants' predicament to the Honour All Issuers Rule although that makes the predicament worse. What I am pointing to is the possibility that in the absence of the Honour All Issuer Rule over a period of time it is possible that some -- there could be some combinations of circumstances between acquirers and issuers that could result in some cases in interchange fees being negotiated below the IFR, notwithstanding this being the general -- the general context.
Q. Going back to your first report, the rest of the factual evidence that you rely upon?

A. Yes.
Q. That is {RC-H2/1/65}, we see at paragraph 7.72 and 7.73, that the totality including what you have from Mr Korn of the witness evidence that you rely upon; is that right?
A. Well, there is, there is -- four witnesses I think have addressed this topic.
Q. So let us look at them in turn, shall we? 7.71 you say:

"... when addressing the Alternative Counterfactuals, the witness evidence of Visa and Mastercard attributes to the Honour All Cards Rule the fact that the interchange fees will be the same as the factual implying that but for the Honour All Cards Rule there they would be lower."

We have already had Mr Korn's evidence. Then we look at what we have here from Mr Peterson. You rely on -- he is making the point that:

"'... issuers in New Zealand have chosen to notify rates at the maximum permitted levels because it is in their individual economic interest to so do as (i) this maximises their revenue and therefore their ability to offer attractive terms to cardholders in the issuing market; and (ii) in light of the Honour All Cards Rule, each individual issuer’s interchange fee has only a small impact on merchant acceptance of that issuer’s cards'."

Do you see that?

A. Yes.

Q. That is not saying that absent the Honour All Cards Rule interchange fees will be lower?

A. But it is -- to me it is attributing the fact that the issuers in New Zealand have chosen to notify rates at the maximum permitted levels to -- in part to the presence of the Honour All Cards Rule otherwise it does not make any sense to carry on with the second point after, (ii).

Q. You accept, do you not, Mr Dryden, again you are inferring into this an impact which has not been expressed by the witness in his statement?

A. I think the statement is -- well, it seems to me that this -- unless the -- it seems to me that this statement is explaining the fact that the rates would be at the maximum permitted levels is in the light of the Honour All Cards Rule, so therefore there is some causation there.

Q. Did you have an opportunity to read the cross-examination of Mr Peterson?

A. I did.

Q. Was there anything in that cross-examination that suggested that absent the Honour All Cards Rule, issuers

would reduce their interchange fees?
A. Yes. If I am not mistaken, in his cross-examination Mr Peterson -- I do not want to say resiled from his position but if my interpretation of his position was correct, he -- he did not maintain it.
Q. I am sure you can draw back to that re-examination but was there anything in particular that thought that the pressure would be such, absent the Honour All Cards Rule, based on Mr Petersen's evidence, that the fees would drop below 0.2 or 0.3 in this jurisdiction?
A. Just to repeat, my reading of Mr Peterson is he is saying, it seems to me reasonably clear as these things go, that the Honour All Cards Rule has a role in pushing the interchange fees to the maximum permitted levels. I think when he was cross-examined he may not have advanced that -- he -- that was not his argument when he was cross-examined on my -- on my understanding of what he said.
Q. Then we have Mastercard's evidence, Ms Devine, Mr Willaert, at (a) and (b) under 7.73; do you see that?
A. Yes. So Ms Devine is saying -- I am also interpreting this as saying that we would be at the cap because of the Honour All Cards Rule.
Q. Do you see that might be a more stretched reading of Ms Devine's evidence here, Mr Dryden? She is saying:

"'... acquirers would have to deal with issuers whose cardholders transacted at their merchants in order to get paid (as a result of the Honour All Cards Rule), issuers would be able to insist on their required settlement rate (i.e. the interchange fee charged).'"

A. Yes. But the issue that we have is with Korn -- with Mr Korn, with Mr Peterson, with Ms Devine, we are addressing this question and the Honour All Cards Rule seems to be entering into their -- sorry, I think there is a slightly different position between them because Mr Korn is dealing a bit less expressly maybe with the cap scenario.

But with these -- and I have already dealt with what he said. With Mr Peterson and Ms Devine, they are giving an answer for why the interchange fees will be at the cap and both of them in answering that question are saying that it is -- they are bringing the HACR, at the very least they are bringing the HACR into their answer, and it is a strange thing, it seems to me that that is an odd thing to do if the HACR has no role in being at the cap.

Q. Well, let us just go back to what you are reading here from Ms Devine. She is saying acquirers would have to deal with issuers whose cardholders transacted at the merchants in order to get paid as a result of the Honour

All Cards Rule. Is that not the natural reading? That she is saying they have to deal with the issuers because of the Honour All Cards Rule and then she goes on to say issuers would be able to insist on their required settlement rate, the interchange fee charged.

A. Well, my reading of it is that given that acquirers have to deal with issuers because of the Honour All Cards Rule the issuers are going to -- because of that the issuers will be able to insist on the -- on the cap and then -- and then, I am sorry, she elaborates so it is clear she is thinking of the Honour All Issuer Rule.

"Acquirers could not refuse to deal with any particular issuer without declining all issuers which they would be very unlikely to do as they could no longer serve merchants if they did this."

So this -- I mean this clearly has in mind the distinction between the presence of the Honour All Issuer Rule and the absence of the Honour All Issuer Rule.

Q. Again, have you had the opportunity to read the cross-examination of Ms Devine in these proceedings?

A. I have forgotten where we ended up with Ms Devine on this.

Q. So you cannot recall any evidence from her where this interpretation of her statement might have been extracted from her?

A. I do not recall that.

Q. Finally, at 7.73 (b), the evidence of Mr Willaert:

"The hold up problem that would arise in the context of bilateral negotiation without any restriction on excessive fees is that the HACR discussed in more detail later in the statement means that issuers and acquirers have no choice but to deal together. The acquirer is dependent upon the issuer to settle a transaction after its cardholder presents his or her card to the merchant and that gives the issuer a stronger bargaining position."

Do you see that?

A. I do.

Q. Again I think we accepted when we discussed before that the HACR in theory does give an issuer a stronger bargaining position than an acquirer?

A. Yes.

Q. But it does not follow, does it, from this that the interchange fees would be lower?

A. No, I am more with you on this one. I am more with you on this one. I think the other ones to me are fairly clearly saying you are at the cap because of the HACR and then we had Mr Korn where it starts with in theory but it started to sound more like a genuine concern about an unlevel playing field. This one I agree the quote does not demonstrate that absent the Honour All Issuer Rule we would be below the cap.

However, I think it is the case that when Mr Willaert was giving evidence, he talked about the unlevel playing field concern that would arise in the absence of the HAR, which is the same concern that Mr Korn is expressing in his paragraph 24. So I thought where we ended up with Mr Willaert is that he could see the possibility or even likelihood of an unlevel playing field which is sort of their way of putting some negotiated outcomes in which the interchange fee is below the cap.

Q. If there is anything in Mr Willaert's evidence that makes that good, I am sure that will be raised in re-examination.

Mr Dryden, do you not see that that is it? That is all the factual evidence that you have to support your position in the face of all of the powerful economic incentives that we have been discussing all day, and you must accept that it is -- you must accept it is not much, is it?

A. It seems the -- it seems to me that it is something more than a theoretical concern, even a genuine belief, of the schemes that the Honour All Issuer Rule is contributing to the result whereby the interchange fees are right up to the cap and they are envisaging a scenario where if you did not have the Honour All Issuer Rule you could have something that they called an unlevel playing field. That is what Mr Korn and Mr Willaert talks about and then you have Peterson, Mr Peterson and Ms Devine attributing causation to being at the cap from the presence of the Honour All Issuer Rule.

To repeat what I said some time ago, it is not my -- that is indeed what I rely on together with I think one can think of sort of real world examples like the two that I gave where it does not seem completely impossible or indeed it seems quite conceivable. That -- that is, you know, that is indeed, you know, as far as I take it.

Q. Ultimately those are mainly theoretical points that you are taking because the point that Mr Korn is making and even the points that you have quoted from the other witnesses are ultimately theoretical in themselves?

A. Yes, but they are, they are -- there are -- they are evaluations that originate from the schemes themselves and not from me. It does not seem to me because of talking about an unlevel -- the consequences of not having a HAR being the real possibility of an unlevel playing field, talking about regulatory intervention etc it seems to me that those witnesses have a material degree of concern that in the absence of the rule there would be some negotiated IFs below the cap and other witnesses seem to be attributing to the presence of the Honour All Issuer Rule the fact -- to that rule the greater likelihood that you would be at the cap.

So I do not think -- so in other words if I was to be looking at this from the other end of the telescope and can I confidently say -- you know, can I say: Well there is no restriction of competition here because I can be confident that even without the Honour All Issuer Rule we are bound over a fairly long period of years to always be at the cap and there will never have been -- there will not have been a break out situation where the position of the acquirers and the issuers is such that you get some negotiated IFs below the cap. You know, I cannot say that I think that is likely.

I think you can see that that could happen it seems to be on the mind of the schemes.

As I said earlier, my argument is not that that would happen as the generality but there could be a degree of this happening in the absence of that rule.

MR KENNELLY: Thank you, Mr Dryden.

I think we need a transcriber break at this point. Sir, if this is a convenient moment?

THE PRESIDENT: It certainly is. Mr Dryden, how are you doing? It has been a long day and this is not easy.
A. I am not sure if it is worse for me or for everybody who is listening, I am doing fine, thank you.
THE PRESIDENT: Do not worry about anybody else, it is more your position. We will take a 10-minute break.
A. I am fine, thank you.
THE PRESIDENT: If at any point you feel that you are not doing yourself justice do let us know because these are long days, it is an intense experience and it is your evidence and I want you to give of your best.
You are doing fine, but you are the one who knows how tired you are. Just bear that in mind.
A. I will do that.
THE PRESIDENT: I am grateful. We will resume in 10 minutes.
(3.15 pm)
(A short break)
(3.27 pm)
MR KENNELLY: Mr Dryden, the analysis in your reports where you suggest that the interchange fees could fall without the Honour All Issuers Rule does not focus on the degree to which they would fall; that is right, is it not?
A. That is correct.
Q. But you are aware, are you not, that the Claimants have

to demonstrate an appreciable counterfactual fall in interchange fees for there to be a restriction of competition.
A. Yes.
Q. So I am just going to consider what it would take for there to be an appreciable reduction. Now, we have been discussing the acquirer's threat not to process an issuer's card and whether that is credible. Let us assume, contrary to what I have been putting to you, that it is correct and to pick up a point that you made earlier the size of the issuer in question might have an impact on the merchant's incentives and credibility of the acquirer's threat?
A. Yes, that is one of the scenarios.
Q. I am sorry?
A. That is one of the scenarios.
Q. So you suggested a large merchant or acquirer with large merchant clients might be able credibly to threaten not to process the transactions of a small issuer? Can you say -- maybe you are saying yes, but my hearing is so terrible?
A. No, I pointed to two different scenarios, one was the credible threat not to process the transactions of a small issuer, particularly one that multi-homed with other issuers, a different scenario which was not

conditional on the size of the issuer was a sufficiently big merchant or even group of merchants negotiating for lower IFs from an issuer but that issuer need not be small.

Q. Well, that last scenario that you described, I think I am not going to ask you any more questions, that is what we have been debating all day.

I am focusing on the small issuer point that I have not asked you about, the idea being that large merchants might not -- might tolerate, they might tolerate not being able to process a small number of transactions in order to avoid the costs and inconvenience of having to switch acquirer.

So let us assume that a large merchant's acquirer could negotiate a lower price with a single small issuer; are you with me so far, Mr Dryden?

A. Yes.

Q. Would you accept that this would make the smaller issuer less competitive?

A. Yes.

Q. It would have lower revenue than other issuers, it would therefore possibly or probably have a worse cardholder proposition?

A. Yes, it would make it less competitive, assuming that the merchant could not advantage it in some way but that

is my assumption. So that is where things like non-discretion rules etc come into play. It is the merchant's inability to favour an issuer with lower IFs that is part of the merchant's predicament, but I think, yes, so we are assuming that rule is in place, then I agree with you.
Q. So the merchant cannot surcharge or give a price signal to the cardholder?
A. Correct.
Q. So the issuer that has agreed this lower interchange fee, the small issuer, is rendered less competitive and logically in turn that ought to cause it to exit the market?
A. It -- it is a differentiated market so it is not clear that in itself that would be enough.
Q. But that is a likely outcome, is it not, all else being equal, if it is less competitive in the market for cardholders because it receives less and potentially much less interchange fee revenue, it is already smaller?
A. Yes, it would be a competitive disadvantage.
Q. If it did exit the market, those lower prices would no longer be available?
A. That is correct.
Q. So would you accept that the reduction of a small

issuer's price in these circumstances is by definition not appreciable?

A. I mean, I could -- it depends if the interchange fee reverts to a higher level when the issuer becomes big, then essentially the merchant is getting some benefit in the -- from when where the issuer is small but I completely agree that it depends on the issuer becoming -- still being there when the interchange fee reverts to a high level.

MR KENNELLY: I have no further questions for Mr Dryden.

THE PRESIDENT: Thank you.

MR KENNELLY: Sorry, for now, I should say.

THE PRESIDENT: We know you will be back, Mr Kennelly.

MR KENNELLY: Also for the Tribunal, Mr Dryden knows this, you may not, perhaps I have said this: Ms Tolaney is going to cross-examine?

THE PRESIDENT: Then you will go back on the exciting area of rules?

MR KENNELLY: It is an exciting area, thank you, sir.

THE PRESIDENT: No, we will leave our questions to the end to the extent we have any. Ms Tolaney.

Cross-examination by MS TOLANEY

MS TOLANEY: Good afternoon, Mr Dryden, I appreciate you have had a long day. So as the President said if you get tired, do say?

A. Thank you.
Q. I was going to ask you a few specific questions about the bilaterals counterfactual. Obviously Mr Kennelly has covered a lot of ground with counterfactuals generally and I am not going to cover that again.
May we look together at your report about what you say about your approach and in particular your "but for" approach and the reference for that is your first report, paragraph 7.29A which is {RC-H2/1/58}. Do you have that?
A. I do.
Q. So you say there that unlike the UIFM, the bilaterals counterfactual contains an agreement to operate a scheme and then if we drop down to 7.29(c) you say that the apparent bilateral MIF setting is a consequence of the prior agreed scheme rules providing for the scope of such bilateral action. You see that?
A. Sorry, could we just go back to the transcript, if that is possible?
Q. Of course. I am just asking you to read your own report at 7.29(a) and (c)?
A. Yes, I thought there was something that I disagreed with just in your opening part. So you said that I say that unlike the UIFM the bilaterals counterfactual contains an agreement to operate a scheme?

Q. Yes.
A. I think both the UIFM and the bilaterals.
Q. I am reading your report 7.29(a):

"Unlike the UIFM I understand that it contains no agreement as to setting IFs but does contain agreement to operate a scheme."

A. Yes, but the point is that both the UIFM and the bilaterals contain agreement to operate a scheme.
Q. Right, I
A. The differentiating factor between them is that the UIFM has an agreement as to the setting of IFs but the bilaterals, depending on what version of bilaterals we are talking about, does not.
Q. Right but I want to focus on does contain agreement to operate a scheme?
A. Understood.
Q. Those are the words I am focusing on. We have covered the UIFM with Mr Kennelly's questions.

The second point I just wanted to show you was in (c) of your first report, 7.29:

"However the apparent bilateral MIF setting is a consequence of the prior agreed scheme rules ..."

Got those points?
A. Yes.
Q. So just pausing there so that we are clear about this.

When a single interchange fee is agreed, this applies to multiple members of the scheme, then that is a multi-lateral interchange fee, is it not?
A. Essentially, yes.
Q. Well, it is how you describe it in fact in your own report. So when you say here "bilateral MIF setting", that is not accurate because there is no multi-lateral interchange fee where interchange fees are bilaterally negotiated between the issuer and the acquirer?
A. Yes, that is simply a typo. It should say "the apparent bilateral or IF setting".
Q. Okay. Now, you agreed with Mr Kennelly this morning that there is nothing inherently anti-competitive about a four-party scheme?
A. I agree.
Q. You also agreed with Mr Kennelly that settlement at par is not the only valid counterfactual?
A. I think the correct statement is: may not be the only counterfactual valid counterfactual.
Q. What you say I think is that settlement at par is the only valid counterfactual left after we go through your "but for" approach?
A. That is right, as a consequence of going through the approach. It is not, as it were, the starting point. It is the outcome.

Q. But I think you would accept that if the bilaterals counterfactual does not involve a collusive agreement, and Mastercard was likely to have adopted it, there is nothing anti-competitive about the bilaterals counterfactual producing positive interchange fees?
A. That is not quite what I am saying. I am saying that if the only reason that Mastercard designs its scheme in such a way as to create an environment for bilaterals is because of the positive IFs that those bilaterals produce, by virtue of agreeing to the scheme, the undertakings are agreeing in effect the IFs because the IFs are the consequence of the scheme that they have agreed to. So then what matters is -- on my approach -- is, are they agreeing to the bilaterals only because of the IFs that are produced or would they be agreeing to the bilaterals even if the bilaterals did not produce IFs and if it is the former, on my analysis there is a kind of substantive analysis rather than a legal analysis, I can see that -- that they have agreed to IFs, which --
Q. So can we just break that down because I think what you have just described is your "but for" approach?
A. Correct.
Q. That is the essence of your "but for" approach?
A. Correct.

Q. Just before we come on to that, I just want to cover off one point which is your suggestion of some form of agreement. So just looking back at 7.29(c), you talk about the prior agreed scheme rules.
A. Yes.
Q. At 7.29(d), you talk about the prior agreement again?
A. Yes.
Q. Again at 7.29(e) you talk about the rules allowing for bilaterals?
A. Yes.
Q. But the starting point here, Mr Dryden, is that in the bilaterals counterfactual, Mastercard and Visa would not have set any default settlement rules of any kind and the essence of it is that issuers and acquirers are negotiating the terms of dealings between themselves?
A. I understand that. That is consistent with what I say here.
Q. Well, it does not appear to be consistent, if you do not mind me saying, because you seem to be talking about the existence of an agreement and there is not one?
A. It is the agreement to these to operate to be members of the scheme.
Q. Right. So the agreement you are talking about is purely participating in the scheme; is that right?
A. Correct, the scheme that then provides either of the

rules in the case of UIFM or the environment in the case of bilaterals in which IFs are agreed.
Q. You accept that Mastercard's case is that there would be no default settlement rules of any kind in a bilateral counterfactual?
A. I am prepared to accept that as a working assumption. But this bit is beyond what I have dealt with in my report so whether the bilaterals are in a sense pure bilaterals that have no default or the bilaterals in order to work have a default and therefore that introduces another element of agreement, that is not something that matters for my analysis here.
Q. Right.
A. Because even in the version where there is no agreement about the default, my analysis goes through. If there is, if there has to be a default to make the bilaterals work that introduces another element of agreement but I have not gone that -- I have not had to take the analysis that far.
Q. No. Because in your own report at 7.10(b), at {RC-H2/1/55}, you address the counterfactual I have just described to you, i.e. no default rules?
A. Yes.
Q. Yes.
A. I am addressing it on the -- exactly as I believe

counsel said, I am addressing it on the way it has been put forward. It is a different matter that I do not address about whether that is workable or not.
Q. Can we turn then to your "but for" approach and I think this starts at 7.32 of your first report, you say that everything rests on the "but for" approach?
A. In my analysis, yes.
Q. Yes. You accept that whether this "but for" approach is correct as a matter of law is not something for you; but you advance it as a matter of economic analysis, I think?
A. That is correct.
Q. Now, there is nothing inherently anti-competitive in the bilaterals counterfactual if it produces positive interchange fees, is there?
A. Well, no, I think there is because if -- if the level of the -- if bilaterals produce interchange fees at the level of the IFR cap, and if those interchange fees are a restriction of competition for all of the reasons I gave in the concurrent session, then the interchange fees are uncompetitive because they are the result of the exploitation of market power against merchants producing inefficiently high interchange fees.
The question we are left with is whether there is agreement and if the schemes have chosen the bilateral

construct only for the purpose of producing those IFs, which are a restriction of competition on my analysis, then it is, if you like, inherently uncompetitive to choose the bilaterals counterfactual because you are choosing a counterfactual that produces something uncompetitive because it produces something uncompetitive.

Q. But that is the point, Mr Dryden. On your analysis it is all about the subjective intention, the scheme choosing a system/scheme that produces interchange fees, positive interchange fees. It is not the fact that it does it, it is the intention on your analysis?

A. Yes, but I would not characterise the intention as subjective, I would characterise it as objective because the question is whether if you give the scheme a choice between settlement at par and bilaterals that for whatever reason do not produce positive IFs and the scheme would prefer settlement at par, to bilaterals that do not produce any positive IFs, and then I change the scenario where the bilaterals pre-introduce positive IFs and the scheme then prefers the bilaterals that produced positive IFs, we can say that this scheme is preferring the bilaterals only because of the positive IFs that they produce. I do not think that is something about -- I do not think that is particularly subjective, that is about an objective choice between those options.

Q. So can I test this with you. Assume Mastercard adopts a scheme with the intention that it produces positive IFs, hypothetically, but the way it turns out in fact means that positive IFs are not produced. Is that anti-competitive?

A. On -- my -- my analysis does not rely on the really on the intention. It relies on the objective analysis. So -- sorry, let me try again.

I mean, I have not really dealt with that scenario because on my analysis they -- everybody seems to think it is rather obvious what the bilateral and the UIFM scenarios would produce, they would produce interchange fees at the cap in the presence of the Honour All Issuers Rule so I have not really had to deal with this scenario of them expecting one thing and something else happening.

Q. Well, test the -- that is why I said it is a hypothesis because the way you have put your analysis, the way you have addressed it, is to say that it is because -- that is the way you put it -- because the scheme Mastercard or Visa would wish to have the positive interchange fees, that is the mischief. So that is what I am just trying to explore with you.

Is it because i.e. because they intended to do so,

and that is the hypothesis, or is it the fact of the outcome; which one is it?
A. I think I understand the question better and I may be straying here a little bit more into legal territory but I think the question necessitates it. The limb that we are dealing with here is the agreement limb.
Q. Well, let us try again --
A. Can I --
Q. Sorry, you are still answering.
A. The limb we are dealing with here is the agreement limb and, straying into legal territory, the notion of an agreement in 101(1) encompasses agreement, collective understanding, other things like this. So the notion of agreement is I think an expectation that you know the parties are agreeing to the bilaterals because of an expectation that the bilaterals will produce positive IFs. That satisfies the agreement aspect. The restriction of competition aspect is satisfied if the -- if the interchange fees do end up being as expected; in other words being -- being positive or at the cap level.
Q. So what I am trying to explore with you -- and can I try it one more time -- assume Mastercard puts in place a scheme where they intend to produce positive interchange fees --
A. Yes.

Q. -- but it does not in fact produce positive interchange fees, is that anti-competitive or is it legitimate?

A. Well, it might be an agreement because of the intention and the expectation.

Q. It is just a yes or no, Mr Dryden?

A. No, it is not, I am sorry, it is not, because you have added together the two things. You are asking me an overall question about -- the question you asked me, is that anti-competitive or is it legitimate?

Q. Well, let us break it down. Is it anti-competitive?

A. No, may I -- I think I just need to finish my answer.

Q. Of course.

A. You asked me is it anti-competitive. That is a compound because it has -- to be anti-competitive or to be illegitimate, it has to be an agreement and produce a restriction of competition and if the -- if you imagine a scenario where you have an agreement to some scheme rules in the expectation they will produce positive IFs but they do not, maybe the right analysis is that you satisfy the agreement limb because there is -- various people are deciding to do something on the expectation of something, but you do not have the restriction of competition because nothing materialises from it, so the answer would be that it is not anti-competitive, but it is not anti-competitive, not

because there is not an agreement, there is, but because there is not a restriction of competition.
THE PRESIDENT: Ms Tolaney, this is looking purely at an effects-based analysis leaving on one side object?
MS TOLANEY: Indeed.
A. I was answering on that basis.
Q. If you removed, let us take -- remove an element of it, if the scheme had no expectation about what interchange fee would be payable, on that hypothesis your "but for" test would not be satisfied, would it?
A. Roughly speaking that is correct and that is the clarification I gave to Mr Kennelly earlier today.
Q. Indeed your "but for" test would not be satisfied even if the bilateral negotiation in fact turned out to provide positive interchange fees?
A. No, sorry, the test is satisfied in that scenario. So if that -- I think that scenario takes us back to the beginning. If that is a scenario in which the participants are agreeing to the scheme regime on the expectation of positive MIFs -- of positive IFs and the positive IFs happen, then -- and moreover they are only agreeing to the scheme arrangement because of the positive IFs that materialise then it satisfies my test
Q. I think, Mr Dryden, I posed two hypotheses, I know you are tired, but the second question was: if there was no

expectation, no intention, but it turned out to produce in fact, on that hypothesis from your previous answers I think the answer is that it would not satisfy your "but for" test because there would be no intention or agreement, as you put it?
A. I think that is correct.
Q. So that is why I said to you it does come down to on your case the intention to produce the positive interchange fees?
A. The agreement element does, I think that is correct.
Q. Yes, and not necessarily the outcome?
A. I think that is correct, the agreement element does.
Q. Right. Can I just also test one aspect of your approach. You know that Mastercard and Visa think that positive interchange fees had benefits for their schemes?
A. I believe that they think that that is the case.
Q. I do not think you would dispute the fact they are probably right about the benefits of positive interchange fees for their schemes?
A. No, I mean, it is -- it has to be true because by revealed preference, if they did not think that positive interchange fees benefited their schemes, they would not have them.
Q. So it cannot really be illegitimate for a business to

take account of whether the likely outcome is positive or negative for its business, can it?
A. No, but the -- the interchange fees restrict competition, we have the agreement limb but the interchange fees restrict competition for all the reasons that we have gone through a number of times.
So the -- the -- yes so I am not sure, yes, perhaps -- I am not sure what more to say.
Q. Well, the only reason is I am focusing on your aspect of the "but for" test being about what is the intention of the schemes and I am simply putting to you that it cannot be illegitimate for a business to take account of whether an outcome is positive or negative or the likelihood of that.
A. I am not sure how that quite fits the framework.
THE PRESIDENT: What framework do you mean?
A. The "but for" framework I tried to set out.
Sorry, I am getting slightly tired but I can carry on, maybe not quite at the pace that I was at.
THE PRESIDENT: Let us -- just pausing one moment and we will -- I just want to express one not so much concern, but marker. I quite understand why you are cross-examining the witness on the basis of his own framework. That being said, these questions of intention and whether something is legitimate or

illegitimate or believed to be legitimate, all of those are very strongly arguably not relevant when one comes to a competition or infringement and the vehicle for ascertaining the witness' economic expert evidence, but I would not want it to be thought that the fact that you are answering those questions -- and we are not suggesting that competition law is different -- means that we will not be giving you a hard time in closing on those points.

As long as that is understood.

MS TOLANEY: I understand that and that is why I said I am testing this purely from an economic perspective.

THE PRESIDENT: On that basis.

MS TOLANEY: I am trying to explore how this "but for" approach works in practice.

THE PRESIDENT: That is entirely understood and in a sense, the witness has invited the questions by agreeing.

MS TOLANEY: Indeed, indeed.

THE PRESIDENT: But as long as it is clear that we are not bound by the framework, then I am happy.

MS TOLANEY: I know sir, I am not escaping the questions at a later time.

THE PRESIDENT: That leads to the more fundamental question of Mr Dryden. Would it help if we rose for 10 minutes and then went for another half hour after that?

A. I am perfectly fine.

THE PRESIDENT: You are perfectly fine.

That is fine, but this is not intended to be an endurance test, it is intended to be a way of getting the best evidence out of you. We will proceed, Ms Tolaney, until 4.30 but then I think it is no later than that.

MS TOLANEY: May we see how you have addressed the bilaterals counterfactual in the past because I think we understand, just to recap, that are saying it is about the scheme adopting --

A. Yes.

Q. -- this counterfactual in the light of the outcome it perceives or in fact will happen. But let us have -- and you put that as the "but for" test.

Just to recap, I think we established from your report at 7.32 this is your first report in these proceedings?

A. Yes.

Q. That everything rests on the "but for" approach.

A. Yes.

Q. Can we now go to {RC-H2/6/1}. This is your expert report dated 17 June 2016 and if we could go, please, to page {RC-H2/6/12}, at paragraph 1.3, we can see that you explain that you were instructed by Stewarts LLP in the

Arcadia and M&S claims against Visa; can you see that, it should be on screen if you do not have it?

A. Yes.

Q. If we then go please, to page 116, {RC-H2/6/116} this is Section 10, which if we go up a bit you can see is entitled "Restriction counterfactual"; do you see that?

A. Yes.

Q. If we could go, please, to page 117, {RC-H2/6/117} paragraph 10.8, you are considering here the defendant's pleaded case in those proceedings and say that it is a system of pure bilaterals which you say is a description of a system without any default arrangement.

Do you see that?

A. Yes.

Q. Then if you look at 10.10, lower down the page, you are considering here the relevant principles and if we could please go over the page, {RC-H2/6/118} if you could read and remind yourself of paragraphs 10.11 to 10.14, please. (Pause)

A. I have read those.

Q. So at paragraph 10.14, you say:

"I proceed on the basis that the most appropriate Restriction Counterfactual is that which [and I emphasise] would most likely have eventuated in the absence of agreement in issue."

Do you see that?

A. I do.

Q. Now, you do not refer to any separate "but for" test for determining the legitimacy of the restriction counterfactual, as you put it here?

A. That is correct.

Q. The only criterion you are identifying here is the likelihood the counterfactual would have been adopted?

A. That is the only criterion identified here, that is correct.

Q. Right. Then if we go over the page, please, {RC-H2/6/119} at paragraph 10.16, you then set out your analysis and at paragraph 10.18, you consider the prohibition on ex-post pricing counterfactual.

A. Yes.

Q. Then at paragraph 10.19(b), over the page, {RC-H2/6/120} you agree with Visa that a system of pure bilaterals particularly in combination with the HACR would give rise to a number of problems, most notably the hold-up problem; do you see that?

A. I see that.

Q. Then at paragraph 10.20 you reject the bilaterals counterfactual on the basis that the hold up problem made it unrealistic and unlikely?

A. Yes.
Q. So pausing there, the hold-up problem that made the bilaterals counterfactual unrealistic no longer applies since the IFR, does it?
A. That is correct.
Q. Now, you make no mention in this report of the bilaterals counterfactual involving any implicit agreement as to positive interchange fees?
A. That is correct.
Q. You do not refer, as we said, to any "but for" test?
A. Correct.
Q. You do not raise any other objection to the bilaterals counterfactual as a matter of principle or law?
A. That is correct.
Q. You seem to have accepted at this time that if the bilaterals counterfactual were realistic and likely, it would be an appropriate counterfactual?
A. I think that is -- I think that is implicit. I mean, I think the -- I think those are all fair statements. I think it is also true that a counterfactual for the purposes of the restriction of competition analysis should be the most likely out of the legitimate available counterfactuals.

What I did not do here was consider the legitimacy of the bilaterals counterfactual on the agreement -- on the basis that it may itself include an agreement.

I think that was a much less relevant issue because I think everybody sort of agreed that the bilaterals was a non-starter because of the hold up problem. The bilaterals is back on the table because of the IFR and the idea that you can now have bilaterals with the idea that it will get you IFs up to the IFR level.

So that takes away the problem of the bilaterals being unrealistic, it puts them back on the table and I think it is a fair statement to say that at that point I have re visited the question -- or I have not revisited, I have addressed the question of whether the bilaterals counterfactual in the presence of the IFR has an agreement element which I did not address in 2016.

Q. Can I ask you some questions about the Honour All Cards Rule. Mr Kennelly has covered most of it, but can I just ask you if we can consider what would happen if there was a MIF without the Honour All Cards Rule.

So if we consider the position of merchants if there was no requirement that they honour all issuers in a world where there is still a MIF, merchants would have exactly the same financial incentive as in the counterfactuals to try and negotiate lower interchange fees with an individual issuer because a reduction in the interchange fees is a reduction in their costs; do

you agree with that?
A. I think the merchant has the same incentive, but it is the absence of the -- it is always difficult to distinguish incentive and ability but on one view, on one view the merchant has the same incentive, but I think has a greater ability.
Q. Yes, so the financial incentive is the question and I think you agree they have the same financial incentive?
A. I mean a £1 reduction in the MIF is worth a pound with or without the Honour All Issuer Rule. The absence of the Honour All Issuer rule may change the merchant's ability to get that pound.
Q. Let us talk and focus on the incentive, not ability.
So do you agree with me they would have exactly the same financial incentive?
A. I mean, I refer to the answer I gave a second ago.
Q. Well, sticking with incentive, because I am not asking about ability, the financial incentive would be the same regardless of the level of the MIF so an individual merchant would have the same incentive to push for a lower interchange fee?
A. I think a pound is a pound wherever you start.
Q. So if merchants had the capacity to drive down interchange fees without the HACR, in either the UIFM or

bilaterals counterfactual by negotiating with an individual issuer there is no reason to think, is there, that they would be in a different position in a world with MIFs but without the HACR?

A. I do not understand the difference between the two scenarios because I am just reading it back: If merchants had the capacity to drive down interchange fees, so that is the first condition, interchange fees without the HACR, they would -- there is no reason to think they would be in a different position in a world with interchange fees but without the HACR.

Q. Yes.

A. So it is just saying the same thing, is it not?

Q. No. It is saying that it is your position that the removal of the HACR would give the merchants the capacity to drive down interchange fees and the question is: there is no reason to think they would be in a different position if they -- if you took the HACR away but you still had a MIF?

A. I do not understand the question.

Q. Because your point is it is the HACR that is causing the imbalance in negotiation?

A. But if there is no MIF there is nothing to negotiate over, so I am not really understanding the question.

Q. I think, Mr Dryden, the point of my question is that in this scenario there is a MIF and the question I am putting to you is that in a world with a MIF, but without the HACR, merchants have the capacity to drive down interchange fees, so there is no difference once you take away the HACR between the scenario without and with a MIF?

A. I do not think that is -- with respect, I do not think that is your case. Because you are saying: I am putting it to you that in a world with a MIF but without the HACR merchants have the capacity to drive down interchange fees ...

What you -- what Mr Kennelly spent a long time arguing with me is that in a world with the MIF but without the HACR merchants would not have that capacity.

Q. We are putting to you, Mr Dryden, a scenario where if you are right and you say that there is capacity -- I know Mr Kennelly has put the questions, you have answered those, I am just following on with a different question based on your report, if you are right then there is no reason to think that merchants would be in a different position in a world with MIFs but without the HACR?

A. Oh, I am sorry. I -- I think a lot rests on MIFs for the purposes of this question, is that right?

Q. Correct.

A. So you are contrasting a situation of bilaterals --
Q. Yes.
A. -- without the HACR.
Q. Correct.
A. Compared to MIFs without the HACR and then you are saying if merchants could negotiate lower MIFs or IFs as the case may be in one -- in one scenario they could do it in the other?
Q. Correct.
A. From the same starting level of interchange fees, I think that is correct.
MS TOLANEY: Thank you. I am turning now to inter-regional and commercial cards and I am happy to start now or --
THE PRESIDENT: Well, how are we doing for time is the first question?
I think I would rather we stopped now. I think Mr Dryden is in need of -- it has been a very long day and I would rather we stopped, but I do not want there to be pressure on anyone at the end of the process to cut their cross-examination of the experts back. As we have seen today, one does get discursive answers. That was entirely appropriate, I want to make that clear, the questioning today has been extremely helpful and I do not want anyone to feel under pressure.
But perhaps we ought to draw stumps now. We will

keep under review where we need to find more time but stretching court days when one has witnesses giving evidence over the day is actually very difficult because the witnesses get tired and there is only so far we can do stretching.

We were debating whether it would be possible to, as it were, interpose experts so they do half a day each but I think that is probably logistically so complex and so difficult for counsel that it is something which would have to be teed up well in advance and we have not done that.

So with some trepidation -- I do not know whether we have got a 10 or 10.30 start tomorrow. I am reminded it is a 10.30 start tomorrow for reasons that I do not need to go into, so we will start at 10.30. We will see how we go and we will ensure that everyone gets the appropriate amount of time with the later witnesses.

MS TOLANEY: Thank you. I think, sir, what we have anticipated as Mr Kennelly said is that we will assume that we are starting at 10.30 and finishing at 1 because I know that there is a CMC at 3.

THE PRESIDENT: Yes, 3. We can go along a bit longer than 1 o'clock subject to the witness' position.

MS TOLANEY: Right.

THE PRESIDENT: We are more than happy to have an abbreviated or early lunch break and then move to say 2 or 2.30 even in order to get a bit more time subject always to the witness' position.

MS TOLANEY: That would be helpful and then we do anticipate going into Monday.

THE PRESIDENT: Yes.

MS TOLANEY: But I think at the moment we do not think -- we will keep it under review -- but we do not think that would necessarily affect the timetable because we are not sure that we can -- we think we can use some of the three days between the two experts allocated slightly differently.

THE PRESIDENT: Well, I will leave it to the parties' good sense but I know that you will raise difficulties with the timetable at the appropriate point for us to assist the parties to assist us getting the evidence out.

Can I thank you all very much on that front.

There is one point which I will raise now because we may make it the subject of an email emanating to the parties out of the Tribunal and it is this.

During the course of Mr Kennelly's cross-examination of Mr Dryden, we had a number of sort of specific points being made about what individual witnesses were saying about the general operation of things and that was entirely helpful and understood. But listening to those questions it struck me that we ought to have some idea of the scale of the schemes' operation, the number of acquirers, the number of cardholders, merchants, not because it is anything other than material that will help us locate within the scale of things the evidence of the individual witnesses and it seemed to me that I, at least for my part, lacked a sort of single point of reference for that sort of location.

What we will do is we will send out in very much a draft form a table sort of setting out facts and figures that we would be interested in having with a view to providing a sort of background.

I would like the parties not to regard this as a particularly important document in the sense that it is background only and it may be that the statistics or data that we would like is so hard to provide that we just scrap this idea and we get other data that fulfils the same function. On the other hand, it may be that the data is readily to hand and you can simply populate the data without a problem or it may be there is some position in between. But it would be, I think, helpful for you to see what we have in mind with a view to the schemes and it will be the schemes who will have to assist on this to enable us to have this kind of context.

It just seems to me if we are writing a judgment on this we ought to know at any given year how many acquirers there were in the market, how many card issuers there were in the market just because we will look pretty silly if we say: Well, there were some but we do not know how many. So it is that sort of material we are thinking about.

Of course we are aware that it is strewn across the documentary record and we could, I am sure, create a table like this ourselves, but I think I would rather we passed it over to the people who actually will have this material readily to hand and we can see whether something helpful can be agreed, as I say, as a background document to understand the very interesting and very complex material and scheme that we have before us.

So we will send that out. The parties should feel free to push back as they wish because it is a late request and one which is made purely to enable us to write a better judgment at the end of the day.

So with that health warning about what we send out, we will send it out this evening. I do not think it would be appropriate to invite you to push back on that until you have seen the document.

So we will say 10.30 tomorrow morning. Thank you all very much.

(4.18 pm)

(The hearing was adjourned until 10.30 am,
Friday, 8 March 2024)