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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

Monday, 11 March 2024

(10.00 am)

MR NEIL DRYDEN (continued)

Cross-examination by MS TOLANEY (continued)

THE PRESIDENT: Ms Tolaney, good morning.

MS TOLANEY: Good morning.

THE PRESIDENT: Mr Dryden, good morning.

A. Good morning.

MS TOLANEY: Good morning, Mr Dryden.

A. Good morning.

Q. I wanted to ask you some questions about commercial cards this morning, please, and again we are concerned with the extent to which there would have been switching to alternative payment cards in the counterfactual, where Mastercard and Visa's commercial card MIFs were zero.

A. I understand.

Q. Thank you.

So can we look together at the witness statement of Ms Suttle, please, which is {RC-F3/4/17}. If you could read paragraph 38 to yourself, please. (Pause)

A. Yes.

Q. If we could then go down to paragraph 41, please, and you can see there that Ms Suttle sets out the interchange fee revenue for Mastercard's five biggest issuing banks. They are confidential figures so please do not read them out, if we go over the page, please, to the table. {RC-F3/4/18}

A. Yes.

Q. We can see they are substantial figures in the totals?

A. Yes.

Q. You see that?

A. Yes.

Q. The sophisticated card features and benefits offered to commercial customers have to be funded by issuing banks, do they not?

A. If they are going to be profitably provided, then total revenues have to exceed total costs of providing those features and all the other features of the commercial card.

Q. I think we can agree that MIF income is important to funding those features and cardholder benefits, can we not?

A. I do not think that is demonstrated by this table in itself because it just deals with the MIF income, it does not deal with other sources of income but I would not dispute the fact that MIF income is in the factual an important element of the income streams to an issuer.

Q. I think you accepted in general terms that MIF income is important in your first report at paragraph 510(b)?

A. Yes, I think I have just said the same thing.

Q. Right. We have seen the figures -- we have them on screen -- in Ms Suttle's witness statement calculating total commercial card MIF income for the UK's five largest commercial issuers in the UK in 2021 to mid-October in 2023; you see that?

A. I do.

Q. You would accept that to the extent that issuers pass on the benefit of MIFs to cardholders, for example in the form of reduced card fees, that MIFs may increase take-up and use of payment cards?

A. Yes.

Q. Ms Suttle also explains, if we have a look at paragraph 43, please, that it would not be commercially viable -- can you see that in the first line -- for issuers to try to make up for lost MIF revenues by imposing additional fees on their corporate clients?

A. I see that.

Q. That is because there is no real prospect of issuing banks increasing cardholder fees to make up for lost MIF revenue without impacting the attractiveness of the card offering?

A. Yes, I think that depends on the competition faced by the issuer in the issuing market, rather necessarily than customer willingness to pay.

Q. But the higher the cardholder fees, the less likely commercial customers are to want those cards?

A. That is true, I am disentangling two things: one is the effect that has on substitution to another issuer; the other is even if there was not another issuer, just the -- whether the customer of a commercial card has willingness to pay at a higher price and those two things it is worthwhile to disentangle.

Q. I agree, but at the moment I was focusing on the second question which I think you agree with which is the higher the cardholder fees, the less likely commercial customers are going to want those cards?

A. Yes, but if we are focusing on the second it is not clear to me the amount would be highly elastic. If commercial cards are attractive to customers then -- and we are setting aside any competitive offering, it is a little bit like doing a SSNIP test and I expect that customers would be willing to pay a bit more.

Q. But not if somebody else offered a better deal is what you seem to be saying?

A. That is back to the first point.

Q. Yes.

A. Maybe not if someone is offering a better deal but then one would need to look at the characteristics of that other deal.

Q. Correct.

Now, we also know that most commercial cards are either charge cards which are cards, the balance of which is paid off each month or are operated in that way?

A. Yes, I certainly understand the balance is paid off. They are not like a consumer credit card where balances get carried forward.

Q. That means interest on unpaid balances is not a significant source of income for issuers on commercial cards?

A. That would follow. May I just go back to one point relating to one of the first paragraphs we looked at which was the statement that the commercial card is a much more complex offer and has more features, and etc.

I think there was evidence at an earlier stage distinguishing sort of the large business customer and the small business customer, I cannot remember the example, it may have been a hairdresser, where the extent of the additional complexity is different between those two cases.

Q. Well, it may be, but we are just focusing generically on commercial cards at the moment. If we go back it was paragraph 38 of Ms Suttle's statement, I think you had in mind.

A. Yes -- sorry, my point is I am not sure you can focus generically because the point that was made at an earlier stage was that there is a difference between different segments of the commercial card market, certainly in the segment of larger corporates there seemed to be more additional features, I think the point was made by a factual witness, if I am not mistaken, that more in the SME segment of the market, there may not be so many of these additional features.

Q. We will come on to any arguments about the case, Mr Dryden, but at the moment the comparison in paragraph 38 with Ms Suttle is between commercial cards and consumer cards. There may be a distinction within commercial cards but at the moment the only thing that she is doing is comparing commercial cards saying they have sophisticated and complex product features, more so than consumer cards and I think you would agree with that?

A. Yes, I am sorry to --

Q. You are answering a different question that has not been put to you yet; that is the only question at the moment.

A. No, I think what I said is relevant. The -- at an earlier stage a factual witness distinguished commercial card segments, some of which this comparison is correct but for others of which this comparison is, is much less stark.

Q. But it is still correct, it is just there may be degrees?

A. I am not sure if I can be any clearer, sorry.

Q. Okay well, I think what would be really helpful, Mr Dryden, is to answer my questions on the topic. I know you want to put forward the case for the Claimants but I will be coming on to segments, but if we start arguing the case at every question, we are going to be a long time.

THE PRESIDENT: Well, yes, Ms Tolaney, but I think he is not unequivocally accepting what you are putting to him and is qualifying the answer he is giving; so he is saying he agrees, but up to a point.

MS TOLANEY: Yes, well, I think -- sir, I understand that, but I think the proposition I was putting was simply that commercial cards are more sophisticated than consumer cards, to which the answer is yes, but it may be a question of degree.

THE PRESIDENT: I think the answer is yes, but there may be some exceptions to that.

MS TOLANEY: Or it may be a question of degree because I think --

THE PRESIDENT: It may be and how the hairdresser differentiates from the --

MS TOLANEY: Exactly, it is a different question.

THE PRESIDENT: Well, let us put it this way, I do not think Mr Dryden is arguing the case. I think he is trying to qualify his answer.

MS TOLANEY: Okay.

THE PRESIDENT: I think that is appropriate.

MS TOLANEY: Can we move on then, please, to Amex. So it is likely that the changes issuers would have to make in order to recover lost MIF income would result in commercial cards switching to other cards such as Amex if a competitive offering was put forward.

A. I am sorry, could you repeat that?

Q. It is likely that the changes issuers would have to make in order to recover lost MIF revenue would result in commercial cardholders switching to other cards such as Amex if they put forward a competitive offering?

A. Yes. I would expect some degree of response by the issuer in their card offer and I would expect some degree of switching to Amex in response to that change.

Q. Now, Amex is a substantial competitor in the commercial cards market, is it not?

A. In some segments and not in others.

Q. So let us look at that. If we go to paragraph 26 of Ms Suttle's witness statement, {RC-F3/4/11}, we will see the figures in the table there. I do not know if we can make that bigger, thank you. These are confidential figures again so we are going to have to navigate that.

What we can see here is fairly substantial market shares for Amex in many of the categories, I accept not all. So take, for example, the figures for the segment which is fourth from the top?

A. Yes, I think I can read out the row titles, the "Large market -- T&E".

Q. Quite striking figures for the segment which is last but one?

A. "Small business -- credit", I see those.

Q. So we can see that based on this table, accepting at the moment in the competitive landscape that there is and I will come on to that, but even at the moment Amex has more than a good foothold in commercial cards?

A. Yes, it has a significant presence in some segments and it is absent from the bottom segment.

Q. Now, the table shows quite a lot of movement in market shares from year to year, does it not?

A. Yes, there is a reasonable degree of fluctuation.

Q. You can see that if you look at the

commercial total there are often substantial changes from year to year?

A. Yes.

Q. What we can see is that there are pretty big swings going on which means that card schemes gain or lose market share pretty rapidly?

A. Yes.

Q. The reason for that is issuers or large commercial customers switching between different schemes?

A. Most likely it is due to switching.

Q. Now, can we have a look at paragraphs 27-29 of this statement, please, at page 12. {RC-F3/4/12}

A. It could also be due to sort of entry or exit of merchants from those segments but switching is going to be part -- a large part of it, I think.

Q. Could you read paragraphs 27-29 of her statement to yourself where she explains how competition works in practice. (Pause)

A. Yes.

Q. So Ms Suttle is explaining there how Amex competes with issuing banks for the business of corporates and the public sector; you see that?

A. Yes.

Q. What we can see is that Amex has a strong presence in the commercial cards market and competes with the same customers as Mastercard and Visa's issuing banks?

A. In some segments but not in others.

Q. So at least taking those segments at the moment, Amex presents a competitive threat for Mastercard and Visa?

A. I agree.

Q. Now, in a market in which Mastercard and Visa were not able to offer interchange fees at all, Amex would have had the ability to offer issuers continued revenues in order to persuade them to switch?

A. If it is offering the -- I have forgotten its name -- GNS.

Q. Yes, the 3.5 party model?

A. Yes. If it were offering that model then it would be able to use its implicit interchange fee as part of the process of attracting issuers.

Q. Indeed, although Amex rolled out the 3.5 party model -- its GNS scheme, as you have just referenced -- to consumer cards in the UK, there was nothing to prevent Amex from rolling out that scheme for commercial cards, if competitive conditions had

justified it?
A. Yes, I think that is true by definition. What its threshold point for doing so is, I do not know. But clearly if it is -- if it is justified, it is justified.
Q. Now, business customers choose the issuer, i.e. not the individual cardholder employees?
A. Correct, that is my understanding.
Q. So Google wants its employees to have commercial cards, Google will choose the issuer, not every individual employee of Google?
A. That is correct, that is my understanding.
Q. A single corporate may require hundreds or thousands of cards?
A. That is my understanding.
Q. So switching by a large business can result in a lot of transaction volume moving between issuers or moving to, here Amex, in one go?
A. That is correct.
Q. That is how market share can be lost or gained quite quickly?
A. Yes. That is the -- that is the process by which it is lost or gained.
Q. I think you mentioned other circumstances. Big corporate customers might be expected to monitor

the market and respond quickly to changes in the quality of the product being offered by different schemes; and that is also fair?

A. I imagine so.

Q. The bulk of corporate transactions do not in fact take place on payment cards at all, but rather through electronic funds transfers or cash or cheque?

A. That is my understanding.

Q. Can we have a look at Ms Suttle's witness statement at paragraph 20, which is on page 8, please, {RC-F3/4/8} so you see the figures there and you can see that EFT was the most common method for commercial spending overall?

A. Yes.

Q. Then cash and cheque?

A. Yes.

Q. With card transactions only third most common?

A. Yes.

Q. So I think we can see from this that there are obvious alternatives to businesses using card transactions?

A. There are definitely alternatives. What is less clear to me from this is whether I mean --

sorry, let me start again. There are clearly alternatives. This -- there is -- I have not -- yes, there is an issue with this kind of analysis which is I think it is the universe -- it may be the universe of spending, so it may include things for which card would never be a sensible alternative and vice versa. It may include things for which these alternatives are a poor substitute. I am less familiar with this, there is an analogous table I think either for all businesses irrespective of size or large merchants only. I think it was Mr Holt made the point about that table, that in the equivalent segment for EFT or something like that, it would include the airline purchasing the fuel for its plane or maybe even the airline purchasing the plane, I am not sure, and that is probably not something that would ever be done on a commercial card.

So there is a question about the denominator here but I do not disagree with the proposition that some of these things will be alternatives for card in some types -- for some types of transaction.

Q. So I fully accept, it is a fair point, Mr Dryden, that it may be this reflects that cards are not seen as the obvious payment method for certain purchases but I think what we can see, given the existence of these alternatives, is that unless using a commercial card has some benefit to the cardholder or business over and above these methods that they commonly use, the use of the card will become less and less?

A. That is true, card has to offer some value add to be used -- from a customer point of view to be used.

Q. So standing back, I think we can agree therefore on four things: first of all, that MIF revenue is a key revenue stream for issuers; is that correct?

A. I think in the factual it is an important revenue stream -- likely to be an important revenue stream for issuers.

Q. Secondly, that Amex is a threat to issuers and the card schemes at least in certain commercial sectors?

A. I agree with that.

Q. Thirdly, that customer switching can and does take place leading to big swings in market shares?

A. In those -- in those ...

Q. Sectors?
A. Sectors, yes.
Q. Fourth, that issuers and schemes are not just competing amongst each other, but also competing with other payment methods such as cash and electronic funds transfer?
A. Yes, there is going to be a degree of substitutability there.
Q. If issuers lost therefore the substantial revenues they receive from commercial card MIFs, there is a real chance that they would be unable or unwilling to issue commercial cards with the same level of functionality?
A. Yes, I think I have already said that without the MIF income, you would expect some sort of issuer reaction in terms of PQRS on the -- in relation to the card offer.
Q. Given the kind of competitive conditions in the commercial card market we have seen described by Ms Suttle, the result may well be substantial cardholders switching away from Mastercard and Visa?
A. There may be significant switching. I do not -- I do not disagree with that. What my report does is distinguish the segments because I think that becomes quite important.

Q. We will come on to that. I appreciate that.

I am moving on to more specifics on the statements now, Mr Dryden. I just wanted to raise with the Tribunal that I will be looking at a lot of confidential figures within the questions I am posing. I think I can navigate round it but there may come a point where it becomes tricky and I just wanted to flag that now.

THE PRESIDENT: That is very helpful, Ms Tolaney.

Mr Dryden, the real question is whether you feel that you can appropriately answer counsel's questions doing justice to the evidence you want to give. Ms Tolaney will say if she finds her style cramped, similarly, if you do let us know and we will take steps. I would much rather this was in public, but not at the price of unfocused questions or unfocused answers.

A. I will do that.

THE PRESIDENT: Thank you.

MS TOLANEY: I think to be fair to Mr Dryden I can probably navigate it because I can point to a box; it may just be tricky for him because he may wish to say "look at that percentage or that percentage", so it is not going to be very long, I do not know whether you want to see how we go or --

THE PRESIDENT: Let us see how we go, but I am quite sure that if -- well, I am sure we can all tell whether the answers are unsatisfactory for reasons that are only to do with the confidential information.

MS TOLANEY: Thank you.

Could we have a look at your second report, please, {RC-H2/2/46}. We are looking at paragraph 8.43(c). Obviously there is the confidential material that we have just mentioned within that. If we read the paragraph, what we see is a reference to Mr Holt claiming that Amex has many of the necessary factors to succeed in the commercial card segment and you say fairly: I agree.

A. Mm-hm.

Q. "... it has some measure of success in the commercial cards segments but for the purposes of this assessment the relevant questions are (1) how Amex would adjust its equivalent charge ... and how much switching that would induce."

Do you see that?

A. Yes.

Q. So we can see that. You do not disagree, as you have said already, that Amex is a threat in the market in certain sectors thereof, but you say the focus should be then on what would then happen essentially?

A. That is correct.

Q. Now, before I come on to what would then happen which I am going to explore with you, can I first ask you some questions about market share. So we have a look at your first report now at {RC-H2/1/227} and we are looking at paragraphs 104 and 105?

A. Yes.

Q. If you can refresh yourself and I will let the Tribunal read those as well. (Pause)

So at paragraph D.104a, you estimate the level to which Amex's market share would need, you think, to increase for the market-wide --

A. Yes.

Q. MSC to go up in the counterfactual assuming Amex's Merchant Service Charge stayed the same?

A. Yes.

Q. We see that figure, if you could, if
the Tribunal could just note that figure at the end
of paragraph D.104a.

Now, if we could just say by
comparison, Mr Holt has done some calculations too.
So if we could just have a look at {RC-H4/4/111},
and if you could see there is the -- in the table
there is the percentage point change in Amex's
market share as the first -- at the end of the first
counterfactual. Have you got that, I will not say
the figure, it is obvious for the Tribunal to see.

Can you see that?

Can you see -- are you struggling,
Mr Dryden?

A. Slightly, I am just --

Q. Can you see on the left there is PSR in
red?

A. Yes.

Q. So just read across there and drop down
a bit you see "Percentage point change in Amex's
market share" and then to the right do you see the
figure?

A. Yes. Yes.

Q. That is in the same, I think,
counterfactual as yours which you see from the

header, "Counterfactual A"?

A. Yes.

Q. Then if you drop down to counterfactual B?

A. Yes.

Q. That is showing if there is a change in Amex's Merchant Service Charge itself and again you see the percentage point change at the bottom. Can you see that?

A. Yes.

Q. Thank you. So we see what both of you at the moment say the change in Amex's share would need to be in order to effect the Merchant Service Charge.

Now, could we then go, please, to Ms Suttle's table, which you have set out actually in your own report so it is {RC-H2/1/224}. Thank you. So this is helpfully a little bit bigger?

A. Sorry, the reason I was slightly hesitating is I am worried that we are comparing apples and oranges and it was just taking me a few minutes to figure out if that is the case, so with apologies could we go back to where you were looking at my report.

Q. Yes, we can. So I understood that Mr Holt's first figure was the same comparison as yours?

A. Yes.

Q. But if that is wrong, then you must say.

A. Yes.

Q. So it is -- it was D.104a, which is {RC-H2/1/227}.

A. So the number, Ms Tolaney, that you are asking the Tribunal to fix on here was which one?

Q. It was the one at the end of (a), so that is where everything is maintained the same and that is the market share and Mr Holt gives a different figure to you on the same hypothesis, I think?

A. Right, and the number right at the end of (a) with the percentage or the ...

Q. What was that, sorry?

A. So (a) says -- and I will not give numbers -- transactions must increase by over X percentage points.

Q. Yes.

A. From ...

Q. X to Y?

A. Well, must increase by over X percentage points from Y to Z so are we focusing on the X or the Z, the first number or the last number?

Q. We are focusing on the last number.

A. Okay, so the last number?
Q. Yes.
A. Then if we go to Mr Holt's table.
Q. Exactly, is {RC-H4/4/111}.
A. So the comparison to the last number?
Q. Right, so you are saying it is the percentage point to change, so it should be the comparison between what you had said was X and rather than --
A. Well, if we are sticking to the last number, if we are sticking to the last number from my report and we are looking for Mr Holt's version of the last number, we should be looking at the -- if you go again to PSR and look to the non-bold row --
Q. Yes.
A. -- above that, it says new transactions shares.
Q. Yes.
A. Look at the middle number, I think that is the comparison.
Q. So the -- if I said the one beginning not in bold?
A. Yes, that, that number.
Q. Right.

A. In the "New transaction shares" row the middle number in the Amex column, that is the comparator number to the last number --
Q. Right.
A. -- in subparagraph (a) of my report.
Q. So it is about 10 apart you would say?
A. About 10 percentage points apart.
Q. That is good to know.
In fact, it does not really matter, I am just simply contextualising this because the questions I am going to put do not matter, but in fact that does not matter on this but I want to just show you where you are before I come on.
The questions, it does not matter to this. Sorry.
Right. So can we go back to your table in your report, which is {RC-H2/1/224}.
A. Yes.
Q. So even taking your higher figure is going to be my point, what we can see here is that in at least one segment, Amex has in fact achieved that market share or higher in the past and you can see that from the last but third row on the bottom.
A. Yes, I see that.
Q. Yes. So we can see that even in a world

where Mastercard and Visa were setting MIFs in order to compete with Amex, Amex has already achieved that market share in at least one segment?

A. That is correct.

Q. So what that would suggest is Amex has a level of acceptance which is acceptable to business customers even in the current climate?

A. For the credit.

Q. For that sector, let us say?

A. For that sector.

Q. Now --

A. The level of acceptance they need for credit may be different to the level of acceptance they need for debit.

Q. So the question then is to think about what would happen in the counterfactual world where Mastercard and Visa are not essentially competitive in the way they currently are. So if we could have a look back at your report at {RC-H2/1/227}?

A. Yes.

Q. It is paragraph D.105.

A. Yes.

Q. Now, if you could just read that to yourself, please. (Pause)

A. Yes.

Q. So you are making the point here which I think you have made orally as well, that there are some segments in which Amex does not compete and you suggest that it is -- that makes it unlikely that Amex could increase its market share in the counterfactual?

A. Yes. So what I am saying there is that the -- and this is assuming no Amex reaction on the MSC which is I think highly conservative, I mean, really very conservative so one would need to come back to that, but assuming no Amex reaction on the MSC, this is saying that just arithmetically, in order for the overall weighted average MSC to be higher in the counterfactual than the factual, Amex is going to need to enter into that segment where it is not currently present at its factual level of MSCs.

Q. Yes. So can we go back to the table at {RC-H2/1/224}, again the table in your report that we were looking at?

A. Yes.

Q. So the final two rows of this table, so that is dealing with the last segment in which Amex is not present, that is the point you are making, I think, in the paragraph we had just looked at, for example?

A. That is right and this is quite a -- this is not the easiest table. The italicised rows are the most disaggregated level of analysis, but then it gets aggregated up, so then the small debit get rolled up to small, reading from the bottom, in the large T&E and the large -- in the large B2B get rolled up to large and then everything gets rolled up to commercial at the top and the percentages in each block are the shares of Mastercard, Visa, Amex and Discover.

Q. Yes. Just look at the last row, so the last two rows in that category.

A. So "Small business debit prepaid"?

Q. Yes.

A. Yes.

Q. So what we can see is that Mastercard experienced a dramatic change in market share in the period in question?

A. Yes.

Q. So looking at that precedent, there is nothing stopping another scheme like Amex from entering the segment and doing the same when you see how rapid the gain was for Mastercard?

A. Well, I -- the competition between Visa and Mastercard is between two schemes that have nearly universal acceptance, so the fluctuations as between them are not necessarily a good guide to the fluctuations between them and Amex because this is a small business debit card, where universal acceptance may be an important card attribute.

Q. But what we can see here is that one scheme that did not have a presence, acquired a presence quite dramatically?

A. Yes, and that is a scheme that has universal acceptance.

Q. Putting the acceptance on one side, because we will have to deal with that, you can see that if you entered -- assuming one could enter the segment, the market share can switch, that is what we can see?

A. Yes, I think acceptance is key but if you -- it is obviously true on the face of it that -- that Mastercard has expanded significantly.

Q. So can we look then at {RC-H3/3/72}, please. This is Dr Niels' second report and he precedes in these paragraphs, so it is paragraphs 5.30, so if we go down, sorry, 5.30 to 5.32 to proceed on the premise of accepting your point about the segment we were just looking at and addressing the significance of that for Mastercard specifically in the counterfactual; so could I ask you to read those paragraphs and let me know when you have read them, thank you.

A. 5.31 and 5.32?

Q. 5.30 to 5.32.

A. Could we go back. Thank you. Thank you.

(Pause)

Yes.

Q. So what you see is Dr Niels making the point that Mastercard's presence has been historically limited in the relevant sector, commercial debit card transactions?

A. Yes.

Q. That for a significant part of the claim period from 2007, most of Mastercard's commercial card transactions were credit card transactions?

A. Yes.

Q. For which Mastercard competes closely with Amex and on that basis you see Dr Niels saying that significant switching from Mastercard would have occurred to Amex in the counterfactual?

A. In credit?

Q. In debit, in that category, yes,

commercial debit card?

A. Sorry, I am reading it differently.

Q. Sorry, you say how you are reading it?

A. So the second half of 5.31 or even the last sentence of 5.31: in particular I would expect substantial switching to Amex for commercial --

Q. Sorry, yes.

A. -- credit card transactions but not for debit card transactions.

That is precisely my scenario. Those debit card transactions account for a -- if we just turn back to 5.30, that green there is the share of the commercial card market that they account for.

Q. In 5.29?

A. I am sorry, at the end of 5.29. That is what does not jump out. I was going to go on and make this point with the market share table, that it gives the shares by segment of the players. What it does not, what does not jump out from that table, is the share of each segment of the whole commercial card market and, and the share of small business debit of the whole commercial card market is that number in green at 5.29, and in 5.31 Dr Niels is saying the same thing as I am.

Q. But what he is saying is that there has been a dramatic increase and he does not accept that Amex could not come in to compete with Mastercard as he explains and I think where you differ is that you suggest that Amex could not come in to compete?

A. I am sorry, where is he saying this?

Q. At paragraph 5.32.

A. Yes, but that is no -- that is not saying what counsel has just said it says. It is not saying -- it is not Dr Niels commenting on Amex entering into debit.

Q. No, what he is saying is that they would have lost all their commercial credit transactions. I am trying to do this without reading out figures.

A. He is not saying that either, he is not saying it would have all switched. He is saying at the end significant switching to Amex would have occurred in the counterfactual in the credit segment.

Q. Yes, that is what he is saying, that what you can see from the way in which it has gone in one category would show you the way it might go in another?

A. He is not saying that.

Q. Okay. We can agree though, can we not, Mr Dryden, that the commercial card market seems to be a market in which dramatic changes in market share can be achieved in relatively short spaces of time?

A. Significant switching can happen within segments within relatively short periods of time.

Q. The switching would be happening in a situation where Mastercard and Visa cannot offer issuers MIF revenue?

A. Yes, clearly all this counterfactual switching to the extent it occurs in particular segments is by definition the result of the change in interchange fees from Mastercard and Visa in the counterfactual.

Q. We know that that MIF revenue is being used to fund costs associated with issuing commercial cards including fraud, interest free period and cardholder benefits?

A. I prefer to think of the interchange fee revenue as being a revenue stream that the scheme gets from every commercial card transaction and that is going to affect its profit maximising PQRS offer, so in that sense you could say that it is funding the PQRS offer.

Q. In the counterfactual, Mastercard and Visa would not be able to offer that MIF income and issuers would have to recover the revenue from somewhere else?

A. Well, they would have to -- they would have to -- again I do not quite like to think of it that way. They would have to re-optimise due to the absence of that income and that could be issuers -- that could be issuers -- for example, that could be issuers increasing fees or reducing aspects of QRS.

Q. But they would have to make their cardholder offering less attractive?

A. I think as I have -- my report indicates it is likely that in the absence of the MIF income the Visa and Mastercard commercial card offer would become somewhat -- somewhat less attractive.

Q. That must put Amex in a stronger position to take market share in a market in which Mastercard and Visa are unable to provide MIF income to issuers?

A. Yes. But I do not think there is any -- I mean, two points. One is, as I have explained a few times already, there is the -- the level at which the PQRS offer is set in the factual is related to how much can be extracted on the merchant side and I will not repeat all of those arguments. It is not really in dispute because it is a feature of my report that in the counterfactual there will be some switching to Amex, the question is -- and I think we saw this when we looked at a paragraph of mine before -- how much switching? Also which we have not got on to yet, the MSC reaction of Amex.

Q. But I think the point is if Amex could reach and maintain a strong foothold in a segment in circumstances where Mastercard and Visa had a competitive offering, as we have seen from your table, Ms Suttle's table, that shows that if Mastercard and Visa were suddenly unable to compete it is likely that Amex would be able to achieve the levels of market share that you say are required for market-wide MSC to increase?

A. In a different segment in which they are not present or in one of the segments -- ?

Q. Start first with the segments in which they are present.

A. Yes, but the percentage that I say they need is overall it is not segment by segment. The segments that they are already in, I agree that they would likely get a -- I think they would get a higher share of that segment. How much higher is a question but I -- they would not have a lower share; I think they would have a higher share of the segments they are present in.

Q. So I think your answer is yes, they would get a higher market share of the segments they are already in but not necessarily in segments in which they are not in; is that your answer?

A. I think that is correct.

Q. But we cannot assume, can we, that in different market conditions there would necessarily be the same split between the segments and the different types of credit charge and debit cards, can we?

A. No, I do not think it is a -- I do not think it is a matter of -- you know, I do not think it can be assumed axiomatically that if they are out in the actual, they will out in the counterfactual.

Q. So if the best offering in the market was a charge or credit card from Amex the market might move to having higher proportions of credit and charge cards?

A. Yes. I mean, I think that is sort of true by definition if they have the best offer then the market will move to them. The question is whether they can and would choose to make the best offer.

Q. So can we move now, and I may come back to it in a moment, from the issuer cardholder side to consider the other side, which is the acquirer and merchants. You suggest that Amex would reduce the fees it charges merchants in the counterfactual in order to remain competitive?

A. I think it is likely that they would reduce to some degree.

Q. You make this point, just to be clear, in relation to both interregional and commercial cards?

A. Yes.

Q. Now, the question is, is it not --

A. Sorry, there is a very slight correction there. It is not entirely about them remaining competitive it is also about them becoming competitive and that is -- that is a really key point because if they are going to enter into this SME debit card segment that they are absent from at the moment, that is more than half of a commercial card market, the question is: what is the MSC that would allow them to penetrate that segment that they are not in now?

So it is -- remain obviously does not make sense for that segment because -- remain competitive does not make sense for that segment because they are not in that segment.

Q. Just pausing there. That suggests you accept there are steps that Amex could take to enter into that segment, correct?

A. Well, the -- I mean, clearly there are steps Amex could take to enter anything.

Q. I think you were just saying that the reason you suggest that there would have to be a reduction in Amex's MSCs is so that they could compete in the segment that they are not currently competing in which suggests you think there is a way in which they could enter that segment?

A. Yes. Well, in order to enter the segment that they are not present in, they are going to have to make a sufficiently attractive offer and there is at least two important elements to that. One is the MSC cannot be too high and in my report I have said that is a key point, I have tried to be precise about that.

The other which I am -- I think could be important but I do not as far as I know think there is much evidence about is that a greater level of acceptance may be necessary in order to have an attractive offer for this SME debit segment.

Q. Can we just go back to the table at {RC-H2/1/224}.

So I just want to go back to that

just because of what you said here. I think, as I understand your evidence, it is that it would be possible for Amex in the counterfactual to come into the last segment in which it is not present assuming it modified its offering to be competitive which would obviously lead to the higher acceptance rate as well?

A. Yes, that is true by definition.

Q. Right.

A. I mean, it is not a very sensible proposition of anybody to say anything is impossible.

Q. No.

A. I mean, it is possible, the question is what are the conditions under which it can occur and then what does that imply for the overall counterfactual MSC paid by merchants.

Q. Right. The only reason I am pressing this, Mr Dryden, is because I think it is important to understand your evidence on this, that it is not just possible, I think you are positing it as that is one of the reasons why you suggest Amex would have to reduce its MSC, so you are actually positively putting it forward as a counterfactual?

A. Yes, I am saying if Amex does not reduce its MSC, then in order for the weighted average MSC of all merchants to be higher in the counterfactual, it is going to have to -- arithmetically it is going to have to enter this segment that it is not in now and I cannot see how it can enter into the segment that it is not in now at its current level of MSC because that has already been rejected by merchants aside from the fact they do not offer universal acceptance which may be important for this segment. If Amex drops its MSC enough and then subject to how important universal acceptance is, it may be possible to enter into this segment, but if it is entering into the segment only in circumstances where it has dropped its MSC in order to get in, the chances of the counterfactual MSC being higher become much less and I think it is -- that is therefore my conclusion, that however you look at it, the counterfactual MSC is unlikely to be higher.

Q. The second point though, to clear up, is that your market share percentage is an overall figure, you say?

A. Correct.

Q. So it does not have to be the market share in this category, it has to be overall?

A. No, it does. The reason for that is

arithmetically in order to get the counterfactual MSC -- arithmetically, in a world in which Amex is not reducing its MSC, in order for the counterfactual MSC to be higher, Amex would have to monopolise every single segment other than the last one. So we would have to reach 100% market share of every single one of all the segments apart from the last one and it would still also need to have some share of the last one. So that is -- that is -- you know, that is the point, it is complete monopolisation of everything and getting a bit of the last -- and getting a bit of the last segment.

Q. But the points are, Mr Dryden, first of all, that you might get a market in which there is a huge switch to credit rather than debit cards, might you not, in the counterfactual?

A. You might.

Q. Secondly, you could have a situation in which Amex offered a hypothetically lower MSC on debit cards but not on any other card?

A. That is possible.

Q. Thirdly, you could have a situation in which or rather you would not have a situation I should say in which merchants would accept Amex credit but not debit cards, would you?

A. Could you repeat the last one, sorry?

Q. You would not have a situation in which merchants accepted Amex credit cards but not debit cards, would you?

A. I do not think so. But I think it could matter for the small business more that you have universal acceptance I think it could matter more for the small business that you have universal acceptance for debit than for credit because for credit they are more likely to have a -- they are more likely to have a back-up payment instrument. I think for debit, it might be their main one.

Q. Now, can we just agree on MSCs three points of context on this issue before coming to the sort of heart of the differences between you and Dr Niels and Mr Holt.

The first point I think you will agree is that Amex would only be willing to reduce its fees if that proved necessary to grow or retain profitable volumes?

A. I think that is right.

Q. Otherwise, Amex has quite strong incentives to keep its fees high?

A. Exactly, otherwise it is a sacrifice for no -- for no gain.

Q. Higher MSCs provide Amex with revenues which it can use to attract customers and which generate Amex's profits?

A. Yes.

Q. Now, focusing on volumes of transactions, Amex would be incentivised to reduce MSCs only if the obvious disadvantages of doing so from its perspective, in terms of its reduced ability to attract business and lower profit, were outweighed by benefits on the acquirer and merchant side?

A. I am sorry, could you repeat that?

Q. Focusing on the volumes of transactions. Amex would only be incentivised to reduce its service charge, Merchant Service Charge, only if the disadvantage of doing that, i.e. that it could not attract business and had made a lower profit, if that was outweighed by the benefits on the acquirer merchant side?

A. Do you mean outweighed by the benefits on the ...

Q. Am I confusing --

A. No, let me check. No, I am sorry, you are quite right.

Reducing -- they are reducing the MSC as disadvantageous on the issuing side because less implicit MIF is flowing across, so there has to be a reason to do it and that has to be a benefit on the acquiring merchant side, exactly as you say.

Q. Now, Amex markets itself as a premium card offering does it not?

A. It does.

Q. Amex's Merchant Service Charges go to funding the cardholder benefits to make it a premium offering?

A. That is correct.

Q. So I think we can agree that Amex would be pretty reluctant to decrease its fees to such an extent that it could no longer offer a premium cardholder offering?

A. Well, I think Amex has got a choice, it can -- it can keep its MSCs at the level that it is and continue to offer a premium card holding or it can drop its MSC significantly and no longer be premium and be more like a generalist.

Q. But I think we can agree that Amex is unlikely to have wanted to reduce its fees so much it could have negative effects for its brand image?

A. Well, I mean, I have not gone that far in my report but if that -- if that is true it makes my conclusion in my report much stronger because if

Amex -- if counsel's proposition is that we can agree that Amex is never going to deviate from its premium MSCs, then I cannot see how it is going to penetrate the small business debit segment that it needs to penetrate in order for the counterfactual MSCs to be higher. In other words, and this is the main point I make in my report, which is Visa and Mastercard are generalists, Amex is a specialist.

Amex sets specialist or premium MSCs which are higher. What does not make any economic sense to me is that a premium player can displace a generalist player at premium prices. It does make sense to me that a premium player can displace a generalist player by dropping down to generalist prices. But it does not make sense that it monopolises the market at its premium prices.

Q. I think your point on the generalist/specialist is that Amex's cardholder base is of greater value to merchants than Mastercard's and Visa's because Amex generates greater incremental sales compared to Visa and Mastercard per customer?

A. No. As I say, the key issue I have in the commercial card analysis is not on the issuing side, it is on the acquiring side of the market. The issue there is in this small SME debit segment that is -- we saw the percentage of the market that it is, in that segment, we know that the dynamics of competition in the factual are that Visa and Mastercard have pushed the MSC up to the maximum willingness to pay of those merchants because that is the dynamic of competition between Visa and Mastercard we have discussed a few times. They are pushing up to the maximum willingness to pay of the SME debit businesses in order that Mastercard and Visa can compete with each other as effectively as they can on the issuing side.

So you have in the factual a sort of revealed willingness to pay of the -- of that segment of the market in terms of maximum MSC, if they were willing to pay more, Visa and Mastercard would have pushed it higher.

So what you cannot have in the counterfactual is that the generalist who has kind of revealed the maximum willingness to pay is displaced by the premium offer at a higher -- at an MSC that we know is more than the willingness to pay of those merchants.

Q. But by "generalist" and "specialist", what you mean is Mastercard and Visa have an offering that goes to a more general market, whereas Amex customers tend to be more affluent cardholders who are likely to spend more money; is that right?

A. It is partly that but it is also on the acquiring side. Visa and Mastercard have near universal acceptance and Amex does not. So Visa and Mastercard are pushing their MSCs on the acquiring side to where they judge is the maximum extent consistent with still being essentially universally accepted. Amex is pushing its MSCs beyond that point at the -- at the cost of general acceptance so they have incomplete acceptance, but consistent with the premium offer that does not depend for some segments on being universally accepted.

Q. But if Mastercard and Visa's market shares in the commercial card markets which is a sophisticated market, had significantly reduced in the counterfactual, then Amex may be able to offer its premium product more widely?

A. Not at MSCs that are more than the revealed maximum willingness to pay of certain merchant segments.

Q. But when you say that the reveal has been more than willing than certain merchants are willing to pay in certain segments, that is in the current market, where there is a competitive offering of Mastercard and Visa that is better. In the counterfactual, there would not be that alternative offering?

A. Understood, their willingness to pay -- willingness to pay is not a function of the competitiveness of the market. Willingness to pay is a fundamental, it is an intrinsic characteristic essentially of the merchants.

Q. But as you said right at the outset I think in -- you pulled me up on my questioning, you cannot look at the charges in isolation of what the alternative in the market, that is what you said at the beginning. If the competitive offering that currently exists of Mastercard and Visa is not there, then that must change the attractiveness of Amex on a wider scale?

A. Not -- no and this is sort of exactly contrary to the thrust of my point on commercial cards. There is a segment of the market, and we have seen how big it is, in which Amex is not present in the factual. The dynamic of competition between Visa and Mastercard is such that they are pushing the MSC as high as they can consistent with still being accepted and actually that MSC is not as high as some other segments because of the nature of the merchants in there, the hairdressers, and etc. But they are pushing up as far as they can obviously because Visa and Mastercard have an incentive to test the maximum willingness to pay because they want to be just at that sort of trigger point in order to get as much across to the issuing side as they can.

That is revealing the maximum willingness to pay of the SME debit segment. What you cannot do in my opinion is have a counterfactual in which Amex gains a share of that segment at an MSC higher than the maximum willingness to pay of the merchants in that segment.

Q. So you are focusing just purely on that one segment though at the moment rather than the whole market?

A. Correct, and that is what my report focuses on because -- because the point is that it -- as I explained earlier even if Amex monopolised every other segment at its factual MSCs, it would need a share of that last segment in order for the counterfactual MSC to be higher and I am saying it cannot get a share of that segment without dropping its MSC.

Q. But I think you have also accepted that we do not know what the division would be between the segments in a counterfactual scenario because there may be far -- it may be a far smaller segment if Amex offered a different offering?

A. Yes. Well, I am not quite sure if I understand that. I mean I -- my assumption would be that if Amex was offering a premium offer into the SME debit segment, it would not get much or any share and a large share would be retained by Visa and Mastercard.

Q. Before I leave this topic, if Amex were to pursue a 3.5 party model targeted at commercial cards, the higher the fees it could charge to merchants, the higher the fees it could pay to issuers, so it would become more attractive to issuers; I think we can agree that?

A. Well, it is not clear, the predicate there or the premise there is that Amex could charge higher fees to merchants in the counterfactual, so are you --

Q. Just assume they can, we would agree that that would make it more attractive to issuers?

A. I mean, it is generally -- I mean, I think it is always true that if a card can, with a big emphasis on "can", increase its MSC on the acquiring side and pass that across, it is going to become more attractive on the issuing side.

Q. I think you have -- you make the point in your own report, that because Amex's cardholders are high value customers, merchants are currently willing to accept Amex at higher rates because they get high value customers in return?

A. That is correct.

Q. So in a world in which Amex was able to increase its market share significantly, and I am talking overall in the sectors, it would become an even more important source of business to merchants, would it not?

A. I think that is -- I may be missing something. That just sounds like it is true by definition.

Q. So surely that would make it much more difficult for merchants to refuse the card, even in different smaller sectors?

A. I am not sure I can add to my previous answer. The -- in this, in the small debit sector where Amex is not currently present, competition between Visa and Mastercard has revealed the maximum willingness to pay of merchants. Even if you erase

Visa and Mastercard from the picture, the willingness to pay there is determined by reference to other payment means, so it is a -- it is a sort of constant in all of this and Amex is not going to be able to charge more than the maximum willingness to pay of that segment.

Q. But you are focusing here, Mr Dryden, on Mastercard has revealed the maximum willingness to pay of merchants but that is in the factual world. In the counterfactual world, things would look very different and my point to you is that once Amex gained a foothold in the sectors that you accept it could do, that might make it very difficult for merchants to maintain a position in other sectors of not accepting Amex because they would not have that luxury of choice.

A. I am not sure how I can answer that other than repeating what I have said already.

Q. Now, I think we have seen in -- I was going back to my context and got rather distracted, in the actual world, and I may be repeating things so I will take this quickly, we have seen that Amex has good acceptance rates in important commercial card sectors such as travel and entertainment.

A. Yes.

Q. It may even have acceptance rates as high as Mastercard and Visa in sectors that are the most important for commercial cards?

A. Well, I am not sure that is necessarily quite right. The SME debit row, the bottom row of the table, we saw how important that is and I do not think it is clear that the acceptance rate of Amex is as high as that of Visa and Mastercard for the purchases that merchants in those segments like the hairdresser want to be making.

Q. But you say in your own report:

"Amex in the factual has an equally high acceptance, as Visa and Mastercard do, which I understand is not the case in general but could be the case for some merchant sectors that are particularly relevant for a type of commercial card."

A. Yes, I think that is consistent with what I have just said.

Q. Yes, that is at paragraph 91 of your first report and I think we have already seen that those acceptance rates have been strong enough for Amex to obtain and retain the market shares we saw in certain segments?

A. Yes, again that is essentially true by definition.

Q. Now, can we look at Mr Holt's reply report, please, at {RC-H4/4/102} and if you could please read -- and the Tribunal as well -- paragraphs 385 to 387. (Pause)

A. Yes.

Q. Do you want to go over the page and then read through to 387, just so you get the whole context. {RC-H4/4/103}. (Pause)

A. Yes.

Q. So Mr Holt makes a fair point that in a two-sided market, one competitor reducing its price on one side of the market does not necessarily generate any pressure for others to follow. Do you see that?

A. Yes, I think it is true that there is -- that it does not follow as a matter of necessity.

Q. Well, competitors might be incentivised to retain or even increase the pricing differential because they want access to users on the other side of the platform?

A. Possibly, but we have to be slightly careful because increasing the differential is consistent with Amex reducing its MSC which is what we have been discussing. So in other words, if the

MIF comes down by 10 and Amex reduces its implicit IF by 5, the differential that Amex has to Visa and Mastercard on the issuing side has increased but at the same time the Amex MSC has reduced.

Q. Well, that is not the point I am putting to you. I am putting to you that Amex might be incentivised actually to retain its charging at the level it is at which increases the differential between it and Mastercard and Visa because it does not need to, on Mr Holt's analysis, follow the pressure to reduce given its different market situation?

A. I mean, that is -- in theory, that is possible. In the diagram that I presented that we saw earlier, I look at everything between Amex not -- not changing its MSC through to Amex reducing its MSC by a corresponding amount to the MIF reduction and I think most likely we are going to be somewhere in between and, I -- and I think in fact that is a general framework which is a little bit abstract.

It does really matter to bring it back to the segments, to the particular market in question and, you know, I reiterate what I said about the commercial market but it then -- one does need to look at the segments and who is present or absent in the factual etc I think to reach the right conclusions.

Q. Could we look at {RC-H4/4/105}, so going back up, please, to page 105. Paragraph 392, Mr Holt has been able to analyse how PayPal responded to Mastercard and Visa's fees reducing after the IFR.

Now, this is in the context of course of consumer Merchant Service Charges but it confirms the general point that one cannot assume that competitors will be pressured to follow a price reduction on one side of a two-sided market?

A. Yes, I think this is a -- well, I -- I have not looked -- I do not think I have looked closely at this, closely at this example. This apparently is an example of indeed PayPal not reacting to a MIF reduction with its -- by reducing its own charges.

Q. Well, in fact, if you look at footnote 513, at the bottom of the page you see PayPal has in fact increased its weighted average fee for merchants in recent years.

A. I see that.

Q. What we can see is that in relation to consumer payments, at least one relatively high cost payment method, PayPal, has concluded that maintaining a high fee differential is not a problem?

A. That apparently follows.

Q. So against that background, can we now move on to look at the scale of the fee reduction that you suggest may occur in the counterfactual and that is addressed back in your first report at paragraph D.104, so that is {RC-H2/2/27}. We have looked at this earlier. We can see the current level of the Amex fee at paragraph D.104a?

A. Yes.

Q. So that is the first figure on line 1 and then we see the figure you suggested Amex would reduce its fee down to in subparagraph (b) and that is the figure on line 2 of (b).

A. No, I do not.

Q. Is it not?

A. Yes, I -- I -- I do not say that. I also realised I said something incorrect earlier, so can I just very quickly deal with that?

I think I was incorrect to say in the no reaction scenario Amex would need to monopolise every segment and get a share of the SMEs -- of the

SME --

Q. Yes, I was coming back to that, Mr Dryden.

A. -- segment yes, I think the correct statement is if it -- if it monopolised everything bar that segment it would just be -- that would just be sufficient and if there is any degree of reaction then it is going to need to get a share of the SME debit segment, so I think I slightly misstated that.

Yes, D.104b is just an "if", it is a hypothetical, it is not a prediction. I think you put it to me as what I said would happen, it is not what I say would happen. It is the other end of the -- it is the other extremity that I consider.

MS TOLANEY: But I think what you say -- sorry, this is maybe where I am going to need to read it out if I am going to --

THE PRESIDENT: Very good. I mean, you want to go into private session?

MS TOLANEY: I think so, would it be worth taking the transcript break?

THE PRESIDENT: I think we will do that and so for the reasons that are obvious we are not going to have effective questioning of the witness and he is not going to be able to give effective answers without us going into private session to enable him to answer questions properly, so we will rise for 10 minutes and Ms Tolaney will be in private session.

MS TOLANEY: Thank you.

(11.26 am)

(A short break)

Hearing in private - redacted

Public hearing recommences

MS TOLANEY: So the point, Mr Dryden, that I am making is that in the situation in Australia, Mastercard and Visa remained able to advance a competitive offering because they were able to issue some other types of cards well above the regulated level.

In the counterfactual, Mastercard and Visa would not be able to do this. You accept that?

A. In the -- in our counterfactual --

Q. Correct.

A. -- they would be more limited in terms of the MIFs and therefore more limited on the issuing side.

Q. Yes, so any reaction from Amex in Australia was in the context of still having a competitive alternative?

A. No. I think -- I mean, anything is

possible, but what you have drawn my attention to here is in Australia, there is a regulation on the MIFs of Mastercard and Visa that is somewhat effective that is bringing the MIFs down but not perhaps down as much as the regulator had intended and in those circumstances, Amex seems to be reacting by bringing down its MSC.

If you then continue that process and bring the MIFs down further, it seems reasonable to expect that Amex's MSC would come down further, the reaction would be bigger.

Q. But why -- let me take it in stages. First of all, what we see is even in that situation Amex only reduces its MSC by 0.15% to 2%, so nowhere near the level that you are suggesting in your 104b.

A. Yes.

PROFESSOR WATERSON: Can we be clear when we are talking about percent and percentage point?

MS TOLANEY: Yes, I understand.

A. I would repeat what I have already said about D104(b) it is there are two extremes. A is the no reaction extreme, b is the full reaction extreme, c is saying we are likely to end up somewhere in between. When counsel keeps saying in spite of my correction that my case is b it is simply -- you know, it is incorrect.

Q. You then secondly raised 4.67 as if that was supportive of your position, but can we have a look at that. So the point is that Amex did not get a greater market share because Mastercard and Visa were able to effectively compete and any steps that it took had to be analysed in that context, whereas here, assuming Mastercard and Visa cannot effectively compete, the same constraints do not apply?

A. I think I am just at risk of repeating my answer. What seems to be happening in Australia is the regulator had intended to regulate in order to bring the MIFs of Mastercard and Visa down. The actual reduction in the MIFs was less than the regulator intended because the schemes were able to take some actions. In spite of the MIF reduction not being as big as intended, Amex did cut its MSCs and Dr Niels makes the point that because the reduction in the MIFs was less than intended, the market share shift to Amex is less than would have been the case if the MIFs had come down as intended, so I do not disagree with that proposition.

Q. Can we look at your second example of

Amex's reaction to the IFR, this is in your second report at paragraph 8.38b, {RC-H2/2/45}.

A. Yes.

Q. The IFR capped fees for consumer cards only, I think we agree that.

A. Yes.

Q. Amex has a stronger position in the commercial cards market than for the consumer cards market.

A. Yes.

Q. We have already discussed Amex's wider acceptance in travel and entertainment, those sectors?

A. Yes.

Q. So Amex is under much less pressure in terms of acceptance by merchants in the commercial card markets as compared to the consumer card market?

A. That is not really clear to me. In the factual they will have pushed their MSC up to the point of merchant resistance.

Q. Well, what we know is that merchants in, take for example, the travel and entertainment sector need to be able to accept Amex?

A. Yes. At least the big players, most of them I think would take that view.

Q. So Amex would be under much less competitive pressure to reduce its commercial MSC rates as compared to its consumer card Merchant Service Charges rates?

A. Yes. Actually for a slightly different reason I think than counsel gives which is in the -- in the -- there is a difference I think between the consumer and the commercial. In the consumer realm, Amex is likely to be multi-homed very often with another card of the consumer, so if the consumer MIF is regulated low, Amex's risk in the consumer market is the merchant might decide to reject Amex because if it does not change its MSC because the gap between Amex and Visa and Mastercard has become too big and the chances are the Amex cardholder also has a Visa and Mastercard, that is the multi-homing point. So by turning down Amex, they keep the transaction.

So there is a dynamic with multi-homing towards Amex reducing its MSC. In the commercial arena, I think it is more likely to be single homing so I think it is more likely that the customer only has an Amex or a Mastercard or a Visa. Then if the Visa and Mastercard MIFs are reduced to zero, I think the downward pressure on the MSC for Amex does not come in to play so strongly for the segments like the large merchants where it already is, the pressure for Amex to reduce its MSC would be in any world where it needs to penetrate into, into the -- into merchant categories where it is not currently present to get something closer to universal acceptance.

Q. So let us talk about then how merchants would react because what I think then, boiling your argument down, as it is reducing, it is reducing to Amex being under pressure to reduce its overall Merchant Service Charge to satisfy merchants in the small categories that it currently does not compete in?

A. I am not sure if it is really under pressure but it is -- in order for the counterfactual MIF to be higher, sorry, in order for the counterfactual MSC to be higher, it seems to me that it is quite likely that Amex would need to make some inroads into the merchants where it is not currently accepted. Whether it would choose to do that or not I do not know but it would need to in order to get the share that it needs to make the counterfactual MSC higher but then the question is how much does it have to reduce its MSC to do that and then the issue is I think when it has reduced its MSC by as much it needs to do that, at that point the counterfactual MSC will not be higher.

Q. But I do not want to go round old ground. That, just to be clear, is premised on your looking at the sectors that we looked at and assuming they will stay exactly the same in the counterfactual world?

A. That is a fair point; I am not assuming any change in the size of the sectors.

Q. Now, the starting point is that at least for major merchants, so those IC on plus plus acquirer contracts, their costs for accepting Mastercard and Visa commercial cards would be lower in the counterfactual?

A. Yes.

Q. The question therefore is how merchants would react to Amex's higher Merchant Service Charges in those circumstances?

A. Yes.

Q. You suggest that the witnesses do not discuss the importance of merchant acceptance and therefore miss the importance of the acquiring side?

A. That is correct.

Q. I think you make two points: the first is you say merchants may react by refusing Amex which would mean Amex becomes less attractive as commercial customers prefer a card which is widely accepted?

A. Yes.

Q. You say to the extent that merchants surcharge Amex that would lead to additional cost for businesses?

A. Yes.

Q. You say that businesses, so commercial customers, would prefer an alternative card to Amex which does not have a surcharge and that would be a Mastercard or Visa card?

A. That could be the case.

Q. So your point is that Mastercard and Visa would not lose cardholders because merchants would be surcharging Amex and that would force Amex to reduce its Merchant Service Charges?

A. Can I see the transcript, please?

Yes, so the question is your point is Mastercard and Visa would not lose cardholders.

Q. Because of your premise that they would be surcharging and Amex would be forced to reduce its Merchant Service Charge in that scenario?

A. To be clear in the counterfactual I think Mastercard and Visa are -- we would lose some cardholders, are we discussing -- can I check: are we still on commercial?

Q. We are still on commercial.

A. Yes. So if -- if one looks at my diagram I consider what happened, I consider all possibilities for the Amex MSC between no reaction and full reaction and I consider all possibilities essentially for what happens to the market share between gaining no market share and gaining -- monopolising the market and I think on both of those dimensions most likely we are somewhere in between: there will be a degree of MSC reaction and there will be a degree of market share gain.

The question is whether there is a combination that is plausible that produces a higher counterfactual MSC.

Q. But I think what I am trying to hone in on here is that ultimately all this boils down in your expert opinion to merchants not being willing to pay Amex's MSC, at its maintained level without reduction, I should clarify?

A. I think that is the key point.

Q. Right.

A. I think it is the key point particularly with respect to Amex penetrating the segment in which it is currently not present. It is a bit more nuanced than that, but that is essentially the key point.

Q. Right. Now, the evidence in this case in summary is that merchants generally take the view that turning down a customer's preferred payment method is bad for business?

A. Yes.

Q. A merchant who turned down an Amex commercial card might well find that the customer would choose to buy elsewhere rather than losing the benefits of the commercial card?

A. Yes.

Q. Merchants' commercial incentives tend towards accepting Amex even if it was more expensive than other payment methods because those customers with Amex cards spend more?

A. Well, Visa and Mastercard push their MSCs up as high as they feel they can while maintaining nearly universal merchant acceptance because that is the stall that they choose to set out in the market: here we are, we are universally accepted.

Amex has a specialist or a premium

positioning in the market where it is not trying to get universal acceptance so it is accepting a degree of trade-off between higher MSCs and lower acceptance.

Q. But let us look at --

A. So --

Q. Sorry.

A. So I think it is in a different position to the -- let us call it the generalist schemes in that regard.

Q. Could we look at {RC-F2/8}, please. This is the statement of Mr Steeley of Marks & Spencer and if we go to paragraph 31 on page {RC-F2/8/6}, please. You can see there he says:

"M&S accepts Amex because customers who use Amex tend to spend more. If M&S did not accept Amex, customers would be likely to go elsewhere to shop due to wanting to take advantage of the Amex Avios rewards programme."

It even says:

"ClearPay is very costly but delivers a net value."

A. I see that.

Q. So the evidence in this trial as well is that merchants generally do not have the ability to discriminate between consumer cards and commercial cards?

A. There has been evidence on that.

Q. So a merchant might be faced with having to reject all Amex cards, including consumer ones, if it wanted to reject Amex commercial cards?

A. If it can't discriminate, that follows.

Q. So it does not seem at all likely that Amex cards would be refused by merchants in the counterfactual to such a degree that Amex is forced to reduce its Merchant Service Charges?

A. I -- I do not think that is quite right. I am saying that -- my analysis is that Amex would need to gain a -- or it is around about the point of -- of having to monopolise everything and potentially have a bit of the small debit segment that we saw earlier, which is -- and we also saw the proportion of the market that that -- that that is. Something is stopping Amex having any share of that at present. It seems to me the most likely candidate is that the customers in that segment for debit cards require something closer to universal acceptance and Amex is not offering that in the factual.

In order for the counterfactual

average MSC to be higher, Amex is going to have to be able to persuade merchants to pay more than their current maximum willingness to pay which I think is unlikely -- sorry I did not express that very well, but I am not saying anything new.

Q. No, I am sorry to go round it but I think it is just quite important that as far as I can see then standing back, your evidence is predicated on certain specific assumptions. The first is that the sectors that we have seen would remain the same, such that Amex had to compete to get into a particular sector in the way that it is currently structured; that is the first assumption?

A. Yes, I have assumed that the segments remain the same.

Q. The second assumption is that merchants would not want to pay and would -- sorry, not even would not want to, would refuse to pay more than what you say has been established as the maximum in the current factual?

A. Yes.

Q. The third assumption is that that maximum would not change in circumstances where the counterfactual is different because there is no competitive alternative from Mastercard and Visa?

A. Yes, because I am assuming for commercial cards that the cardholder is single homing.

Q. I am sorry, I missed that. Single homing. So could you explain what you mean by that?

A. Yes. So let us take two different scenarios, a scenario where the customer is multi-homing so they have an Amex and a Visa or a Mastercard. Then we have the regulation of the Visa and Mastercard MIF to zero, then the merchant's willingness to pay for the Amex is conditional to some extent on the attractiveness of the other card the cardholder has in their pocket.

If however it is single homing, which I think is more realistic for commercial; in other words the employee of the business only has an Amex or a -- or a Mastercard or a Visa card, then the merchant is not facing any change in the counterfactual in the other card in the cardholder's pocket because there is no other card in the cardholder's pocket.

Q. That is not the test. The maximum willingness test is predicated on there being a competitive alternative, not whether a person has two cards in their pocket?

A. Yes, but it changes what the alternative is and if they have one card in their pocket, the alternative is, we saw it earlier, it is the paying in cash or the ETF or something else and that is -- that is a constant. That has not changed between the factual and the counterfactual.

So if in the face of those alternatives the merchant's maximum willingness to pay for a card is what it is, it is not going to go by reference to those alternatives, it is not going to be any higher in the counterfactual.

Q. But the other assumption of your evidence I think is that merchants have any real bargaining power in circumstances where issuers would be very attracted to the Amex offering with high fees, and merchants would not have a realistic alternative but to accept?

A. That is right. But -- but what I am saying and sorry to repeat myself, in the factual, Visa and Mastercard have pushed the MSCs to the limit of the merchant willingness to pay for those merchants that do not accept an Amex, I am thinking of smaller merchants, and that establishes their willingness to pay: Amex cannot come in in the counterfactual and start charging an MSC more than the revealed maximum willingness to pay.

In other words, a premium scheme cannot displace a generalist scheme at premium prices. The premium scheme can displace a generalist scheme at generalist prices, if it is -- if the generalist scheme has become constrained by regulation as to its MIFs. But you cannot -- the former situation does not in my opinion does not work.

Q. Well, I will not go round it again, but again the final assumption I think in your evidence is that there is a generalist scheme and that is the fatal flaw on the counterfactual; there is not one.

A. No, it is not. It is -- that does not follow at all from -- from what I have just said.

Q. Can I then finally deal on this with surcharging. The evidence in these proceedings is that merchants do not surcharge generally and do not have any intention of starting even in respect of high-cost payment methods.

A. Yes.

Q. So I think you will agree that there is a limited appetite to surcharge?

A. That is -- I agree.

Q. So the reality is that even without Amex reducing its fees substantially, sufficient numbers of merchants would accept Amex commercial cards for Amex to be able to grow its market share enough that the market-wide Merchant Service Charge would be higher in the counterfactual and surcharging does not come into it?

A. I think surcharging does not come into it very much if -- so let me explain how surcharging would come into it. Surcharging would come into it if there was surcharging and there was multi-homing and especially I think if there was multi-homing. In the commercial situation, I am prepared to agree that there is not much surcharging but there is also single homing. So really I -- I really agree that surcharging is not particularly key -- is not the thing that is going to drive the Amex MSC in the counterfactual below its factual level. What is going to do that is if Amex is trying to get into a segment that it does not currently penetrate where it -- where in order to do that it is going to need to increase its acceptance and where the acceptance challenge is the willingness to pay of the -- of the small merchants who are not currently accepting Amex. It is going to have to drop those MSCs to get those merchants on board because the outside constraint of those merchants is not Visa and

Mastercard; it is cash or electronic funds and etc.

Q. But we have agreed, Mr Dryden, that the Amex acceptance levels are at least 82%?

A. We have.

Q. Can we go to your first report at paragraph 9.9, please, that is {RC-H2/1/86} and it is paragraph 9.9. So we obviously disagree as to whether Amex's acceptance rate is limited in the way described here. You focus here entirely on Mastercard and Visa's business switching to Amex but it would be possible, would it not, for the market to shrink because of issuers deciding not to provide commercial cards whether generally or in particular segments?

A. That is possible.

Q. The market might shrink in the sense that the total number of transactions on payment cards could reduce with transactions being diverted to various different payment methods?

A. That is possible.

Q. Could you go to {RC-F3/4/18}. This is Ms Suttle's witness statement which we have looked at earlier and could we just read paragraph 42, please, to yourself, and with apologies, but if you could read paragraphs 43-48 and let the Opus

operator know when you need the page turning.
(Pause)
A. Yes, thank you. {RC-F3/4/19}. (Pause)
Yes.
Q. So Ms Suttle --
A. Did we have to do 48 as well?
Q. Yes, let us do that. Thank you, I just want to show you the whole passage. If we go over the page, please {RC-F3/4/20}. You do not need to read the whole of that but over the page again?
A. Okay. {RC-F3/4/20}
Q. So broadly if you cast your eye over it she is showing the different reactions?
A. Yes.
Q. Essentially her conclusion, if we go back to paragraph 46, is that unless Mastercard can offer MIF income via commercial cards, the result would result in Mastercard being at a very significant disadvantage and inevitably losing its market share across various markets.
A. That is, that is what the -- that is what this says.
Q. Yes. We have discussed earlier the point that Mastercard's presence in the commercial cards market was until recent years concentrated on credit

cards and the segments where Amex had a strong presence?

A. Yes.

Q. So that must increase the risk that Mastercard in particular would not have remained viable without commercial card MIFs?

A. Yes, so I think we have, we have the different segments and then the segments where Mastercard -- where Amex is already present, I do not disagree that there could be a share shift or in fact would be a share shift to Amex within those segments. But then we have the -- particularly the segment where Amex is not present where I think getting the share shift to Amex is going to require it to have much more complete acceptance given the nature of the customers and given the nature of the merchants they transact with and that is going to require them to reduce their MSC.

So my observation when I read this, this factual witness statement which is the key point in my report, was that the factual witnesses did not seem to be dealing with Amex's acceptance challenge that they would face in order to increase their share in every market.

Q. But standing back and thinking again about both Mastercard and Visa, given the specific competitive conditions that apply to commercial cards, if you remove the ability to provide MIF revenue to commercial card issuers, I think we can agree that a four-party scheme would at least face a risk of becoming unviable?

A. I think it would face a competitive disadvantage. Exactly how -- it would still retain some significant advantages in terms of acceptance which may even matter for some of the large -- so even some of the large customers, corporate customers, may still care more than others about acceptance on the other side of the market. So it has an acceptance advantage, it also has a kind of issuer advantage in that the Visa and Mastercard schemes have a lot of issuers on the issuing side essentially kind of proliferating their cards and like a mass marketing force for the scheme with -- so in the counterfactual there would be a disadvantage to Visa and Mastercard from the loss of the MIF income, they would retain some advantages compared to Amex, so undoubtedly it would be a competitive disadvantage, whether -- how big that competitive disadvantage would be, I do not know.

MS TOLANEY: That is me done on this

topic.

THE PRESIDENT: Thank you, Ms Tolaney, thank you very much.

MR TIDSWELL: While you are getting ready, may I ask one question, can we go to [draft] transcript page 34, line 16, where you say you are talking about what -- why Amex might reduce its MSC and I want to make sure I have not misunderstood you because you seem to be talking about two reasons here, but I was not sure I understood there were two reasons; I thought the whole point of producing the MSC was to gain acceptance. Are you suggesting there is another reason there?

A. No, they are both about acceptance.

MR TIDSWELL: Yes.

A. But one is retained acceptance and one is gain acceptance.

MR TIDSWELL: Yes, I see.

A. So the retained acceptance scenario is where they are already accepted in the factual and Visa and Mastercard's MSCs are lower in the counterfactual and that could change the merchant's trade-off in favour of saying that the gap is just too big, we will not accept Amex and hope that enough of the transactions divert back to Mastercard and Visa. So that is the downward pressure in the kind of retained situation.

The gain situation is where they are currently not accepted in the factual and to make inroads in the counterfactual and my argument is in order to make inroads into those segments in the counterfactual they would not do it at the factual level of their MSC, they would need to come down in order to penetrate merchants who did not already accept them.

MR TIDSWELL: It is all about acceptance.

A. Yes, it is all about acceptance.

MR TIDSWELL: Different categories. Thank you.

Further cross-examination by MR KENNELLY

MR KENNELLY: Mr Dryden, I want to go now to the Honour All Products Rule, we discussed the Honour All Issuers Rule in detail when we were discussing these matters on issue 3.

But on the Honour All Products Rule, could I ask you to turn up your first report, {RC-H2/1/125}, do you have that, Mr Dryden, it is {RC-H2/1/125} at paragraph 12.24, do you see that?

A. I do.
Q. You say:
"I consider that the Honour All Cards Rule could only be anti-competitive for current purposes if it results in merchants paying higher MSCs."
A. Yes.
Q. Then you identify one potential mechanism for this to occur by way of the Honour All Products Rule at 12.26 over the page on {RC-H2/1/126}. At 12.26, you say: under the heading "Possible Effects":
"To the extent that a scheme had any non-must take (weak) cards, the Honour All Products element of the HACR could lead to higher MSC payments and thus restrict competition ... "
Then at 12.27 you say:
"This would happen if the Honour All Products element of the HACR makes it too costly for merchants to turn down certain weak cards, as they would also have to turn down the schemes' must-take cards and would lose business as a result."
A. Yes.
Q. In that case the rule may allow schemes to set higher MIFs on those weak cards because the

merchants' threat to reject those cards is not credible.

A. Yes.

Q. So your theory of harm for the Honour All Products Rule rests on three propositions: first, that there are must-take and non-must take or weak cards; is that right? That is the first one, I think. The second?

A. Stronger, stronger and weaker.

Q. Yes, stronger and weaker and the second necessary element is that in the absence of the Honour All Products Rule merchants who accept "must take" cards would refuse to accept certain non "must take" cards?

A. Yes.

Q. The third necessary element is that as a result under the Honour All Products Rule, schemes are able to set higher MIFs on the weaker cards --

A. Yes.

Q. -- than they would otherwise set, giving rise to the higher MSCs?

A. Yes.

Q. You accept, do you not, that the evidence to support this theory is inconclusive, do you not?

A. Essentially that is right.

Q. At 12.6, Mr Dryden, if you go to page 121, so it is {RC-H2/1/121}, paragraph 12.6(a)(ii) you say:

"While the theory of harm is clear, the evidence on actual effects is mixed. In particular, there is no evidence to assess whether the defendants have any weak cards (a prerequisite, as we said, for anti-competitive effects to arise)."

Do you see that?

A. I do.

Q. Now, turning then to your third proposition if I may, that MIFs of the weaker cards would have been lower absent the Honour All Products Rule. Could I ask you to go to 12.31 which is on page 126 of this report, {RC-H2/1/126}. You say:

"In assessing the effects of the honour-all-products element of the HACR, I distinguish between two types of evidence: (i) direct evidence of an effect of the rule on the level of MIFs; and (ii) indirect evidence on the effect of the rule on merchants' acceptance ..."

A. Yes.

Q. Then we look at the "Direct Evidence" heading and we read 12.34:

"In terms of methodology to assess

the impact ... one may need to look at natural experiments ..."

Skipping ahead:

"In particular one could exploit the fact that the IFR softened the Honour All Products element and check whether that change resulted in a decrease in MIFs".

For this, you rely, do you not, on the evidence of Helen Jones, the executive director of Visa Business Solutions Europe, do you not?

A. Yes.

Q. That is what you mentioned at subparagraph (b). You quote paragraph 34 of her statement and you can read what you quoted from there in subparagraph (b) in your statement.

A. Yes.

Q. You do not identify any other evidence to suggest that commercial card MIFs fell in the post-IFR period, did you?

A. I think that is correct.

Q. You accept that the claimants' factual evidence, Mastercard's factual evidence and the claimants' survey do not address whether commercial card MIFs fell in the post-IFR period?

A. That is right, that is what I say.

Q. So let us look at this evidence from Ms Jones. Could you be shown, please, {RC-F4/14/14}, paragraph 34 is the one you cited and it is about -- below the halfway point about line 9. Do you see it says "Following the interchange fee regulation", this is what you quoted in your report?

A. Yes.

Q. "... Visa brought the commercial card MIF rate for small business cards in line with the consumer rates."

Do you see that?

A. Yes.

Q. Now, you are aware, are you not, that Ms Jones filed a second witness statement in these proceedings?

A. Yes.

Q. To be fair to you, Mr Dryden, it was filed after you wrote your own report, but let us turn it up, it is in {RC-F4/18/1}. If you go to page 2, paragraph 7, {RC-F4/18/2} you see what Ms Jones said about what she had previously noted at paragraph 34 of her first statement. Have you seen this before?

A. I do not remember having seen it before.

Q. Do you want to take a moment to read it, please.

A. Yes, thank you.
Q. So obviously she makes clear that the commercial card MIF rate for small businesses -- for small business cards, sorry, was not brought in line with the consumer rate following the IFR, so --
A. Yes.
Q. -- you cannot rely on her evidence anymore, can you, for the point you were making?
A. No. I was -- I am afraid I just -- this passed me by.
Q. No, it is no criticism of you at all, Mr Dryden, just to be clear that as far as direct evidence is concerned that means you have not been able to identify any to suggest the relaxation of the Honour All Products Rule resulted in any decrease in commercial card MIFs?
A. That is right.
Q. In fact, the evidence suggests that the weighted average debit and credit Visa commercial card MIFs have increased since 2016 when the Honour All Products Rule no longer applied to commercial cards. Are you aware of that fact?
A. Broadly.
Q. May I just show you. If you go to {RC-H4/4/197}, this is annexed to Mr Holt's

evidence, this is confidential so I will just take some care. Page 197, it is figure A6.1 and you see the average MIF, this is based, as you know, on Visa disclosure data and you see the average MIF rate for commercial card transactions in the UK, this is the UK, and you see debit is green, credit is blue and the average is red; do you see that?

A. Yes.

Q. Lest there be any confusion about what the red signifies, could you be shown just the same page but higher up, paragraph A130. It is a point made about the overall average commercial MIF rate.

A. Yes, it is saying that the red is going down because of a mix effect --

Q. Exactly.

A. -- between the green and blue.

Q. Yes. Then to see the increase in Ireland, next page, please, 198, {RC-H4/4/198} figure A6.2, the red line is the average, light green is debit and blue is credit?

A. Yes.

Q. The reality, Mr Dryden, is that there is no evidence to suggest that the relaxation of the Honour All Products Rule resulted in any decrease in commercial card MIFs?

A. I do not think there is evidence and that is ultimately consistent with what I conclude.

Q. So we will go to your second proposition then, that the Honour All Products Rule did not have any effect or whether it had effect on merchants' acceptance of different product categories.

Now, as we saw for merchants acceptance and whether it is effected for the Honour All Products Rule you only cited indirect evidence and you focus on merchants' acceptance of commercial cards, just to go back to your report, so you can see it is, it is {RC-H2/1/127}.

A. Yes.

Q. Could you read 12.37. You say:

"The factual evidence on the existence and extent of any actual effects of the Honour All Products element on merchants' acceptance is mixed."

You note that:

"Mastercard's factual witness evidence suggests that the rule appreciably affected merchants' acceptance, while Visa's and the claimants' factual witness evidence suggest otherwise."

A. Yes.

Q. So to the extent you can rely on Mastercard, you cite Mr Willaert's evidence in your own report and before we go to the text, it is right, is it not, that Mr Willaert does not say in terms that the Honour All Products Rule caused merchants to accept commercial cards that they would otherwise have declined?

A. I -- I have just got some extracts here rather than the full quote. What I am saying here is he says without the HACR a payment card could be declined at the till because of the type of card, so he is attributing at least the possibility of something happening to the absence of the HACR. Then he is saying without the Honour All Products element of the HACR, the issuer would face -- would face a risk that the new product may not have a commercially viable level of acceptance, at least initially, which I think must mean that without the Honour All Products element of the HACR, the issuer would face the risk of less acceptance and that is -- that is what it is.

Q. Over the page, Mr Dryden, {RC-H2/1/128} you make a further point from Mr Willaert's evidence about absent the HACR Mastercard would have lost market share but you say, do you not, that it is ultimately unclear whether there he is referring only to the Honour All Products element or to the Honour All Issuers element or both; is that not right?

A. That is what I say.

Q. Now, against that as you fairly acknowledge there was the evidence from Visa and you cite that at 12.37b?

A. Yes.

Q. Quoting Mr Korn, which goes the other way, does it not?

A. It does, that is what I am -- that is the point that I am making.

Q. The claimants' evidence as well at (c) on the same page?

A. Indeed and I am also making the same point about that evidence.

Q. The point -- the fact that the claimants' evidence indicates that the Honour All Products part had no effect is supported by what you say at 12.38, the data from the survey Claimants in these proceedings -- again this is confidential so I do not want it read it out loud, but do you see it in 12.38, Mr Dryden, especially the last sentence?

A. I do.

Q. So it is not quite right, Mr Dryden, to say that the evidence as to whether the Honour All Products Rule affected acceptance of commercial cards is mixed, it is not really mixed, is it? It strongly indicates that the Honour All Products element had no appreciable effect on merchants' acceptance?

A. Well, the evidence is mixed. As we have just seen, my ultimate conclusion is and I am quoting 12.54a:

"I consider, however, that the evidence on actual effects is mixed and in particular that there is not enough evidence to assess whether schemes have weak cards ..."

So I am coming down on the side of saying having reviewed all of the evidence and observing that it does not all point one way, I am coming down on the side of saying there is not enough for -- to substantiate the theory of harm.

MR KENNELLY: Those are my questions on the Honour All Products Rule. Mr Dryden, I am about to move on to the surcharging rule, I see the time. This may be an appropriate moment.

THE PRESIDENT: How are you doing, Mr Kennelly?

MR KENNELLY: I am making great progress on the rules and it is obviously very important to get Dr Frankel in the box today. As the Tribunal can see, we are running behind.

THE PRESIDENT: Yes.

MR KENNELLY: So if you could, and if Mr Dryden would not mind having a shorter lunch break, that would obviously be of great assistance to us.

THE PRESIDENT: We will shave 20 minutes off if we can and we will resume at 20 to 2.

MR BEAL: Sir, could I please make a general point about timing. I am not going to have a big moan, I just want to put the statistics before the Tribunal.

THE PRESIDENT: Yes.

MR BEAL: If, as I anticipate, my learned friends are going to go through to lunchtime tomorrow, their cumulative total with my experts will be somewhere around 21 hours. What I have been allotted in the time available this week is 15 hours. Those are the figures, sir.

THE PRESIDENT: Well, Mr Beal, the critical question is not absolute comparison of time but whether your ability to put your case is being inhibited by delay and that is what we are most anxious to avoid.

MR BEAL: Sir, what we had allotted was parity of treatment on time and I have cut my cloth accordingly.

THE PRESIDENT: Yes, okay.

MR BEAL: What I am afraid I do need to point out, without wishing to add more heat than light, is that parity of treatment has not been respected by my learned friends.

As I said, I do not want to make a big moan about it but I do think it is important I put the marker down.

THE PRESIDENT: I understand the marker but I think the issue for the Tribunal is to ensure that you are not unduly cutting your cloth to fit the time and I do not want you to do that. If you need more time than the 15 hours, even paring it back, then we will find the time.

MR BEAL: Thank you very much.

THE PRESIDENT: Okay. We will resume at 20 to.

(1.01 pm)

(The short adjournment)

(1.40 pm)

THE PRESIDENT: Mr Kennelly.

MR KENNELLY: Thank you, sir.

Mr Dryden, we were moving on to the no surcharging rule and you understand I think Visa's case on this: That its rules were subject to local law so that if local law expressly permitted or prohibited surcharging, that overrode Visa's rules.

A. I understand I am straying into legal territory here but I understand that if local law prohibited surcharging, then there cannot really be an effect of a Visa rule prohibiting surcharging. If local law permits surcharging, there can be an effect presumably of a scheme rule that prohibits surcharging.

Q. But let us assume, Mr Dryden, that if local law expressly permitted surcharging, that overrode any restriction on surcharging that Visa had in its rules?

A. Oh, I understand. Then the rule is sort of redundant or inoperable.

Q. Indeed.

A. Irrelevant, I understand --

I misunderstood. I understand.

Q. You do not find, do you, Mr Dryden, that Visa or Mastercard's rules prohibiting surcharging had any appreciable effect on competition during the claim period? Your view is there was insufficient evidence to assess whether these rules had any appreciable effect?

A. Yes, it is slightly more nuanced than that, but I say that there is limited evidence for me to conclude that there is an appreciable effect.

Q. Well, maybe we are saying the same thing, Mr Dryden, but you say there is not enough evidence to assess whether or not the effect of the no surcharging rule was appreciable?

A. Yes.

Q. You also concluded for commercial cards that it was not clear whether surcharging or declining imposed any appreciable downward pressure on MIFs?

A. On what, sorry?

Q. On MIFs?

A. Which rule?

Q. For commercial card use?

A. Yes.

Q. Could I ask you to go in relation now to merchants' perspectives to {RC-H2/1/96}. This is your first report, paragraph 9.44.

You say that:

"In practice it is not clear that surcharging and declining commercial cards has an appreciable downward pressure on MIFs. You say: evidence from the claimant survey suggests that surcharging and declining the schemes' cards, including commercial cards, is uncommon."

Do you see that?

A. Yes.

Q. You gave some detail about that in footnote 282 on the same page which is confidential, so I will not read it out to you, Mr Dryden, but if you could just read that to yourself, you will see --

A. Yes.

Q. -- what you recorded about question 15 of the survey and the percentage of Claimants who responded "Yes" to the question as to whether they imposed surcharges for any type of Visa or Mastercard?

A. Yes.

Q. You are also aware, are you not, that the witness evidence filed by the Claimants in these proceedings shows that many of the Claimants did not surcharge even when they were permitted to do so?

A. Yes, I think that is the point that I am making at paragraph (b) on this page.

Q. On that point, Mr Dryden, if you go to paragraph 13.36, this is the same report, page 138 {RC-H2/1/138}, paragraph 13.36. Now, here again you use the expression "mixed" you say the claimants' factual evidence in relation to the surcharging rule is similarly mixed.

You go on to say that:

"... Some Claimants explaining they did apply surcharges or recommended surcharging where possible ... others indicated they have never applied surcharges to Visa and Mastercard cards ..."

A. Yes.

Q. Others said it would depend what their competitors did.

Now, you refer to three Claimants which did apply surcharges or recommended: Pendragon, Jet2 and Ageas; do you see that?

A. Yes.

Q. So this is the evidence -- when you say the evidence is mixed, this is the evidence that you say shows a willingness to surcharge where permitted to do so?

A. Within the factual witness evidence, yes.

Q. So to look at that more closely, Mr Dryden, could we go, please, to Mr Bailey's witness statement, he was the head of tax and treasury at Pendragon, the first of the three companies that you mention here?

A. Yes.

Q. That is in {RC-F1/1/15}. Paragraph 44. Do you see that?

A. Yes.

Q. There Mr Bailey said Pendragon has at times, when it has been legal to do so, tried to impose surcharging on high value transactions?

A. Yes.

Q. Do you see that then at 44(c) he explains the difficulty in surcharging.

A. Yes, I think he made the same point when he was giving oral evidence that they allowed dealerships to surcharge but less than 20% of the dealer -- but many of the dealerships are reluctant to take that up and they choose not to surcharge.

Q. Do you remember why he said they were reluctant to surcharge?

A. I do not but I can imagine that it is because of the business stealing effect.

Q. Because they are afraid of losing the sale?

A. Yes.

Q. The next company that you mentioned in your evidence was Jet2. Could we go, please, to {RC-F2/3/1}, the witness statement of Mr Buxton, he was the director of group finance and treasury. Page 8, please. {RC-F2/3/8}, paragraph 37. You see halfway down paragraph 37, he says:

"If we were permitted to do so again [because of course it has been impermissible to surcharge since 2018] then the application of surcharges would be a commercial decision and I could not speculate on the outcome."

So you see there he is saying even if permitted to do so, he could not say for sure if he was going to surcharge or not; do you see that?

A. Well, I think he is saying we did it prior to 2016 which may -- which may be within the claim period, I cannot quite remember, but we did it but prior to 2016, so that is a historic statement of fact. Then he is saying if we were permitted to do so again, so that is I take that to be a forward-looking statement as of now, then he does not know if they would or they would not.

Q. Indeed but, Mr Dryden, as you know, the prohibition on surcharging by law came into effect in 2018?

A. Yes.

Q. So here Mr Buxton was acknowledging that although they had previously surcharged on credit card and Amex, they ceased to do so for credit cards at the end of 2015 and for Amex the end of 2016. So it is true, is it not, that even though they were permitted to surcharge, they ceased to do so?

A. I am sorry, I am getting a little lost. From 2016 until now, could counsel help me and explain if they were permitted or not permitted?

Q. Let us assume, Mr Dryden, that I am right that surcharging was permitted between 2015 and 2018 and that the ban on surcharging by law came in in 2018, if that is the correct legal position --

A. Yes.

Q. -- Mr Dryden, it is true, is it not, then that even though they could have surcharged on credit card and Amex in 2016 and 2017, they -- Jet2 -- chose not to do so?

A. Yes, I am getting slightly lost on the years but I am happy to take that as given. The two things I am reading most clearly into this is factually they did it prior to 2016 and forward looking from today, if it was permitted he does not know.

Q. But if I am right, Mr Dryden, that they could have surcharged before 2018, this suggests, does it not, they had a commercial reason for not surcharging even if they could have done so?

A. Yes. So if counsel is right to identify a period before 2018 when they were allowed to but they did not, then that is evidence from this merchant that at least for that period of time they chose not to surcharge even when they could.

Q. Could I show you what Mr Buxton said about that, transcript, please, Day 4, page 61, line 12 {Day 4/61:12}.

I would ask you just to read down from -- because I am asking him questions about why he did not surcharge when they could have on commercial cards; do you see that?

A. Yes.

Q. Then when you have finished reading down from line 12 on that page, please let us know, Mr Dryden, we can go to the next page?

A. Yes, that is fine.

Q. Next page, please. {Day 4/62:1}
A. Yes.
Q. So his reason for not surcharging when he could have was the major competitors were not surcharging?
A. Yes.
Q. It was not a Visa or Mastercard rule, was it?
A. Not in this period, it appears not.
Q. The third of the three companies that you mentioned which suggested a willingness to surcharge was Ageas Insurance Limited and you refer to the evidence of Ms Coupling?
A. Yes.
Q. Mrs Coupling, as she asked to be called, and I will just show you what she said about surcharging. Again in the transcript {Day 5/65:11}.
So I put to her that she had not suggested anywhere in her statement that any rule imposed by Visa or Mastercard before 2018 had prevented Ageas or its partners from surcharging, do you see that?
A. Yes.
Q. She said no, she did not -- she accepted she had not suggested that any rule had prevented

them from surcharging when they were able to do so.
A. I think that is right but taking it from the top, at line 3 she is saying that they were surcharging and stopped in January 2018 in accordance with the law. So they were surcharging and then they stopped. I take that to mean they were surcharging and then they stopped when the law means they are not allowed to surcharge.
Then you have just taken me to something that says you do not suggest that a rule before 2018, which is when they were surcharging, prevented them from surcharging and she is saying: no, which I think makes sense. So that would seem to be if I am not getting muddled up that seems to be an evidence point for the fact that this merchant did surcharge when both the law and the scheme rules allowed them to.
Q. But Mr Dryden perhaps I will show you her statement, but before I do, because you relied on her witness statement, do you recall that in the Ageas evidence some partners surcharged when they were able to do so but Ageas itself did not?
A. I do not remember the distinction between Ageas and its partners.
Q. I will show you the evidence. It is

{RC-F2/7/10}. This is a short point, Mr Dryden, that the surcharging even when they were permitted to do so was not complete. Paragraph 70, do you see that?

A. Yes.

Q. Some of these partners surcharged and some did not.

A. So this is evidence for some surcharging.

Q. The previous paragraph, 69, last sentence:

"Prior to 2018 [that is when the ban came in] Ageas did not surcharge on its own brands and Age UK did not either."

Do you see that?

A. Yes.

Q. Even of the three companies, of the third that you say indicated a willingness to surcharge, for this one at least, the surcharging was incomplete as between the companies in the relevant group?

A. Yes, which is entirely consistent, I think, with the overall conclusion that I am reaching.

Q. About the mixed nature of the evidence and the fact that it does not show that in general Claimants were willing to surcharge?

A. I think the evidence is that when surcharging is allowed, both as a matter of law and scheme rules, we see a little bit of surcharging but not necessarily very much.

Q. Mr Dryden, now looking at surcharging and transactions from other jurisdictions.

Could I show you the PSR internal report {RC-J5/51/49} about cross-border EEA MIFs, I would ask you to look at paragraph 4.101. So one acquirer explains:

"In principle merchants can recognise and surcharge cards issued ... abroad. This can create undesirable frictions in the consumer experience and can lead to abandonment of the transaction."

Next page, please: {RC-J5/51/50}

"Others were not aware ... overall no acquirer we spoke to said it was easy or common to surcharge based on the location of the issuer."

Do you see that?

A. I do.

Q. Then at paragraph 4.113, page 51, {RC-J5/51/51} there is a reference to how it might be done but I would ask you to look at the very last sentence on that page, the one beginning "but surcharging for UK EEA transactions", do you see that?

A. Yes.

Q. "...is likely to create consumer journey frictions, which may discourage merchants from [next page] introducing it."

There is a reference about competitive disadvantage?

A. Yes. All of this seems to be entirely consistent with where I come out on surcharging. The points that are made here are that there is a good reason for many merchants not to surcharge because they will suffer a business stealing disadvantage. The statements are that it is not common, and I agree, that it is not typical and I agree. So in other words even where surcharging is permitted by law and by scheme rules, we do not see a great deal of it but I think the fair position is that there might be a little bit of surcharging in that world.

Q. Moving on then, Mr Dryden, to the question of by object infringement and the rationale for the no surcharging rule. Do you agree, Mr Dryden, that the surcharging of Visa branded cards by merchants is at least potentially harmful to cardholders?

A. It is potentially harmful to cardholders.
Q. So if a cardholder is in a position of vulnerability, such as purchasing essential goods where there is little merchant choice, they might be particularly vulnerable to the negative effects of surcharging?
A. They may be.
Q. Or a tourist away from home with limited or no access to cash or alternative payment methods?
A. Yes, that is possible.
Q. For a tourist, the hold-up problem is more acute because they are more likely to lack alternative means of payment?
A. That is possible. But I think that is one side of the ledger. It is worth I think going back right to the, you know, concurrent session and what I have said a number of times which is there are two fundamental conditions for a competition problem associated with interchange fees, one is the lack of surcharge, one is the lack of surcharging and the other is incomplete multi-homing by cardholders and in the academic literature we see the two things time again as the fundamental conditions. Once you have any degree of single homing and a lack of surcharging then you have the conditions for the

merchant via externality that create this competition problem that we have leading to excessively high MIFs.

So I agree that in the absence of a rule that prevents it, merchants might not surcharge anyway which means that the rule does not necessarily have a big effect in bringing that condition, bringing that condition about, although obviously the rule will squash out that relatively small amount of surcharging that might be happening.

Now, do I agree that a no surcharging rule in principle could have some benefits for the vulnerable and etc? Yes, but it also comes at a cost to consumers which is by squashing out the price signal, it can remove any possibility that the dynamic of competition between card schemes is to produce downward pricing pressure, downward pressure on MIFs which would benefit customers or merchants.

So what is being -- you know, while I do not deny that there are possible benefits, there is also the core harm in this case which is that the lack of the pricing though is one of the factors encouraging the higher MIFs.

Q. These benefits, these possible benefits which a no surcharging rule could secure, those are partly why the United Kingdom and the EU surcharging for cards covered by the IFR; is that not right?

A. I am not very familiar with the reasons but I think that reasons such as these lay behind that ban.

Q. Just to make you more familiar, Mr Dryden, could I ask you to look at Dr Niels' evidence in H3/2, this is his first report. {RC-H3/2/252}

A. Yes.

Q. You see paragraph 7.100 at the top of 252?

A. Yes.

Q. He addresses this is useful because he also pulls in some of the factual evidence upon which the schemes rely in these proceedings?

A. Yes.

Q. He mentioned justifications?

A. Yes.

Q. You see the first quote from Mr Korn's evidence and then at 7.101 --

A. Yes.

Q. -- in fact it may be quicker, since we are under some time pressure, for you to read 7.101 to 7.104 on the following page.

A. Thank you, we can turn the page. (Pause)

Yes, thank you.

Q. You are a quick reader, Mr Dryden. In view of this and I think in fairness to you, this is the point you have just been making to the Tribunal: it is not clear, is it, that the no surcharging rule is so inherently harmful to competition that actual harm can just be presumed?

A. No, but I think I am not presuming actual harm, I am doing the -- we would be at the 101 or we are at the 101(1) stage of the analysis and the question is whether there is a restriction of competition. If there is a restriction of competition it may well be justified at the 101(3) stage by efficiencies and these pages are putting forward some things that are putative efficiencies. But a no surcharge rule is even if it does not have many effects, even if it does not have very big effects because the merchants would be choosing not to surcharge anyway because of business stealing, a no surcharge rule is actually in the context of this case quite a fundamental rule because it is the schemes having a rule that prevents any kind of price signal functioning on the acquiring side of the market. It is the absence of that price signal that is together with a degree of single homing at the root of the competition problem. So it is quite a big thing from an economics perspective to say I have got a rule that is -- that is removing a price signal, that if it existed might force me to compete on that price signal.

So I think there is a reason to think that the no surcharging rule is a -- if it has appreciable effects or if we are in by object, a reason to think that it causes a restriction of competition, and in saying that, it does not deny the later -- it does not deny that at the 101(3) stage, one would not be looking hard at these efficiencies.

Q. Mr Dryden, just to be clear about what you understand to be the test for by object infringement, are you saying that even if all the evidence showed you that in fact merchants would never surcharge at all in the absence of the rule, it could still be a restriction of competition by object?

A. That is matter for the Tribunal, I think, not me, because the analogy would be, might be, a cartel, might be a cartel. So if I had a cartel and I knew with 100% certainty the cartel had not affected the price, would that be by object or not? I do not know.

Q. Let us assume, Mr Dryden, and again, I am not asking you to offer a legal view, so just assume the legal test is -- that the test is that something is so likely to have negative effects that it would be redundant, it would be pointless to conduct an effects exercise. If that were the test, can you see why it may be difficult to say the no surcharging rule is a by object infringement?

A. Yes, of course I can clearly see that. If the totality of the by object test is that I can be sure there will be effects, and if the second assumption is that let us assume that there are definitely no effects then it is not an infringement by object.

Q. It is true, is it not, Mr Dryden, that the European Commission has considered Visa's prohibition on surcharging multiple times and it has never concluded that the no surcharging rule restricted competition by object, has it?

A. I do not think it has.

Q. Nor has the Commission ever found that Visa's no surcharging rule constituted an independent restriction of competition by effect?

A. I cannot independently remember because I get slightly -- there are so many decisions, so many decisions, but I am prepared to -- I am sure that is right.

Q. Thank you, Mr Dryden. I will move on, if I may, to the co-badging rule which is the last part of my cross-examination on the rules, and I will begin, if I may, with the development of the co-badging rule.

Do you know, Mr Dryden, that until June 2016, Visa's co-badging rule prohibited co-badging with international payment card systems which were deemed by Visa to be competitive?

A. Yes, I think, I think I am aware of that.

Q. Since June 2016, so since the IFR, Visa's rules have permitted issuers in the United Kingdom and Ireland to co-badge with international payment schemes regardless of whether they are deemed to be competitors of Visa?

A. Yes.

Q. So for the purpose of examining whether the co-badging rule restricted competition by effect, it is useful, is it not, to look at what happened after June 2016, when Visa permitted issuers to issue cards with two or more international payment card brands?

A. Yes, I think that should be informative.

Q. Just to be clear, that is a seven-year period since the IFR came into force?

A. Yes.

Q. You are aware, are you not, that in that period, Visa has never received or rejected a request from an issuer to approve a co-badging arrangement with an international payment scheme?

A. I think that that has been put forward, yes.

Q. You have not identified any evidence of any such international co-badging scheme arising?

A. No.

Q. But you nevertheless conclude, do you not, that it is open to the Tribunal to find a restriction of competition by effect? Just to show you --

A. Yes, of course.

Q. -- it is in {RC-H2/1/141}. It is your first report, Mr Dryden.

A. Yes.

Q. Paragraph 13.51. It is at least open to the Tribunal to find a restriction of competition by effect?

A. Yes, I think, if I may, it is worthwhile -- it is worthwhile just to read 13.49

and 13.50.

Q. Of course.

A. So 139 I am saying:

"... there are clear theories of harm for the [non-discretion discrimination, the no surcharging rule and the co-badging rule] to result in higher MSC payments and thus to be anti-competitive, [but] there is limited evidence available on actual effects or appreciability ..." for any of those rules.

Then I say there may be a bit of a circularity issue which is the lack of effects may be a bit due to the presence of some of the rules. Then I say:

"However ... the mere existence of a rule may suggest that the rule has some effect ..."

In other words, why have the rule if it literally has no effect. Then I say that is not for me, that any inference that can be drawn from the existence of a rule is a matter for others.

Then I said:

"There is at least evidence that some surcharging takes place when permitted."

We saw that.

"Even if the effect of each rule was non-appreciable in isolation," there may be a cumulative effects point.

Then I say:

"Given the above, [it seems to me that] it is ... open to the Tribunal to find a restriction of competition by effect ..."

Then I say it depends on the legal thresholds, and then I say in any case I consider some of these rules might be considered a restriction of competition by object.

Q. On the question of effects, Mr Dryden, as you quite properly say it does depend on the evidence. Let us look at how you analyse possible effects of the co-badging rule in this first report.

If you go back, please, to page 136 {RC-H2/1/136} and we will start with the theory of harm and look at the evidence. You have the theory at 13.23.

A. Yes.

Q. About halfway down you say:

"I consider that co-badging may be a form of cardholders' multi-homing and therefore - to the extent that [the co-badging rule] limited co-badging - it may also have limited such multi-homing ..."

A. Yes.

Q. Merchants' ability to benefit from it.

A. Let me try to explain that a bit more clearly.

As I referred you to a few minutes ago, the theory of harm in this case concerning the MIFs depends on these two fundamental conditions, lack of surcharging and lack of multi-homing, and what is quite interesting is the no surcharging rule is really buttressing the lack of surcharging and the co-branding rule is buttressing the lack of multi-homing. Because if one had a -- if cardholders prevalently had cards that were carrying two schemes, then the merchant could turn down the higher MSC scheme and not lose the trade because the consumers -- the cardholder's card could put the transaction through on the other one.

So these two rules, no surcharging and co-badging, precisely pair off to the two fundamental conditions for there not to be competitive pressure on the MIFs in the no surcharging and the lack of multi-homing.

So that is why I am saying here there is a theory of harm that ties into the -- that is why I am saying here there is a theory of harm for the co-badging rule.

Q. Indeed, Mr Dryden, in theory. But we still need to look and see the purposes of effects whether in fact the co-badging rule did limit cardholder multi-homing.

A. Yes.

Q. So we go back to your report, page 139, paragraph 13.40, you {RC-H2/1/139} say:

"In relation to [the co-badging rule which was] not directly addressed by the Claimants), the defendants' factual witness evidence suggests it did not have any appreciable effect."

But then at 13.44, skipping down a page, you say {RC-H2/1/140}:

"Overall, the evidence on [the co-badging rule] only comes from the defendants and does not seem conclusive, in that it does not explain important issues, such as to what extent [the co-badging rule] limited co-branding with international schemes, and why the defendants had to expressly agree on the issuing of a co-badged card ..."

A. Yes.

Q. Now, as you say, the Claimants have not adduced any evidence on the appreciable effects of this rule, have they?

A. They have not. I am not sure they are particularly well placed to, but they have not.

Q. If you go to page -- you have read from this a moment ago, but just go back to it -- page 10, paragraph 13.49, and this is the point you made a moment ago to the Tribunal that the very existence of the rule may have limited the claimants' ability to collect relevant evidence that the rule existed. That may show, or an inference that it produced effects?

A. Yes.

Q. Halfway down 13.49, you say {RC-H2/1/141}:

"That is partly intrinsic to the presence of the rules ... [the co-badging rule] may have prevented the emergence of domestic schemes so any effect compared to them cannot be observed."

But you are aware, are you not, that Visa has permitted, and extensively permitted, the issuance of payment cards that are co-badged with domestic payment cards throughout the claim period?

A. Yes, I do not know the extent of that.

Q. I will come to the extent in a moment. But do you accept that the reason why domestic schemes co-badge with Visa is because they often lack the wherewithal to offer things like international payment or more advanced technology themselves?

A. Yes, that makes -- from the domestic scheme, that makes it attractive to co-badge with Visa or Mastercard. The other way round, it makes it potentially more attractive for Visa and Mastercard to co-badge with them because they are less of a competitive threat.

Q. Before I take you to all the detail of the domestic payment schemes and co-badging, and just to be clear, Mr Dryden, do you accept that co-badged schemes between Visa and domestic payment schemes are very widespread throughout Europe?

A. I do not know, but I --

Q. I think I will have to show to you.

A. I think I am prepared to accept it. I am not sure it affects what I say here.

Q. I will show it to you anyway, Mr Dryden, so the Tribunal can see it. It is {RC-J5/37.1/130}. This is the Girocard brand in Germany.

A. Yes.

Q. You can see in the middle piechart 75% is the share of Girocard, I think, by way of card payments?

A. Yes.

Q. The fourth bullet tells you that the Girocard share of the market is growing. Do you see that?

A. Yes.

Q. Now, look at France {RC-J5/37.1/121}. This is Cartes Bancaires, the French domestic scheme. Again, co-badged with an international scheme, and you see the percentage share of card payments that it has in the centre middle circle, 89%?

A. Yes.

Q. Then Italy.

A. Yes.

Q. {J5/37.1/163}.

A. Yes.

Q. Third bullet, 72% of the number, this is debit card payments, of the number and 67% of the volume of debit card payments was made.

A. Yes.

Q. Through the co-badged domestic scheme.

Do you know, Mr Dryden, that the Visa co-badging rule applied in the same way in Germany and Italy and France as it applied in the

United Kingdom?

A. I am prepared to accept that.

Q. So the rule does not appear to have restricted the emergence of domestic co-badged payment cards in other jurisdictions, has it?

A. No, I think that sentence, the second sentence of 13.49, is a typo on my part.

Q. You think you meant to say international schemes?

A. Yes, for it to make any sense, or at least sense.

Q. So shall we correct that and say "international schemes"?

A. Yes. Because then it all makes sense with what was in the lead-up to it, because in the lead-up I am recognising that you have co-branding with domestic schemes, but then I am quoting Mr Korn in 13.42 as saying the CBR is about international competitors and not to prevent co-badging with domestic schemes.

So then what I am saying is the problem we have is to know about given -- given -- our problem is to know about whether the co-badging rule would have prevented co-badging with international schemes, and I am saying that is --

what I should be saying in 13.49 is that is tricky, because the rule itself could have prevented the emergence of the international schemes with which co-badging could then happen. So in other words, if co-badging is an entry or expansion method for a new entrant or expander international scheme, the rule may have precluded that so you do not actually see this rival schemes to Visa and Mastercard .

Q. We will record that correction, Mr Dryden --

A. Thank you.

Q. -- in paragraph 13.49.

So coming then to the point you just made about the distinction between domestic and international co-badged cards, were you aware there were substantial technical and operational difficulties associated with co-badging to international payment schemes?

A. I am -- well, at least the Visa factual witnesses put forward that that is the case and I have cited that in the paragraph we were just looking at, 13.42.

Q. Are you willing to accept that evidence on its face as evidence that there are substantial technical and operational difficulties associated with co-badging to international payment schemes?

A. I have no reason to disagree with that. But I imagine that may have been tested. I -- it is not for me to -- I do not think it is for me to comment on that.

Q. Are you aware that resolving these technical difficulties is itself technically complex?

A. That is not -- I mean, I imagine it could be but it is really for others to give evidence on whether it is.

Q. Could I show you Mr Holt's evidence on this, which records factual evidence. This is {RC-H4/4/154}. This is Mr Holt's second report. It is paragraph 568 from the third sentence, I think, is ... If you keep reading through 569 and about halfway down 570, it is all covering the same point that we have been discussing.

A. Yes. Yes.

Q. I think you say, Mr Dryden, that you have no basis for disputing any of this. I am not saying you accept it, but you have no basis for disputing it?

A. Correct, this is not in my knowledge. The question would be, for me would be where to put it.

Does it belong in, does it belong in the restriction of competition analysis or does it belong somewhere else.

Q. Indeed, and we will have submissions about that in due course. But for present purposes, assuming it is relevant for the by object stage, do you agree that building the network that Visa has requires years of investment and innovation?

A. Yes.

Q. That co-badging with an international scheme could result in the free riding by a rival scheme on Visa's technology and services?

A. That is -- that is less obvious to me. I mean, there is a, there is a potential analogy here, which is if you think of Visa and Mastercard as being Nike and Adidas, the no co-badging rule is a little bit like Nike saying to a retailer, who here is taking the place of the issuer: you are not allowed to have a shop, so you are not allowed to have a retail outlet that has Nike and Adidas, so you are not allowed to co-badge your shop with the two brands or, for that matter, with an entrant brand, if we think of some entrant sports brand, you are not allowed, you are not allowed to do that.

So it is a restriction on a different

level of the market. It is on the issuing level of the market downstream of the schemes saying to the issuer: you just cannot retail my scheme alongside another scheme.

Now, that will have a tendency to promote single homing for obvious reasons, and that -- because single homing is so critical to the restrictive effects of the MIF, that could promote the restriction of competition. That may well be justifiable at another stage of the analysis, but it seems to me that it is too hasty just to say that is free riding.

Q. I only asked you, Mr Dryden, if it could also result in free riding. I think you accept that there could be free riding possibilities in the scenario that I described and that you have just described also?

A. I think that is right. Just as in my retail example, you in principle could have a free riding issue to which a restriction could be the ultimately justifiable.

Q. Because if there are free riding possibilities, that could lead to a decrease in investment incentives for the scheme who has been prejudiced by the free riding. Again could, Mr Dryden; only the possibility. That is all I am canvassing with you.

A. Yes, it is a possibility. But on the other side of the equation you have the fact that Visa and Mastercard have an extremely high share of international card transactions, and it is a highly stable equilibrium because the MIFs are flowing across from the acquiring side and they essentially have high, very high and stable market shares that have been durable, many even for decades, associated with also very high profits.

So there is a free riding problem in principle that could be analysed. There is also a market for the closure side of the coin. If co-badging is by issuers who are downstream it is not going to be allowed.

Q. Mr Dryden, just coming back to reality and the question of whether, whether as a matter of fact, the co-badging rule actually makes any difference, you are aware, are you not, that it is the issuers, the issuers, who choose whether to issue co-badged cards?

A. Yes.

Q. Issuers who have to resolve these technical difficulties that we have mentioned as possibilities?

A. Some of -- to the extent there are those difficulties, some of it may fall on the issuers to solve.

Q. Of course you accept that issuers are commercial entities seeking ordinarily to maximise their profits?

A. Yes.

Q. All else being equal, given that the MIF is a source of revenue for the issuers, they would prefer higher rather than lower MIFs from acquirers?

A. Yes.

Q. They would have very little incentive, the issuers, to design cards that seek to overcome the technical difficulties that we discussed a moment ago?

A. Yes, that factor would limit -- that factor would limit their incentives.

Q. If the goal --

A. The issue is it is quite a stable equilibrium, because if the -- and everything is a little bit connected with everything else. If there was a degree more surcharging on the other side, that begins to create the circumstances in which it becomes attractive to a cardholder to have a co-badged card, including a scheme that may be less surcharged. So then you are beginning to create the incentive there for the issuer to, to co-badge. But I -- but I would agree with you, in circumstances where all that is involved is a sacrifice of MIF income and there is no compensating benefit from the cardholder, it may not be very attractive for the issuer to co-badge.

Q. But if the issuer's assessment is on balance it is likely to get less cash through lower MIF revenue, that is likely to diminish its incentive to co-badge?

A. Certainly, that is an effect.

Q. Now, you suggest that issuer incentives for co-badging with international schemes, so issuer incentives are the same as for co-badging with domestic schemes? Shall I show you --

A. Yes.

Q. It is in your second report, {RC-H2/2/64}. It is paragraph 12.21.

First of all, you are noting a point that Dr Niels has made. You say you are recording what he says at 12.21. It is over the page, little (iii) at the top of page 65 {FC-H2/2/65}, this is what Dr Niels says:

"[The] issuers would have no incentives to issue co-badged cards if that limited their interchange fee revenues ..."

Then you go on to make the following observations on his arguments, and I think you address the incentives point at 12.22(b)(iii)?

A. Yes.

Q. You say:

"Dr Niels' point about issuers' incentives not to co-badge cards due to reduced interchange fee revenues is invalidated by his example of the Laser and Mastercard co-badged card ..."

Do you see that?

A. Yes.

Q. But Laser was a domestic scheme, was it not?

A. Yes, but I think it is a proof point against -- slightly contrary to what I just may have said, this seems to suggest that an issuer is choosing to co-badge Mastercard with a lower MIF alternative, and I think what was just put to me is they would never have an incentive to do that.

Q. So we look at what the incentives are for co-badging with the domestic schemes to look at the issuer incentives and compare them, and we will start, if I may, with what Mr Holt says about incentives, the incentives to co-badge with domestic schemes, and that is {RC-H4/4/154}, paragraph 569. So we have, at the first he refers to --

A. Yes.

Q. -- technical difficulties which arise for both domestic and international schemes, but then he describes how that can be resolved, and then you see why co-badging with domestic schemes can be mutually beneficial. Do you see that?

A. Yes.

Q. At the bottom of the 569.

That is the point you accepted earlier about co-badging with the domestic scheme and gave a domestic issuer global acceptance outside their home market, and can help an international scheme get domestic acceptance in that market.

A. Yes.

Q. Do you see that, Mr Dryden?

A. I do.

Q. You have no evidence to contradict that, do you?

A. No, but we seem to have jumped propositions a bit, because a minute ago we were on the question of whether an issuer would ever issue a card, co-brand a card with a lower MIF to Visa and Mastercard, and this seems to be an example that I had overlooked that they would.

Q. Sorry, Mr Dryden. When we covered the question of issuer incentives, one of the points that we canvassed was whether issuers liked more money than less money, and I think you accepted it was likely that at least one of the factors favouring the issuer's choice was to prefer the more money option over the less money option?

A. Yes, I agree.

Q. Now we are looking at other benefits, mutual benefits which accrue for co-badging with domestic schemes, and you have seen what Mr Holt says at 569?

A. That is fine, but it just tells us that the more or less money thing is not determinative; it is a factor.

Q. Indeed.

A. Yes.

Q. Indeed, and then we contrast large international schemes such as Visa and Mastercard. The point that is being made here, is it not, Mr Dryden, is that the differences between domestic schemes and international schemes create mutually beneficial effects when they co-badge?

If you want to say yes, you had better say yes for the transcript otherwise it will be missed.

A. I can see, yes.

Q. But for international schemes they have a wide overlap in terms of their functionalities --

A. Yes.

Q. -- geographic reach, market penetration; a point you made a moment ago?

A. Yes.

Q. So they have a wide overlap. Issuers have the incentive to seek maximum revenue from either of the schemes. So they would encourage the schemes to compete, to be the sole badge on the issuer's card?

A. Yes. But I think it cuts both ways, so the fact that the overlap is greater means that the scheme is more reluctant, may be more reluctant to allow the co-badging because it is a greater competitive threat; it may also mean that the issuer is more swayed by the MIF differential.

Q. Thank you, Mr Dryden.

On the question of by object infringement, and we will deal with this briefly because it is ultimately a legal point, but again, assume Mr Dryden, and this does not involve you accepting this at all, this is an assumption which I am asking you to make, that the legal test is that to be an infringement by object the harmful effects are so obvious that it is redundant to conduct a by effects analysis.

A. Yes.

Q. If that is the test, do you see how the co-badging rule is obviously a by object infringement?

A. So if it, if that is the test and part of that is it being obvious that there is an appreciable effect, or even any effect perhaps, then I think I agree with counsel, it follows. But it is also obvious that this is a rule, like the no surrender charging rule, that is one of two prongs that are absolutely related to the two conditions for the MIF competition problem: the reducing multi-homing and eliminating surcharging.

So I think that is the distinction I would draw; that if you require -- yes, I think -- hopefully that is clear.

MR KENNELLY: Thank you, Mr Dryden.

I have nothing further for Mr Dryden at

all. That is the end of my cross-examination of him. I think Ms Tolaney has some questions for him arising out of Mastercard's specific situation.

Cross-examination by MS TOLANEY

MS TOLANEY: Good afternoon, Mr Dryden.

I just want to ask you a few questions about Mastercard's Central Acquiring Rule, which you know was amended in 2015, and just to put this in context, before 2015 unless there was a bilateral agreement with the issuer, the central acquirer was required to pay the MIF applicable at the point of sale. After the change to Mastercard's Central Acquiring Rule in 2015, the central acquirer could pay the lower of the MIF at the point of sale and the intra-EEA MIF.

A. Yes.

Q. Now, as you say in your first report, the Commission held in the Mastercard II decision, which was in January 2019, that Mastercard's Central Acquiring Rule infringed article 101(1) of TFEU in the period between 27 February 2014 and 8 December 2015?

A. Yes.

Q. We can see that in the Mastercard II decision, so I will just refresh your memory --
A. So in other words, infringed in the first of those two situations you gave me?
Q. That is right.
A. That counsel gave me.
Q. That is exactly right.
A. Yes.
Q. So I think if we go to {RC-J5/30/1} and just look at recital 88, which is on page {RC-J5/30/22}.
A. Yes.
Q. So we can see that the Commission found expressly that the infringement started on 27 February 2014, which was the date of the 2014 Visa commitments decision?
A. Yes.
Q. The end date of 8 December 2015 is when the IFR came into effect?
A. Yes.
Q. So you say nevertheless that the factual basis of Mastercard II applies to the period before 27 February 2014?
A. I do get a bit lost in these dates.
Q. Let me remind you of your report. It is

{RC-H2/1/118}.

A. Yes.

Q. Paragraph 11.69.

A. Yes.

Q. So you see your first sentence:

"I consider the Commission's findings ... are intended to describe the factual position that applied before the specific period covered by the decision."

A. Yes.

Q. Now, before the period covered by the decision, 27 February 2014, which was the date, as we have just established, of the 2014 Visa commitments decision, Visa was operating its old (inaudible)?

A. Yes.

Q. There is a legal issue between the parties as to whether or not Visa was doing so lawfully. But that is not an issue for you.

A. Understood.

Q. Let us just assume Visa was operating its rule lawfully. You accept that it is a relevant factual distinction between the period before 27 February 2014 and the period after that date?

A. So in other words, it is relevant for

Mastercard what Visa's rule is?
Q. Correct.
A. Yes.
Q. In the period after 8 December 2015 --
A. Well, I am sorry. Yes, from an economic point of view, whether one has to be assuming parity between the schemes for the purposes of conducting analysis a la MIFs, I -- I do not know. But it is clearly a fact -- it would seem to me to be a factual difference.
Q. In the period after 8 December 2015 the IFR came into effect, and again, there is a factual difference with that as well?
A. That is a factual difference.
Q. Can I just ask you a few questions about Mastercard's non-discrimination rule, please. Can I just remind you how the factual witnesses describe the rule. This is at {RC-F3/1/26}. It is paragraph 66 and it is the statement of Mr Willaert. (Pause)
If you could also read paragraph 67 as well. Thank you. (Pause)
A. Yes.
Q. So there was an issue as to the operation of the NDR between the parties and whether it

related to cards co-badged with domestic payment card schemes or had a broader application.

Now, I think you agree that the question of whether the NDR applied to domestic co-badged cards or had the broader application is a factual matter?

A. I agree.

Q. Now, could you look at your report, please, {RC-H2/1/144}. Thank you, and it is paragraph 14.22.

A. Yes.

Q. So you say there the NDR is a stronger version of the surcharging rule?

A. Yes.

Q. Because it prohibits merchants who accept Mastercard from discouraging the use of those cards?

A. Yes.

Q. Now, you then go on to say, as we see, that the rule is more general than the SR?

A. Yes.

Q. "... as surcharging is only one possible avenue for merchants to discourage the use of Mastercard cards, and the NDR prohibits merchants to also use other strategies ..."

A. Yes.

Q. That is assuming, is it not, that the NDR has general application to all Mastercard cards and not just co-branded cards?
A. Because in the UK and Ireland, could I be reminded, there are no co-branded cards?
Q. That is right.
A. Yes.
Q. The UK, there was no domestic scheme in the UK whose cards could be co-badged with Mastercard, and in Ireland, cards issued under the Irish Laser domestic debit card scheme were co-badged with Maestro, but transactions on those cards were automatically processed through the Laser scheme where there was scope to do so. Do you accept that?
A. I am sorry, could I see the transcript? I have forgotten the question. Could we scroll up, please? The question is ...
Q. You asked me whether the NDR had no relevance in the UK essentially because there was no domestic scheme in the UK whose cards could be co-branded with Mastercard, and I said yes but I am asking you that you accept that is the case.
A. I accept there is no co-badging in the UK.
Q. Right. In Ireland cards were issued under

the Irish Laser domestic debit card scheme and co-badged with Maestro, but transactions on those cards were automatically processed through the Laser scheme where there was scope to do so?

A. I understand.

Q. Laser started to collapse from around 2007, but when it was around operated with lower interchange fees than Maestro.

A. I understand.

Q. So given all co-badged cards in Ireland were automatically processed through the lower cost Laser scheme where there was scope to do so, the NDR had no impact in Ireland, did it?

A. I see. I'm sorry, it took me a while. So the proposition is if the transaction has been automatically been routed through the lower cost scheme, i.e. to the merchant's benefit, depriving the merchant of the chance to steer, is not detrimental to the merchant.

Q. Correct.

A. If that is, if that set of premises is all correct, then I agree. Where the non-discrimination rule becomes harmful is where it is preventing -- is in circumstances where it is preventing the merchant from steering the transaction to a lower cost payment card.

Q. That is right. I think you read into the NDR a rule which prevents steering in general; correct?

A. I may do. I mean, if the NDR is limited to sort of intra co-branded cards, then its effects only go that far. If the NDR is not only about the co-branded card but any other card that may be presented at the merchant, then the -- the harm would extend to those other cards and it depends on what the rule is.

MS TOLANEY: Thank you. I do not have any further questions.

THE PRESIDENT: Thank you very much, Ms Tolaney.

Re-examination by MR BEAL

MR BEAL: Mr Dryden, I shall not, I hope, unduly extend your time in the box, but I do have a handful of points by way of re-examination.

Please could we bring up transcript day 12, page 11, lines 1-2 {Day12/11:1-2}. Could you look at the top of the page there.

A. Yes.

Q. You say -- can we scroll up so I can get the context, I am sorry, on the previous page, the bottom of page 10 {Day12/10:20}:

"Then you have the question of whether competition among schemes exerts a downward discipline ... I think the answer to that is no; in fact, competition amongst schemes can exert an upward pressure ..."

Can we scroll to the next:

"... if they are not constrained by merchants and they are not constrained by other schemes, the answer is yes. So there is a version where -- and then finally appreciability.

"So there is a version where if you satisfy that set of essential facts you have a restriction in 101(1), because essentially some prices are being set into the market by big players on that market ... and not being constrained then you go over 101(3) to find out if there is a justification ..."

Do you have any comment to make on that section?

A. Well, I could perhaps be clearer.

Q. I had thought, for some reason, at that stage, it may have been corrected subsequently, I thought that at that stage you said that the perspective was 101(1) rather than 101(3)?

A. Yes. Let me, I think, hopefully be slightly clearer.

So the essential facts according to the Mastercard decision for a restriction of competition, i.e. at the 101(1) stage, is that the -- there obviously has to be an agreement and then you come to restriction of competition. The MIFs have to be a floor on the MSCs. The MIFs have to be passed through -- higher MIFs have to be passed through into higher MSCs. Thirdly, it has to be the case that merchants and acquirers are not in a position to resist high MSCs. Fourthly, it has to be the case that inter-scheme competition does not place a downward pressure on MIFs and may even apply an upward pressure on MIFs, and fifthly, it has to be the case, taking that and anything else into account, that overall the schemes have market power in the setting of the MIFs which are a cost into the acquiring market. Then finally, the schemes in question have to be appreciable on that market.

Then you have objective necessity. That is my understanding of the essential facts for a 101(1) restriction. Anything that is then claimed to be a benefit arising from the issuing side, or anything else for that matter, is part of the 101(3) assessment.

Q. Do you remember you were asked quite a large number of questions by my learned friend Mr Kennelly about whether or not at the HACR, in a counterfactual with a UIFM, there would be scope for negotiation of a better deal which would potentially reduce the MIF below the rate set by an issuer?

A. I remember.

Q. There was an issue as to -- you were taken to certain bits of evidence and it was suggested to you that that was the only evidence out there, and Mr Kennelly rather threw down a gauntlet and said I could come back to this if necessary in re-examination, which he may be able to predict where I am going. Can we look, please, in the transcript, {Day6/17:23-24}.

A. Yes, so that is the question.

Q. Then the answer is page 17, line 25 through to page 18, line 5.

A. Thank you. (Pause)

Q. Do you recall that evidence being given?

A. I do not.

Q. Could we move, please, to transcript

{Day6/136:18-20}. This is part, I think, of a closed session so I shall not read it out. But if you could look, please, at the way the question is put at lines 18-20. Then the answer comes at page 137, lines 6-7 {D6/137:6-7}.

Next piece of evidence, please, transcript page 179, lines 19-23, {Day6/179:19-23}. This is open evidence from Mr Peterson on Day 6 and the answer comes --

A. Sorry, who were we just looking at? Who was --

Q. The person we were just looking at was Mr Nicol.

A. Nicol.

Q. Yes, but I am not going to detail his evidence because it was all given in closed.

Then Day 6, Mr Peterson, page 179, lines 19 to 23, and the answer is then at line 24 through to page 180, line 1 {Day 6.180:1}.

A. We can turn the page, thank you.

Q. Then in terms of Mastercard evidence we have Mr Willaert, {Day9/68:23}, please. The answer then is given at page 69, line 2 {Day9/69:2}. So if there is any way to straddle page 68, line 23 and then the answer at the top of page 69, that would be wonderful.

A. Sorry, can we just go back?

Q. I am hoping we can get both on the same page.

A. It is okay. Page 68, line 23; is that right?

Q. Page 68, line 23 through to the top of page 69.

A. We can turn the page, thank you.

Q. Then, finally, there is a selection of other evidence, but I am proposing to go through just some edited highlights.

Finally, please, Ms Devine {Day9/226/18-20}, and the answer then begins at page 227, top of the page {Day9/227:1}.

A. Thank you. We can go to 227.

Q. Down through to --

A. Yes.

Q. -- line 16 or so. So, I mean, that is a quick canter through some of the evidence that has been given. Do you have any observations to make on that?

A. Some of the earlier ones I did not find too clear. The last two, so this one, which is I think Devine?

Q. Ms Devine.

A. Peterson, which I think was the penultimate one.

Q. Mr Willaert.

A. Mr Willaert, I am sorry. So I think the last two seem to be, to be pointing to the real possibility that a smaller issuer might accept, or be forced to accept lower IFs than the cap in this UIFM without the Honour All Issuer Rule scenario. The earlier ones it was not so clear to me, one way or the other.

Q. You were asked some questions about American Express and its position in the market. Do you know whether American Express acquires Visa and Mastercard transactions?

A. Not as -- as I am aware, it does not.

Q. Do you know who does acquire American Express transactions?

A. I think -- I am not sure the extent to which American Express does do itself. There are also these entities that I think are called facilitators that have an agency-type role, if I understand it correctly, in acquiring Amex transactions.

Q. It was put to you by my learned friend

Ms Tolaney that an example of Maestro losing significant market share in the 2000s was an example of the detriment of not having high interchange fees available as a commercial proposition, and she took you to a judgment of Mr Justice Popplewell, as he was.

A. Yes, yes.

Q. Could I ask you, please, to look at a decision of this Tribunal. It is {RC-J5/24.01/165}. I hope there we have subparagraph 4 of paragraph 258. You see there that it is dealing with Maestro?

A. Yes.

Q. It says:

"Cross-examination also established that Maestro ... suffered a number of shortcomings compared with Visa Debit. Mr Douglas, Mr Perez and Mr Willaert all accepted that Maestro had a limited international acceptance, particularly in the USA ... despite these witnesses' explanations that international spending represented a relatively small share of spending by cardholders, and the suggestion that Maestro found acceptance 'where it mattered' ... we nevertheless consider this was a major contributory factor which led to the decision of HSBC and RBS to reject Maestro ..."

So is that attributing the demise or the poor performance of Maestro to the absence of high levels of interchange fee?

A. No, this is saying there is at least another factor at play which is the degree of acceptance and, skipping ahead to subparagraph 5, the suitability for online transactions.

Q. Finally, my learned friend Mr Kennelly put to you that there had not been any legal decisions concerning the no surcharging rule.

Please could I invite to you look at {RC-5/14.8/6} and recital 21. This is by no means the only treatment of this particular issue, but I just wanted to see how the European Commission deals with the concept of no surcharging. Could you scan, please, recital 21. You will come to a section, I think, where it says "the no discrimination rule" and you should there see a reference to footnote 7. Do you see that?

A. I do.

Q. Would you please be kind enough to read footnote 7?

A. Yes, can we scroll?

Q. There is a definition there of the no discrimination rule. Could you please read that and tell me what you derive from that description of the no discrimination rule?

A. I am really just going on the second sentence of the footnote, which seems to suggest to me that the no discrimination rule here amounts to a no surcharging rule. As we saw a few moments ago in my report, I say that the NDR encompasses a no surcharging rule because surcharging is a form of discrimination.

So, first of all, here they are saying the no discrimination rule really amounts to a no surcharging rule, and it does not appear to be limited to situations of co-branding; it seems to be more general.

Q. When we look back up to recital 21 having obtained that definition, can you see what the European Commission has to say about the effect in the acquiring market of that rule?

A. Yes, it is saying that the rule -- I mean, consistent with all of my analysis, it is saying that the rule is having a reinforcing effect of the restriction of competition that arises from the MIFs. In other words, there is always two ways to look at the rules. One is you can look at the rule as factual context for the assessment of the MIFs, and here it is saying it is essentially -- well, sorry, let me just say this two ways. You can either just take the rule as factual context of the assessment of the MIFs when it focuses on the MIFs. You could also look at the rule as the focal point and look at whether the rule itself is restricting competition.

Here, I think it is the former. I think it is focused on the MIFs and it is saying that the rule is having a reinforcing effect on that restriction of competition.

MR BEAL: Thank you very much.

THE PRESIDENT: Mr Dryden, thank you very much. It has been a marathon session and we are very, very grateful to you for your time and your evidence. You are released from the witness box with our thanks. Thank you very much.

A. Thank you.

(The witness withdrew)

MR KENNELLY: Sir, it is probably the transcriber break now before we begin with Mr Frankel --

MR BEAL: Dr Frankel.

MR KENNELLY: Dr Frankel, forgive me. Professor Frankel in fact.

THE PRESIDENT: That makes sense. We will rise for 10 minutes and we will resume with Dr Frankel.

Thank you very much.

(3.07 pm)

(A short break)

(3.18 pm)

THE PRESIDENT: Mr Beal.

MR BEAL: Please may I call Dr Frankel to the witness box.

THE PRESIDENT: Please, thank you very much.

DR ALAN FRANKEL by MR BEAL

THE PRESIDENT: Dr Frankel, good afternoon, I hope you have got some water there. You probably heard what I said about the screen, if you need to see other bits of the context, do let counsel know and they will make sure it comes up.

A. Sure.

THE PRESIDENT: Otherwise I shall hand you over to Mr Beal who has some questions.

Examination-in-chief by MR BEAL

MR BEAL: Dr Frankel, Professor Frankel, which is your preferred --
A. Dr is fine.
Q. Please could you take out bundle {RC-H1/1/1}, you have I think all your reports there in one bundle unmarked. That is the front page of your first report; is that right?
A. Correct.
Q. Could you turn, please, to page 160. {RC-H1/1/160} You will see that there is a signature there. Whose signature is that?
A. Sorry, my paging is different.
PROFESSOR WATERSON: 161.
MR BEAL: Sorry, 161 is your signature but the declaration begins at page 160. Is that your signature at 161? {RC-H1/1/160}
A. I have it on 157, but it is my signature.
Q. Can you confirm whether or not the declaration you have given there is a declaration that you are happy to abide by for the purposes of these proceedings?
A. Yes.
Q. Could we next look, please, in {RC-H1/2/1}, that is the front page of your reply report; is that right?

A. That is correct.
Q. I am hoping that the numbering will not be off here, could we go to page 123? {RC-H1/2/123}
A. Yes.
Q. There is a signed declaration statement of truth there. Again are you happy to abide by that declaration that you have given to the Tribunal?
A. Yes, I am.
Q. You prepared a third report.
Sir, this third report was submitted on Friday and we do seek permission to rely upon it as I indicated briefly on Friday, on 29 February 2024, a number of documents were included in the RC-R bundle which we anticipated would be put to Dr Frankel by way of cross-examination. As a result of inviting Dr Frankel to look at those documents, he decided that he wanted to make some small corrections and also add some points and he has done so in that very short third report and we seek permission to rely upon that third report, please?
THE PRESIDENT: I am grateful. It is not objected, subject to our discussion --
MR COOK: Sir, we accepted it should go in obviously with the caveat that there are a lot

of very new points in there which I will take Dr Frankel to and we cannot address all of them but we can deal with the sort of the general thrust of these points with the caveats that you yourself referred to last week, sir?

THE PRESIDENT: Yes, well, on that basis, Mr Beal, we will admit that report.

MR KENNELLY: Sir.

THE PRESIDENT: Sorry, Mr Kennelly I had assumed --

MR KENNELLY: Not at all. We do not object to the report going in either but it makes factual points which we would like the opportunity to address in a very short five-page statement which we will lodge tomorrow in response to it on the points which we cannot address by reference to the record before the Tribunal now.

THE PRESIDENT: Who will that statement come from?

MR KENNELLY: From Mr Holt.

THE PRESIDENT: Thank you very much, I am sorry I cut you out, Mr Kennelly.

Mr Beal, on that basis, we will admit the statement to the extent that there are points to be made about an inability to respond, then we would expect those to be made in closing so that we can take them into account but it is admitted.

MR BEAL: I am not sure the report has yet found its way into the Opus bundle because it had not been formally admitted, but obviously the Tribunal has its own copy.

THE PRESIDENT: We have and we can try and get it uploaded to Opus during the course of the afternoon.

MR BEAL: Thank you, Dr Frankel. There will be some questions for you.

Cross-examination by MR KENNELLY

MR KENNELLY: Good afternoon, Dr Frankel.

A. Good afternoon.

Q. Dr Frankel, it is your evidence that MIFs are a cartel device; that is correct, is it not?

A. Yes, in essence.

Q. Do you accept that that is not the economic consensus?

A. Well, sure. I -- I agree that there are economists who have different opinions about that yes.

Q. May I show you one, you are familiar with the work of Professor Tirole of course?

A. Yes.

Q. May I show you one of his opinions -- sorry, reports from 2011 and that is {RC-J5/14.8.01/1}, so you see what we are discussing. Are you familiar with this document?

A. Yes, I am.

Q. Could I ask you to turn, please, to page 6 {RC-J5/14.8.01/6} or be shown page 6. Do you see the second paragraph there that begins "Interchange fee regulation ..."; do you see this?

A. Yes.

Q. "... has sometimes been motivated by the associated agreement among competitors (the issuers)."

He says: this illegal price fixing argument, which was the basis of the NaBanco case, is based on an incorrect analogy; do you see that?

A. Sure, I see that.

Q. "An increase in the interchange fee is not a price increase for some final users like in standard cartel theory, but a reallocation of cost between two categories of end users (merchants and cardholders)."

Do you see that?

A. I see that.

Q. I am going to take you through this and then ask you some questions about it, Dr Frankel.

"This point was made by authorities staff in some regulatory hearings, and yet is not always taken on board as a key principle for policy intervention."

At the bottom of that page, Professor Tirole refers to the European Commission, about three lines from the bottom, he says:

"The European Commission has chosen to regulate cross-border interchange fees in such a way that the merchant fee does not exceed the retailers' avoided cost when a cash or cheque payment is replaced by a card payment."

Do you see that?

A. I see that.

Q. In footnote 13, to which that paragraph refers, Professor Tirole cites what he says is useful information about halfway down footnote 13 on that page, useful information about the Commission's methodology and he quotes from it, do you see that?

A. Yes.

Q. "'As regards calculation of the (cross-border) MIF, Mastercard has engaged to apply a methodology developed in economic literature to assess efficient interchange fees which is called the "avoided cost test" or "tourist test". The fee which meets this test also referred to as the balancing fee [and I emphasise those words "balancing fee", Dr Frankel, we will come back to them] ensures that user benefits are enhanced. The balancing is such that merchants do not pay higher charges than the value of the transactional benefits that card use generates for them. Merchants derive such transactional benefits if card payments reduce their cost relative to cash payments ...'"

Skipping ahead:

"'The implementation of the balancing fee ensures that the merchant is indifferent as to whether card or cash payments are made.'"

Then, Dr Frankel, just above where we have been reading on that page 7, we are on page 7 now, I am so sorry, page 7, thank you, {RC-J5/14.8.01/7} and under the heading "Looking for a market failure" the second paragraph under the heading "Looking for a market failure", second sentence:

"Because there is widespread confusion about where the market failure lies, we start by identifying it. It is sometimes believed that the joint determination of an interchange fee by banks represents an attempt to cartelise and raise prices. Economists and anti-trust enforcers are rightly suspicious of attempts by competitors to get together and raise prices to users. The snag with this reasoning [says Professor Tirole] in the case of payment cards, though, is that there are two groups of users and that increasing the interchange fee raises the price of card transactions for one group (merchants) and lowers it for another (cardholders).

Put differently [over the page, [{RC-J5/14.8.01/8}] in a first approximation the interchange fee affects the price structure and not the price level. This feature by itself makes received knowledge about cartelisation inadequate."

Do you see that, Dr Frankel?

A. I see that.

Q. Then the conclusions in this piece and this is the last thing I will show you on this document, Professor Tirole's conclusions are on page 19, {RC-J5/14.81/19}, "Understanding how interchange fees are set in the absence of regulations" at the top of page 19, "Regulation", just the second bullet for the moment:

"Merchant demand for card usage can be defined in two ways: narrow (the net benefit for the merchant: how much they directly save when a card payment substitutes for a cash or a check payment, as well as the enablement of transactions which otherwise would not occur) and broad [definition] (a concept that further includes the cardholders' perceived benefit from card usage). The narrow concept is appropriate in the case of a consumer who does not need to be attracted through card acceptance (the hypothetical tourist), while the broader concept applies when the merchant views her card acceptance policy as a means to attract consumers to her shop. What the merchants can bear lies between these two benchmarks."

Then skipping down to the critical bit:

"The implications for policy-making" according to Professor Tirole.

First bullet point:

"Regulated IFs should not lie below the level set by the 'tourist test' which reflects the first benchmark; that is, the IF should be at least equal to the difference between the merchant's benefit from card usage and the acquiring cost."

But, he says:

"This level however probably is a conservative estimate of the socially desirable IF for two reasons:

It does not reflect industry profit and its long-run impact on entry innovation and end-user welfare.

It does not reflect the negative social externalities exerted by alternative means of payment (tax evasion for cash ...)"

And so forth.

Do you see that, Dr Frankel?

A. Yes, I see it.

Q. Do you accept, as Professor Tirole does, that positive interchange fees in the United Kingdom and Ireland are capable of efficiencies?

A. As a theoretical matter, there is a possibility that interchange fees could cure an externality problem. I think it is highly unlikely that they are in fact designed to do so and achieve that result.

Q. So you say in theory, positive MIFs are capable of internalising externalities in two standard markets?

A. You can write out a model on paper and I could draw it on a blackboard that shows this argument, the tourist test argument, for example, it is a straightforward argument. I think the policy implications though fall far short of saying therefore MIFs should be okay.

Q. So you have not seen any evidence at all that shows that MIFs do generate efficiencies?

A. Well, it is more that I have not seen evidence that show that efficiencies are generated. I think the argument itself is -- is highly implausible and the logic of it suggests a completely different kind of policy response other than letting the banks get together with their schemes and set a MIF.

Q. So you say that MIFs do not internalise externalities in these two sets of markets at all?

A. It would be highly unlikely. What they say, what -- this is just Tirole. What Professor Tirole is saying here is really that he can -- if you can measure the average cost savings of a card relative to cash, say, that a MIF set at that level, this is his bare minimum argument, that a MIF set at that level could achieve an efficiency. Well, what is the assumption underlying that? It is that the MIF goes to the issuing bank and the issuing bank is perfectly competitive and passes on that entire MIF to the cardholder as a lower fee or as a rebate to -- to correct an externality at the point of sale.

But if that is the problem, if the problem is that the merchant has different costs for different payments, the obvious solution is to ask the merchant: how can we be of help? Do you want to pay a MIF? Do you want to give a discount to your credit card customers or your debit card customers? If so, we can administer that fee and show it as a credit under on their monthly statement, but that is not what they do, they use the MIF and I think there is a good reason why they use a MIF.

Q. So are you saying that although Professor Tirole has set out the model you say the evidence shows no justification for positive MIFs?

A. No, that is not what I am saying. It is not just that it is a lack of evidence. It is the very logic of the argument does not lead to the -- to the solution of a MIF. The MIF is not -- is not the least restrictive solution to the alleged problem, even if it is a problem, it might be of trivial magnitude, it might be of big magnitude, but the first thing you would want to do is say: okay, merchant, can you steer, can you solve this problem on your own? If not, because they do not have the technology, it is 1970, so what can we do to help you solve this problem? What MIF would you like to pay to your own customers to show up as a discount to give them the right incentive to use the card? That would let merchants compete with each other over the terms of card transactions to their own customers.

Q. So on that basis, Dr Frankel, do you think that the European Union in enacting the interchange fee regulation should have set the caps at zero?

A. I am not -- the European Union is a political body. MIFs are set and regulated with a combination of Competition Law, economics, private action and political interventions. I am not going to advise the European Commission how they should act.

My advice as an economist would be to migrate to a par settlement system we could talk about going forward versus counterfactual which is rearward looking, but my view is that the sensible thing to do is to have a par settlement system, let merchants solve these payment externalities themselves.

Q. But I am asking you as an economist, Dr Frankel, is it your opinion that the European Union's policy response in the IFR was wrong?

A. Well, it was an improvement over what came -- there are things about the IFR that I think are not ideal, but it was an improvement over what pre-existed the IFR. It is a good start but I would -- I would not stop there if it were up to me, which it is not.

Q. If it was up to you, sorry, it would?

A. If it were up to me there would be -- there would be slightly different policies, not just -- it would not stop with the IFR.

Q. May I just show you the IFR and just check what you do and do not accept. {RC-Q1/14/4}, this is recital (20), thank you. This refers to the caps being based on the merchant indifference test first of all, Dr Frankel, are you familiar with this recital in the IFR?

A. I am sure I have read it before.

Q. If you skip down about six lines you see a sentence beginning "It thereby stimulates these efficient payment instruments"; do you see that?

A. Yes.
Q. So the European Union is saying through its legislature that MIFs capped pursuant to the merchant indifference test:
"... stimulate the use of efficient payment instruments through the promotion of those cards that provide higher transactional benefits, while at the same time preventing disproportionate merchant fees, which would impose hidden costs on other consumers. Excessive merchant fees might otherwise arise due to the collective interchange fee arrangements, as merchants are reluctant to turn down costly payment instruments for fear of losing business. Experience has shown that those levels are proportionate, as they do not call into question the operation of international card schemes and payment service providers. They also provide benefits for merchants and consumers and provide legal certainty."
Do you see that?
A. I see all that.
Q. Do you agree with that?
A. No. Not really.
Q. Could you tell the Tribunal what parts of this analysis you disagree with?

A. So yes, it is incomplete and it is a simplification. First of all, what they -- what the methodology does is to try to get it right on average, to come up with what is the right subsidy for using cards that on average will provide the right incentive to customers, the merchants' customers, to use a lower cost payment. Well, that cost differential will vary from merchant to merchant. At some merchants it is going to go the wrong way; maybe they need a negative MIF or interchange fee. Other merchants maybe it is too low and they need a higher interchange fee. So that is just one detail.

But, you know, each of these thoughts -- first of all, there was some political language in here. There is a compromise going on here in this document but the economic theory is that the merchant indifference test MIF solves the problem, it is the right solution. I just disagree with that.

Q. Where is the political language, Dr Frankel, that you think you see here?

A. Well, the first part of the paragraph talks about the merchant indifference test developed in economic literature which identifies the feel of what a merchant would be willing to pay -- it would be willing to pay. So how -- if they are willing to pay it, why not ask them: what MIF do you want to pay?

So -- but that is where I get the merchant indifference test.

Q. Dr Frankel, do you think that the European Union made a mistake with the level of the fees -- the level of the caps that it set in interchange fee regulation?

A. It depends what the alternative was. If no legislation would get past that would move us to a par settlement system I would say this is a great improvement.

Q. But Dr Frankel, Dr Frankel, the European Union is telling us, the legislature is telling us in terms of the basis for the setting of the caps. It tells us they are set by reference to the merchant indifference test which caps of that nature:

"... stimulates the use of efficient payment instruments -- efficient payment instruments -- through the promotion of those cards that provide higher transactional benefits, while at the same time preventing disproportionate merchant fees, which would impose hidden costs on other consumers."

So again I ask, from your perspective, as an economist, what is the error in setting the cap at 0.2 and 0.3 for debit and credit?

A. Well, there is a couple of layers it that question. First of all, doing the cost studies is hard. Doing the cost study for one merchant is hard, doing it for every merchant in Europe is impossible. I prefer to rely on a decentralised competitive solution but the idea here, I do not object to the idea, I agree with the idea theoretically if -- if issuers were perfectly competitive and if the European Commission had infinite wisdom and information and could set the MIF just right for each merchant, then this would come true. But those -- those conditions do not exist.

Q. On the question, Dr Frankel, of the differential costs of cash and cards, the point you made a moment ago, you speak to this in your own report, do you not, can I ask you to go to that in your first report {RC-H1/1/31}.

A. Report page 31?

Q. Yes, it is H1, your first report.

A. Yes.

Q. Page 31, it is 27 on the inside. I am always going to give you, Dr Frankel, the RC page number?

A. That is what I was asking.

Q. In the bottom right-hand corner, so page 31 {RC-H1/1/31}. Do you have that?

A. Yes.

Q. At paragraph 67, you are dealing with this question of costs. You say -- and I am looking at the second sentence of 67 -- MSC increased by MIFs often have made card transactions more costly to merchants than cash and sometimes even cheques; do you see that?

A. Yes.

Q. But then look at the evidence that you cite for that. Do you see at footnote 51, you refer to the memorandum by the British Retail Consortium, do you see that?

A. Yes.

Q. From 13 March 2001, do you see that?

A. I see that.

Q. Then you refer to BRC briefing in the same footnote in cost of collection survey 2007; do you see that?

A. Yes.

Q. Those are cost studies before our claim period, are they not?

A. I frankly do not remember when the claim period starts overall. But they are all -- but there have been a -- there has been a lot of literature on -- on payment costs and the one takeaway is that it is really hard to agree on the right way to do it: even the Commission I think concluded that the optimal interchange fee is probably closer to zero than they ended up with.

Q. Well, Dr Frankel, you are speaking to the differential between costs of the card and the cost of cash. The first piece of evidence you cite here is from 2001 and 2007, when interchange fees in Europe were much higher, Visa and Mastercard interchange fees were much higher then than they are for the period we are dealing with under issue 3, post-IFR.

A. I am sorry, I did not know -- you want to talk about post-IFR?

Q. Yes.

A. Okay, and what is the question?

Q. I showed you the IFR and how the Commission and the European legislature had considered the application of the merchants'

indifference test which led to the caps 0.2 and 0.3?
A. Yes.
Q. Then you said differential costs, cards and cash, are complex and I showed you paragraph 67 of your report which is where you address this question?
A. Yes.
Q. The evidence you cite is from a period long before the interchange fee regulation?
A. Well, I am sorry, hang on. Let me reread this.
The sentence that I footnote here is not specific to post-IFR, it is a general statement that I say debit cards should have reduced costs compared to cheques for everybody, everyone should have benefited. But instead debit cards were made more expensive by MIFs. Okay. Sometimes even more than cash and sometimes even more than cheques. This has nothing to do with the IFR, I understand the IFR reduced the MIF and maybe it should have reduced it more.
Q. Are you saying it should have reduced it more?
A. Well, my recollection is that the -- I think it was Ernst & Young maybe that did a study

of the costs. It is difficult to do these studies. But even if you thought that applying the same MIF to every merchant in Europe and doing it, either having a scheme do it or having a political body do it, or have a court do it, it is my view that that -- that there is, there is a more sensible way to go about that that is more consistent with competition.

Q. Dr Frankel, just to be fair to you. I am taking you to this paragraph in the context of a discussion about MIF sets at 0.2 and 0.3 under the IFR. I appreciate this was not written for the IFR. I have taken you to the age of the BRC data and I want to show you the next thing that you cite in this footnote, you say: a Visa supported study published in 2006 based on US data reported that credit cards and Mastercard and Visa debit cards cost merchants more than either cash or cheque. Do you see that?

A. Yes.

Q. Now, again, to the extent that you are criticising the MIFs set at that cap, under the IFR, do you accept that US data from 2006 is of no assistance to us in understanding whether the costs of cash have been properly calculated by the

European Union?

A. My -- although I have not gone into it in great detail for this for Trial 1, I think it may come up in Trial 3, but if there is an efficient level of the MIF and so on. But I do not think any of these studies are up to the task of getting this right.

I think -- I believe in letting each merchant figure this out -- not -- not imposing a uniform solution to all merchants.

Q. Dr Frankel, just coming back to the premises, the basis upon which you said that the MIFs involved in the infringement by object -- and I should say the MIFs, I mean we are dealing here with issue 3 and interchange fees applied under the bilateral counterfactual or the UIFM. You said that interchange fees applied that way would be an infringement by object.

Is it your understanding that in addressing whether MIFs, Multi-lateral Interchange Fees, or IFs, in asking whether they are infringements by object, is it your understanding that it is unnecessary to assess whether the MIF serves to balance the issuing and acquiring sides of the market?

A. I think that is a legal question, I am not comfortable saying what is necessary.

Q. But I am not -- again, forgive me, I am not asking you to say what the law is. I am asking you to tell us what you think is the basis -- because you speak to "by object infringement", you say that things are "by object infringements" and when -- I just wanted to check when you said something is a "by object infringement" what you understood that to mean. Do you think -- is it your understanding that in addressing whether something is a "by object infringement" in this context -- I should be more precise: when you are addressing whether a MIF or an IF is a "by object infringement" in these proceedings, is it your understanding that you do not need to consider whether the MIF serves to balance the issuing and acquiring sides of the market?

A. I have done my best in this case to apply the idea of a "by object infringement" as I am instructed and understand it. It is my understanding that this idea of balancing which I still do not understand, is not part of the first stage of the analysis. If I am wrong, I am wrong, but that is a legal question.

THE PRESIDENT: Dr Frankel, I understand your difficulty, with respect, but just moving back a stage. Is it your position that you just cannot articulate how one would undergo the balancing exercise in order to achieve a defensible outcome? That, it seems to me, is not a legal question, but one that may be underpinning your thinking in which case do expand. If I am barking up the wrong tree, do let me know.

A. Let me try. Like I said, if you go -- if you wind technology back, we do not have computerised cash registers, we do not have the ability to apply surcharges and discounts without holding up lines of customers, a world of 1970, 1975 some of us remember it.

In that environment, it is more plausible that coming up with a solution that on average gets it right and gives the right incentives to migrate to an efficient technology, I could see that being done. I would implement -- I think it would be a better competitive solution to implement it differently instead of just giving the money to the issuers, and there was no -- there were no rewards, it is not clear whether there was much issuer pass-on of MIF revenue back then. I can imagine doing this balancing exercise. People keep calling it "balancing", if the idea is to create the right incentive for people to choose the right payment instrument on average and merchants cannot do it themselves, this is not a crazy idea.

THE PRESIDENT: Is the reason for that answer technology or the universality of the scheme or both?

A. My -- so my view is that it is just highly unlikely that -- I mean, the schemes and their member banks back in the day that owned and controlled them had an incentive to use MIFs to exercise market power, to bring revenue in to themselves. So it is hard for me to divorce myself from -- from that competitive problem. The idea that it can be used as a solution theoretically I agree with. I just think it is unlikely to be in that solution instead of a continuation of a problem. I am not sure that answered your question.

THE PRESIDENT: No, thank you very much, I do apologise.

MR KENNELLY: Not at all, sir. Coming back, Dr Frankel, to something you said a moment ago. You said balancing which I still do not understand; do you recall those words?

A. I do.

Q. Did you really mean balancing, which I do not agree with?

A. No. I have debated interchange fees on many occasions and for many years I have heard this phrase used, we have got to balance the two sides, we have got to get both sides on board. These talking points that do not have a lot of economic content to them. They are not very precise statements. Like I said during the concurrent evidence, it feels good. Who wants to not be balanced, but I am not sure how I determine when something is balanced when -- I can tell when there is the right economic incentive to use the efficient payment method, perhaps.

Q. But, Dr Frankel, you said this concept does not have a lot of economic content to it, this concept of balancing the two sides of the issuing --

A. Correct.

Q. The issuing side and the acquiring side of the market?

A. That is my view.

Q. But Professor Tirole has written about this extensively. You have seen the economic content that he sets out with his colleagues and sometimes by himself, giving economic content to this concept of balancing the issuing and acquiring sides of the market. Just being blunt, Dr Frankel, do you think Professor Tirole got this wrong?

A. I do think he has got the policy implications wrong. The models are beautiful, but the models only show what they are designed to show. So if the idea is to -- is to determine what is the optimal interchange fees, one of the -- one of the targets of much of the economic literature, how do you figure out what is the optimal socially efficient interchange fee? The models may do that but it is -- often it is impossible to distinguish a model to determine the optimal interchange fee from what is the profit maximising monopoly interchange fee.

Q. Your view, Dr Frankel, really is that there should be no interchange at all, ideally?

A. Not quite. I think it should only be as a result of voluntary agreements.

Q. But absent that, there should be no interchange?

A. At least as a general rule, yes, I can think of theoretical exceptions that I might be persuaded in a particular circumstance make sense but my default after thinking about this for a long time is that we would be better off had the interchange fees not been introduced in these schemes.

Q. Your view, is it not, Dr Frankel, that issuer costs that we have been discussing at length and it is discussed in the literature, arising from cards and card usage, should be borne by the cardholders --

A. Yes.

Q. -- to the extent they are willing to bear them?

A. Well, it is important if they are issuing costs that the cardholders are not willing to bear but they benefit the merchants a lot which is, which is the idea behind the merchant indifference test, and these rationalisations for the interchange fee, so if there are costs, if it is costly for the issuer to get -- to provide card services to their own cardholder and the cardholder is indifferent, not willing to pay much, it will not cover those costs, they would rather not use the card but the card generates overall benefits to the merchant, what is another way of fixing that? Let the merchant internalise those what we call externalities. So give the incentive to their own customer to use the payment method that benefits the merchant. How do they do that? They give them a discount and if the discount reflects the value, the extra value to the merchant, it may induce the customer to say: well, it was not worth it to me before, but now it is and I will use the card.

Q. But imagine a scenario, Dr Frankel, where merchants are absent any rule from any scheme, merchants are reluctant to discount or surcharge their customers. In those circumstances, do you still think interchange should not exist save where entered into through voluntary agreement?

A. My conclusion is that first of all I -- we can discuss the premise, I am not sure I agree with the premise, but if it is hard to get surcharges or discounts going. Discounts are more friendly, and merchants are often willing to offer discounts. Surcharges are harder for reasons we could discuss. If a merchant really is benefiting in a way that the cardholder does not take into account and for some reason they are not -- I do not know why they would not be willing to offer a discount, that should be a win-win for them.

Q. I am sorry, Dr Frankel, I am not sure you have answered my question. I asked where merchants -- let us assume merchants are very reluctant to surcharge or discount, so in that scenario do you still say there should be no interchange?

A. Can I just ask for a clarifying point. So you want me to assume that merchants are benefiting a lot but they still do not want to offer a discount for using a card?

Q. Yes.

A. As a theoretical matter you could force them to do the efficient thing I guess in that circumstance, that is I guess the defence. But as a policy matter, that seems pretty hard to justify.

Q. But if the merchants are benefiting, which I accept you have doubts about if they are benefiting and the merchants will not surcharge or discount in those circumstances it could be legitimate to have an interchange fee?

A. Well, if the merchants are -- if the merchants are benefiting, first of all they are never all going to be benefiting by the same amount, but if they are benefiting it could justify a system in which they can -- they -- the scheme can facilitate them providing a benefit to their own customers, to force them to do it for their own good my instinct is no, I would not go that far as to say that is economically justified.

Q. But what you do accept, I think, is that it is not realistic to load all of the issuers' cost on the cardholders where the merchants benefit, but there are benefits accruing to the merchants from the operation of the payment card scheme?

A. For most payments, most circumstances it is perfectly sensible to let the costs lie where they fall. I could -- I could go to the bank and I could send a wire transfer to Europe, you could send a wire transfer to me if you were to hire me, that is how you could pay me and you pay your costs, I pay my costs to our respective banks, we do that all the time. There is no -- I do not have a problem getting clients to pay me because they are not willing to pay the $25 wire transfer fee. We have other problems but ...

So, you know, letting the costs fall where they lie, I also use the example of cheques.

Q. What about the example of a two-sided payment card market, the one that we actually have in this case. Are you saying in this case in our scenario, the costs should lie where they fall?

A. Sure.

Q. On cardholders?

A. Well, let me give you an example that has been discussed in this case. In New Zealand, there is a debit card scheme called Eftpos, there is no MIF, merchants can deposit or can accept Eftpos transactions for free. Why does that happen? Because the banks want them to open current accounts with that bank, they give them free -- historically they gave them free transaction acceptance services. What about on the cardholder's side? Cardholders typically get either unlimited or a specified number of transactions a month free. 200 maybe. 100 whatever it is under their account plan and it works fine.

Q. Well, let us just take that in stages, Dr Frankel. Have you seen the evidence from Mr Peterson about the fate of the Eftpos system in New Zealand?

A. I have read several statements about New Zealand.

Q. You have seen the evidence about the lack of innovation in Eftpos, the lack of contactless technology, are you aware of that evidence?

A. Yes, I do recall that it is based on I think the Maestro standard that did not have contactless.

Q. So the evidence is that the lack of investment and revenue from interchange hindered the development of Eftpos and the innovation that might otherwise have occurred?

A. Well, it is not always so clear. The -- first of all, innovation can happen at the scheme level and it can happen at the issuer level. The schemes for example form the Emvico organisation, they -- the schemes at the scheme level introduce that new technology for payment security and functionality. You know, where do they get their money? Well, they charge a small amount of scheme fees to their member banks with each transaction.

The investments in -- in domestic schemes have often been neglected in my view because banks would prefer to have MIFs than not have MIFs. That does not make the MIFs pro-competitive, but it means if they can, if they can get MIFs, if they can let the domestic scheme wither, banks often have been willing to do that.

Q. Are you suggesting that Eftpos was left to wither in order that the banks could get MIFs through --

A. No.

Q. -- interchange?

A. No. Just that -- first of all, the fact that someone says it is technologically backward, there have been a lot of recent developments in our society, some of which were not foreseeable, some of them have been foreseen over and over again and it did not happen for a long time, like contactless payments, like internet payments. With Covid, contactless became very important and the whole society quickly shifted over.

It is very difficult if you were maybe planning on upgrading your technology over the next decade and had the whole society switch over in a week, it could be very difficult.

But I am not going to judge the banks of New Zealand for not having some of these new technologies.

Q. Coming back to loading costs on to cardholders which I think you suggest is one of the things that was part of the Eftpos model. Cardholders' appetite to bear issuers' cost does not take into account the benefit to merchants in having card payments; that is true, is it not?

The cardholders do not understand the link between paying more for their cards and having wider acceptance on merchants innovation and other benefits that may flow from interchange?

A. I am sorry, this question is getting complicated. The first step was cardholders do not know that something benefits the merchants. I think if you go to a merchant and you see different price points for different quality products or different options, some merchants give you free gift-wrapping, some charge you an extra charge for gift-wrapping or delivery, some -- so customers are accustomed to seeing merchants have different strategies and sometimes up-charging for optional items.

Q. What is up-charging?

A. An additional fee or a higher price for a larger size, for an extra service, an extra item added to the bundle.

Q. But, Dr Frankel, in this country, you have seen the overwhelming evidence that merchants are reluctant to surcharge even when they are allowed to because they are afraid of losing the sale.
I appreciate the situation may be different in other countries but here the vast majority of the evidence

has been that merchants are reluctant to surcharge even when they are allowed to.

A. You know, it is -- surcharging is a relative thing. First of all surcharging has a contagion aspect. There is a positive externality, but by surcharging you make it easier for your competitors to surcharge and it is hard for a merchant to be the first one in his industry or in his city to add a surcharge.

Once it gets going, it can accelerate. In the UK you also had an interchange fee of below 1%. Surcharging tends to occur more the higher the fees are. In my country, we have a 2% interchange fee and more merchants are beginning to surcharge. I am sorry, there were like other parts of your question?

Q. Not at all. That was very helpful.

I move on now to the hold-up problem, Dr Frankel, and I am going to show you your first report {RC-H1/1/22}. Paragraph 46. At the top of that you refer to the decentralised interchange fee counterfactuals. Do you see that?

A. I do.

Q. You say first that they suffer from a similar need for universal participation, a need

which is of the schemes' own making; do you see
that?
A. I do.
Q. You refer to the Honour All Cards Rule and the non-discrimination rule. But focusing on the Honour All Cards Rule for a moment, do you mean the effect of the Honour All Cards Rule is to ensure universal participation among merchants?
A. I do not know what you mean by universal participation among merchants. If you mean a merchant universally participates with all the issuing banks, but there is no rule that says all merchants in the UK have to accept cards, I understand that.
Q. So by universal participation, you mean -- well, what do you mean by the words "universal participation" in the second line of paragraph 46?
A. It means all merchants must enter into interchange fee agreements or accept interchange fees demanded by every issuer in the scheme.
Q. Is that not universal participation by merchants?
A. We can stipulate that -- we can define that as universal participation.
Q. Let us look at the last sentence at

paragraph 46, Dr Frankel. You say:

"The result is that in a decentralised interchange fee regime, each issuer would be able to exercise the entire monopoly power of the entire scheme or [and this is the bit I want to focus on] have an incentive to set its fee at a ruinously high level."

Do you see that?

A. I do.

Q. In the context of issue 3 and the schemes' proposed counterfactuals post-IFR, do you accept that the IFR now prevents interchange fees being set at a ruinously high level?

A. By what I meant here, yes.

Q. Coming back to the question of counterfactual, Dr Frankel, you mentioned a moment ago in answer to the President's question that it is important to recognise the extent to which the current situation is affected by the MIFs and the anti-steering rules that have been in place for many, many decades.

A. Yes.

Q. Is it your view that in a proper counterfactual we should ignore the IFR entirely?

A. I think so.

Q. Is that because the IFR was created to deal with the problem -- a problem that you say is a competition problem and has been for many years?
A. Yes, in part there would be no IFR, there would not have been a need for an IFR in my counterfactual.
Q. So do you say that for the counterfactual we should assume away all of the effects of MIFs and anti-steering rules that have been in place since they were created?
A. That is --
Q. That would require it, would it not, the economists and the Tribunal, to imagine a market context totally different from the one we have currently?
A. Very different in many ways, but yes.
Q. There is no factual evidence before us to help us work out what that would look like if we assume away MIFs and anti-steering rules since they were first created?
A. I think there is plenty of factual evidence to guide our thinking about those things.
Q. Including in the witness evidence before the Tribunal?
A. Well, I have read a lot of witness

statements, some of them have been quite helpful to me and others less so. Witnesses who speculate about what would happen under one scenario or another, sometimes I find them interesting but not necessarily credible.

Q. If the Tribunal was to develop a counterfactual that had to exclude the IFR and all the effects of MIFs and anti-steering rules since the day of their creation, what factual evidence can assist them? Can you point the Tribunal to any part of any witness statement or oral evidence given in these proceedings that might help the Tribunal develop that counterfactual?

A. Yes. As I mentioned a few minutes ago, we have a great example in New Zealand of a scheme that has no MIF. Now, the -- your question includes the rules and the MIFs together. The rules are not that important, this is where Mr Dryden and I looked at things a little bit differently. The rules are much less important if there is no MIFs. Your question also -- originally you referred to the anti-competitive effects, if those are all gone I think we should assume all the anti-competitive effects are gone.

Whether you had an Honour All Cards

Rule or not, if there is no MIFs and there is no -- no surcharge rule subject to legal issues and no non-discrimination rule it would not bother me if there was an Honour All Cards Rule. So the importance of these things varies.

Q. To work out then a legitimate counterfactual, we have to imagine a world where there were never any MIFs and no Honour All Cards Rule either ever and no surcharging rule either.

A. Well, you are talking about my counterfactual or a bilateral or unilateral counterfactual?

Q. You just said, Dr Frankel, that in a legitimate counterfactual we should assume away the effects of the MIFs and anti-steering rules, save perhaps for the Honour All Cards Rule from the date of their creation and the effects that were generated by those MIFs and anti-steering rules from -- from the date of their creation?

A. As a matter of economic logic, that is the thought experiment. Now, it does not mean we cannot approximate it and do our best to figure out what are the main outcomes of those policy changes, those rule changes, had they been gone for the last 30 years.

Q. Dr Frankel, I want to move on, if I may, to your analysis of the schemes' counterfactuals, the ones we put forward. You regard these I think from your reports as in substance identical to the current MIFs?

A. Correct.

Q. Can I take the Tribunal to what you say about them again in your first report {RC-H1/1/17}, paragraph 33. You say:

"From an economic perspective, the counterfactuals the schemes describe are inappropriate insofar as they are not competitive alternatives that remove the anti-competitive restriction, but rather [you say] are alternative ways to describe, implement and preserve the existing anti-competitive restrictions."

Do you see that?

A. I do.

Q. Then at page 39 of the same report, paragraph 86, {RC-H1/1/39}:

"The proposed bilateral interchange fee or UIFM counterfactuals both retain an underlying competitive restriction."

Do you see that?

A. Yes.

Q. Now, I would like to go next to an article that you wrote in 2006, Dr Frankel. {RC-J5/10.6.1/1}. "The economic effects of interchange fees", do you see that?

A. I do.

Q. I would ask you to go to page 3, please, {RC-J5/10.6.1/3}. Just above the heading:

"The effects of interchange fees."

Above that, you say:

"Mastercard and Visa, their member banks, and a number of economists have offered both legal and economic justifications for the manner in which those associations set interchange fees. In this article, we provide an overview of the effects of interchange fees, describe possible alternatives, and review the justifications offered for such fees."

Do you see that?

A. I do.

Q. As regard the effects of the interchange fees you find, summarising, that they are a collective exercise of market power which lead to inefficient outcomes; does that sound like a fair summary?

A. Yes.

Q. At page 11, {RC-J5/10.6.1/11} you deal with "alternative payment arrangements", it is the heading; do you see it, Dr Frankel?

A. Yes.

Q. You say:

"There are a number of arrangements that might avoid the collective setting of interchange fees. The costs and benefits of interchange fees will inevitably be evaluated in comparison ..."

You mention two criteria here: the practicality and the competitive effects of such alternatives, do you see that?

A. Yes, I do.

Q. Immediately below that, you describe par collection and just again to summarise when you say "par collection", that is settlement at par?

A. Correct.

Q. The next alternative is on page 13 {{RC-J5/10.6.1/13}, B, mandatory unilateral or bilateral fees.

There are two alternatives here and you begin by saying:

"Another possible alternative is a decentralised interchange fee system. In a decentralised system, each issuer would announce the fee it will charge to acquirers when redeeming its cardholders' transactions ..."

That is the first alternative and then you say:

"... or payers of banks, issuers and acquirers, would enter into bilateral contracts [over the page] governing the amount of interchange fees, if any, paid in connection with card transactions between them."

Do you see that?

A. Yes.

Q. So that first alternative, Dr Frankel -- and do not worry, we will come to what you say about it, we will go through the article properly, but that first counterfactual, where -- sorry, the first alternative where you say each issuer would announce the fee it will charge to acquirers when redeeming its cardholders transactions, that looks like the UIFM, does it not?

A. Yes, these are proposals that have been around for a long time and I was responding to economic literature that said there are these two other ways we could do it, and catastrophe would emerge if we did it that way and therefore we need a MIF.

Q. The second is -- the second alternative here looks like the bilaterals counterfactual, does it not?

A. Yes.

Q. Then you address the questions of practicality and competitive effects, the two criteria that you raised earlier and you deal with practicality first and you deal with that on page 14. You say:

"A decentralised system has been criticised on the basis that thousands of member banks would have to enter into a web of millions of contracts connecting each bank to every other bank. But when banks have been confronted by the need to establish such a web of bilateral contracts in the past, they have found clever ways to avoid having each bank transact directly with every other bank."

You refer to correspondent banking and the fact that a relatively small number of banks could have direct contracts and settlement accounts while offering processing, clearing and settlement services to other banks. Do you see that?

A. I do.

Q. Yes.

So then you go on to say:

"The Top 10 acquirers account for about 86% of all Mastercard and Visa bankcard dollar charge volume"?

A. This is US, obviously.

Q. Of course, the US.

Then:

"The top 10 issuers account for 84% of charge volume."

Then you say:

"Not more than 90 contracts ..."

Do you see that? Not millions?

A. I do.

Q. Next page:

"... would therefore be required to cover 72% of all charge volume."

Do you see that, Dr Frankel?

A. I do.

Q. These objections to the practicability of bilateral contracts, the objections you are addressing here look like the objections to Mastercard's bilaterals counterfactual in these proceedings, do they not? The idea that it is impracticable to deal with solely issuers and acquirers?

A. So in terms of the physical communication links that are needed among the banks, I think I was correct that you do not need to connect every permutation, it would be like having every aeroplane fly between every possible city. You could have a hub and spoke network to reduce the number of contracts necessary to have a payment system. You do not even need a central hub, like the interact system in Canada has no central scheme switch.

Q. You wrote this, Dr Frankel, in the context of the United States where there were thousands of member banks?

A. Yes, I was not -- I was not guaranteeing that this would actually work, just that I was telling people you should not assume that it cannot work based on this one issue.

Q. You are aware, are you not, that although here you are referring to the thousands of member banks in the US in the United Kingdom and Ireland the number of issuers and acquirers are far fewer --

A. Correct.

Q. -- far smaller than the US?

A. Indeed.

Q. The second criterion you address of the competitive effects and that is now on page 15.

You say -- this is the second paragraph, having dealt with practicability you say:

"Another criticism of decentralised interchange fees is that each issuer -- no matter how small -- would have monopoly power over each acquirer."

You say that concern derives at least in part from another competitive restriction, the Honour All Cards Rules; do you see that?

A. Yes.

Q. You describe how the Honour All Cards Rule works?

A. How it fails --

Q. This is familiar territory.

If you could read down to:

"The hold-out problem could lead to fees by all banks to the monopoly level."

A. Yes, that -- it turns out the fees could actually be set above the monopoly level. That is a technical detail.

Q. I am not going to challenge you on that, Dr Frankel.

Over the page, 16. Second paragraph, you say: although bilateral negotiations can lead to a hold-up problem, just pausing there. You are describing the hold-up problem in the context of the US, do you accept that in the context in these proceedings for the post-IFR domestic and intra-EEA consumer MIFs, there is no hold-up problem, the IFR caps have stopped that?

A. There is a hold-up problem, but the amount by which it cannot get above the -- the statutory limits on the MIFs. So there is still a hold-up problem, but the -- the extent to which it could exercise market power is capped.

Q. It is mitigated or the hold-up problem exists, but it is mitigated the caps in the IFR?

A. It is limited in how bad it can get.

Q. You go on to say that having referred to the hold-up problem, I think what you are saying next is it is not clear that collectively set interchange fees resolve the hold-up problem, rather than transferring -- I think this is what you describe -- the effect of MIFs transferring the exercise of market power from the individual issuer to the network comprised of issuers?

A. Exactly.

Q. Then you say skipping down:

"Networks might also address the hold-up problem through other means such as eliminating the Honour All Cards Rules requiring issuing banks to conclude agreements with acquiring banks."

Do you see that? So networks can address the hold up problem by removing the Honour All Cards Rule?

A. Yes. Well, it -- I said "might also". The networks might also address the hold-up problem through other means and I give an example. Maybe if you get rid of the Honour All Cards Rule and you put the contractual pressure equally on banks, this is just a thought experiment, but if you require banks to reach a deal with every merchant where the bank cannot issue a card to anybody it would flip the competitive dynamics. It would go down to a par settlement system.

Q. Just pausing here, Dr Frankel, we will continue going through it. You are not condemning the UIFM or the bilaterals counterfactual in the same terms with which you condemn them in your expert evidence in these proceedings. The language is different, is it not?

A. I am -- my opinion is that the MIF has the economic effect indistinguishable from a pricing cartel. I had the opinion then and I have it now.

I have been asked on multiple occasions to give talks including in Sydney, Australia, saying: Well, if we cannot get rid of the MIF, what else, what would you suggest? Is there another way we can deregulate the industry short of regulating the MIF or banning the MIF that might achieve a more competitive outcome and that is what got me thinking of and writing these articles.

Q. But your focus here, Dr Frankel, on the problem with the UIFM or the bilaterals counterfactual is really the effect of the Honour All Cards Rule, is that not right?

A. That is part of the problem, sure.

Q. That is your main concern, at least in this article. I am not saying this is the totality of your thinking but in this article, the main reason I think why this alternative does not work, in your view, is because of the Honour All Cards Rule?

A. So when I -- what this section is all about is I would be okay with a bilateral system in which each -- well, there is an overriding issue. Who negotiates a bilateral deal? Is it an acquirer or is it a merchant? Put that issue aside. A system in which only voluntary bilateral agreements are implemented by the scheme I would be okay with.

Q. But you also said another possible alternative is where each issuer would announce the fee it would charge to acquirers when redeeming its cardholder's transactions. So the issuer just announces it unilaterally. That is back at page 13, if you want to go back, Dr Frankel.

A. It is on 16 right in front of me here.

Q. I think 16 may only be discussing the bilateral fee agreements.

A. I think -- well, okay I think it had both. But okay.

Q. At page 16, where you are discussing the Honour All Cards Rule you identify the problem with the Honour All Cards Rule and I am now looking at voluntary bilateral fee agreements under heading C?

A. Right.

Q. You say, you see:

"The most significant conceptual problem with bilateral interchange fee contracts arises from the presumption ... that each transaction in the bilateral fee system must fall under the coverage of a fee contract due to the association's Honour All Cards Rules".

Do you see that?

A. Yes.

Q. Then you go on to say:

"But if [and this is your analysis of it being anti-competitive] such a rule [and then there is a dash and some text, we will come back to that] but if such a rule [skipping to the next dash] would lead to higher fees, then the rule would be anti-competitive."

Do you see that, Dr Frankel?

A. Yes, but what is in the dashes is important.

Q. Of course, no, I was just going from the two dashes to show you what you are concluding?

A. Okay.

Q. It is also easier to read. I was going to put this to you, Dr Frankel, you can come back to the text within the dashes but you are saying here if such a rule, the Honour All Cards Rule, would lead to higher fees, then the rule would be anti-competitive; do you see that?

A. That is what I wrote.

Q. So equally though, if the Honour All Cards Rule does not lead to fees being higher than the actual, do you accept by this logic the rule would

not be anti-competitive?
A. I do not know if I had thought it through that far when I wrote this, but let me look at it.
If a system of voluntary bilateral -- well. You are suggesting that even mandatory bilaterals, if for some reason they generated a low fee or you are saying the same as the regulated fee?
Q. No, I am only asking you about, first of all, the Honour All Cards Rule. We are discussing here the Honour All Cards Rule and what makes the Honour All Cards Rule anti-competitive. That is the first thing, and I am asking you if the Honour All Cards Rule does not lead to higher fees than the actual, just a theory for the moment, then the Honour All Cards Rule is not anti-competitive?
A. What is troubling me is my sentence was not very well constructed, because higher than what? I did not specify.
Q. Well, I will help you, Dr Frankel. Higher than the IFR caps.
A. No. I have already explained why that does not happen -- that does not work. That is just the -- the effect of mandatory bilaterals leads to higher fees than the competitive benchmark, which will be par for most merchants and issuers. There

maybe may be occasional, voluntary bilateral. To me, that is the competitive benchmark.

Q. But if you remove the -- I am focusing on the Honour All Cards Rule for the moment. If, in the counterfactual, you take the Honour All Cards Rule away and the negotiated interchange fees will still go to the cap. Do you understand me so far?

A. Yes, I --

Q. You accept it is not anti-competitive?

A. I see what you are doing. So I understand. But I certainly did not foresee the IFR in 2006 or this debate.

What I mean there is if requiring -- let us get to what is in the dashes, because this is really what is driving the context for the sentence.

If such a rule requiring that a merchant must enter into a fee agreement with an issuer, let alone requiring that each merchant have a fee agreement with every issuing member as a precondition for the merchant to be allowed to accept card transactions, that is the key idea.

If you say to a merchant, so, you know, Mastercard says in this case our proposal is to have no settlement rules, except there is one, which is you have to enter and do a deal with every issuer or we are not going to give you any services at all. So if these rules, if this policy drives fees up, okay, so yes, it is capped, it is not going to go above where it already is, but it is going to go above relative to the right counterfactual which is par settlement.

Q. But it is the HACR we are talking about here. It is a very simple question. If you remove the Honour All Cards Rule from the counterfactual.

A. Yes.

Q. So you are allowing the parties to negotiate freely, but you take out the Honour All Cards Rule and the fees rise to the IFR caps anyway, is the Honour All Cards Rule anti-competitive?

A. Wait, first of all, the anti-competitive feature here is having a rule that requires this universal set of contracts.

Q. But, Dr Frankel, I am just reading what you wrote. I mean, if I have misread it please tell me, but if such a rule would lead to higher fees then the rule would be anti-competitive?

A. It is correct. Higher than par is anti-competitive.

Q. But it is the higher fees. This is an alternative, an alternative to the actual?

A. So some of the --
Q. You are comparing the counterfactual to the counterfactual?
A. Wait, this is a semantic debate we are having. Some of the semantic confusion arises because higher can refer to over time, like if it is at 0.3 today and it is at 0.3 tomorrow then it is not anti-competitive, or higher than another state of the world which is a competitive market, which is what I really had in mind.
Q. I am only asking you about the effects of the HACR. If the HACR does not lead to higher fees than would exist absent the HACR.
A. Okay.
Q. That could not be any more simple.
A. I understand. It is a "gotcha", but I do not -- I have stated my opinion. I do not think this is a competitive -- it becomes pro-competitive or innocuous simply because it was regulated at point 3 and it stays at point 3.
Q. I will move on, if I may, to your counterfactual. It is in your -- I think it may be in your further version of the counterfactual. It is in your first report {RC-H1 -- I am sorry, I see the time.

Sir, I have not even asked permission for the Tribunal to sit longer than half 4.

THE PRESIDENT: You have been thoroughly engaged in the task so there is no need to apologise.

We have got 5 o'clock finishes on other days. I do not know how we are doing.

A. I am fine.

THE PRESIDENT: Thank you very much, Dr Frankel. Do you mind if we go on until 5 o'clock? I am addressing myself to the shorthand writer.

MR KENNELLY: I am very grateful to the Tribunal, shorthand writer and Dr Frankel.

Your first report, H1/1/39 {RC-H1/1/39}, paragraph 88, you describe here how the settlement at par could be obtained, I think you are saying without a prohibition on ex-post pricing. Do you see that, Dr Frankel?

A. I am sorry, can you repeat?

Q. Let us just read what you wrote rather than have me paraphrase it.

Three lines down under paragraph 88:

"... it is considered by some that to attain a par settlement regime a new Scheme rule would be required prohibiting 'ex-post pricing'."

Do you see that?

A. Yes.

Q. You say:

"I disagree with that description, which confuses the issue unnecessarily."

A. Yes, I wrote that. I think it is right.

Q. "Achieving a par settlement system does not require [in the absence of a MIF] a scheme prohibition on ex-post pricing, but merely that the Scheme desists from administering interchange fees. An interchange fee is deducted by the Scheme in the settlement process from the amount taken from the issuer's settlement account balance to credit to the acquirer's account for crediting to its merchant (net of an MSC, which would be lower in the par counterfactual)."

Then you say:

"The schemes can and do control the settlement process and can and do require their members to maintain funds to settle their obligations. If the Scheme simply did not deduct an interchange fee from the amount taken from the issuer and given to the acquirer, there is no way an issuer could, on its own, demand and obtain payment from the acquirer short of withholding deposits into its settlement account -- which the scheme could simply continue to forbid on penalty of ejection from the Scheme."

Do you see that?

A. I do.

Q. So what you envisage there is as part of administering the settlement process, the schemes could refuse to deduct an interchange fee, prevent issuers from withholding funds from the acquirers?

A. I probably should have said non-voluntary. Except for a voluntary contractual agreement between two parties, which would be fine. They could administer that, but otherwise they could just keep their hands off the system, just do the settlement.

Q. There is no evidence that Visa would actually do this, is there? Or Mastercard?

A. Mastercard does it in Switzerland.

Q. Is there any evidence to that effect apart from what you have just said?

A. They have zero MIFs in Maestro -- well, in many of the Maestro transactions.

Q. But there is no evidence before this Tribunal. I will turn to Visa. Mastercard can ask you about what Mastercard does. There is no evidence that Visa would do this unless required by law to do it?

A. I have -- I have a Visa interchange fee list from New Zealand where it said Visa debit transactions are processed, there is no interchange fee, and they changed the language on it but I understand that it is routed as an Eftpos transaction. But sure, Visa and Mastercard around the world have used MIFs in most places.

Q. In this country, Dr Frankel. Here. In these proceedings, there is no --

A. Yes.

Q. -- evidence that Visa would do this here?

A. Rather than what?

Q. Rather than charge positive interchange fees.

A. If it -- if it is permitted to charge positive interchange fees I have no doubt they will continue to charge positive interchange fees.

Q. Because Visa has strong competitive incentive to offer positive interchange fees to compete for issuers?

A. Well, wait --

Q. If it can do so lawfully.

A. Yes, there is a -- there is a procedural oddity that happens in cases here that I guess is no longer an oddity, which is if you treat the schemes asymmetrically, so one is allowed an interchange fee and another is not, that would be a problem.

But as long as Visa and Mastercard are treated symmetrically, I do not think it is a problem, and if Amex starts to take over the world, there is additional tools that we could talk about to deal with that.

Q. Well, let us assume that both Mastercard and Visa are required to undertake something that you describe here. This would deny issuers the opportunity to charge an interchange fee?

A. They would have an opportunity to do it. They would have to convince a merchant to part with the money, or maybe they would pay an interchange fee to the merchant if the merchant could create some value to the issuer.

Q. But the rule change you describe would still require the issuers' agreement. They would have to sign up to this if they wanted to be in the Visa and Mastercard scheme?

A. Yes, presumably.

Q. But if issuers could switch to Amex's 3.5 party scheme, rather than sign up to this they would switch, would they not, issuers?

A. Well, so if -- first of all, Amex has constraints on what it can do. Regulatory constraints.

I -- there are a couple of policies that are available to merchants and maybe some of them are no longer available but could be available again if Amex has a bad effect on the marketplace. Steering, surcharging of Amex transactions could deter Amex from charging high fees and running away with the market. You could turn Amex into a four-party system; it came close.

Q. Dr Frankel, I have to ask you to come back again to the miserable United Kingdom where we are actually based. What regulatory constraints do you have in mind in this country that stop Amex charging interchange fees up to 0.2 and 0.3 in a 3.5 party system?

A. Well, it could charge up to 0.2 and 0.3. It does not have debit. It could charge 0.3 for credit card transactions, I think, but it was not -- its business model did not work at that level and it pulled out.

Q. Sure. But if the issuers were facing zero interchange under your idea and 0.3 with Amex, that would be a powerful incentive for the issuers to switch to Amex, would it not, if they revive the 3.5 party scheme?

A. So if merchants are free to steer, I do not think it would be a problem. If I am wrong, if Amex starts winning banks and growing like crazy, you know, this one case cannot solve the entire industry's structural problems perhaps.

But there are other competitive tools and regulatory tools. At some point it becomes a dominance issue if they really grow that big.

Q. In terms of regulatory tools, Dr Frankel, you mentioned a constraint, Amex might be surcharging by merchants?

A. Correct.

Q. You of course are aware in this country it is illegal to surcharge merchants --

A. I understand.

Q. -- for MIFs covered by the IFR.

A. Yes, and Visa and Mastercard and others in the industry have long opposed the ability to surcharge. If they had zero MIFs and Amex started winning transactions, they might change their mind about the desirability of surcharges.

Q. So your answer is this would prompt

regulators to intervene and do something to mitigate Amex's market power?

A. They could. I think it is asking a lot for the Tribunal to -- to solve all these permutations of scenarios. But there are, there are tools out there, like steering and surcharging, and discounting, discount for Visa.

MR KENNELLY: Sir, I have reached the end of that topic and I am just short of 5 o'clock. I am in your hands. I am making good progress if that is the tribunal's concern.

THE PRESIDENT: That is the tribunal's main concern and I suppose it is also Mr Beal's.

MR KENNELLY: Yes.

THE PRESIDENT: If you have reached a point that is a natural break, then we should take the option and exercise that break. We are resuming, I think, at 10 o'clock tomorrow.

MR KENNELLY: Yes.

THE PRESIDENT: We are running through until 5 o'clock.

MR KENNELLY: Yes.

THE PRESIDENT: Well, that is what we will do.

There remains the question of Dr Frankel's purdah. I do not know, Mr Beal, whether you have any views on that. We are, as before --

MR BEAL: I now have Mr Dryden to talk to, so I do not require any special arrangements with Dr Frankel for this evening.

THE PRESIDENT: Very good.

Dr Frankel, it is as much for your protection as anybody else's, so please do not talk to anyone about your evidence and we will see you tomorrow morning at 10 am. Have a good evening.

A. Thank you.

THE PRESIDENT: Thank you very much. 10 o'clock tomorrow morning.

(4.50 pm)

(The hearing was adjourned until 10 o'clock on Tuesday, 12 March 2024)