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

Tuesday, 12 March 2024

(10.00 am)

(Proceedings delayed)

(10.07 am)

DR ALAN FRANKEL (continued)

Cross-examination by MR KENNELLY (continued)

THE PRESIDENT: Mr Kennelly, good morning.

MR KENNELLY: Good morning.

THE PRESIDENT: Professor, why do you not come into the witness box. Good morning, Professor. Do sit down. Make yourself comfortable.

A. Thank you.

MR KENNELLY: Would you like to get some water or just get settled before I --

A. Thank you.

Q. Dr Frankel, I would ask you to be shown, please, {RC-J5/14.6/1}. Do you recognise this document?

A. I do.

Q. So it is the talk given by Peter Taylor from the Commerce Commission of New Zealand at a conference in Australia in 2010 and Mr Taylor was then the General Counsel of the New Zealand Commerce Commission, was he not?

A. That is my recollection.

Q. As he explains at paragraph 2, this talk related to the

Commerce Commission's litigation against Visa and Mastercard in New Zealand. Do you see that?

A. Yes.

Q. I am going to take you through this document and ask you some questions about it at the end. At paragraph 4, he explains:

"While most actions abroad have resulted in regulatory or quasi-regulatory intervention, the Commission has achieved a unique settlement through the litigation process ..."

Do you see that?

A. I see that.

Q. Over the page at section B {RC-J5/14.6/2}, he explains the factual context in New Zealand. At paragraph 6, he explains that:

"New Zealand consumers are among the world's most frequent users of payment cards to make purchases."

Skipping ahead:

"... the penetration of payment cards among merchants and consumers is extremely high ... we have some of the highest debit and credit card usage of any country."

Then at 7, paragraph 7:

"Approximately 70% of all retail purchases are conducted using credit or debit cards. Non-cash payments are dominated by debit cards, commonly referred to as EFTPOS ... which are ubiquitous and the majority [as you have said] of [those] transactions do not incur an interchange fee."

Skipping ahead to page 5 {RC-J5/14.6/5}, at section D we see "The Commission's Case", the Commerce Commission's case, against Visa and Mastercard and the banks. At paragraph 25:

"The Commission's case, in summary, was that there was an arrangement between competitors in the acquiring market ..."

So, again, like our case:

"... other banks and the schemes which:

"a. provided for the maintaining or controlling of the price for acquiring services, by way of the merchant service fee, in breach of [the anti-trust provision in New Zealand] of the Commerce Act ... [which]

"b. substantially lessened competition in the acquiring market ..."

Do you see that, Dr Frankel?

A. Yes, I do.

Q. At paragraph 26 {RC-J5/14.6/6}, we see the theory of harm that the Commerce Commission outlined:

"We did not allege any collusion between Visa and MasterCard but argued that there was an arrangement in respect of each scheme set out in interdependent and interlocking agreements with the banks relating to the operation of that scheme. The specific provisions ... challenged were ..."

We see what was challenged:

"a. the 'MIF rules' which provided for the centralised setting by the schemes of a [MIF], which had to be paid by an acquirer to a card issuer;

"b. the 'no surcharge rules' ...

"c. the 'no discrimination rules' ...

"d. the Commission also challenged the 'honour all cards rules' which required merchants to honour all Visa and MasterCard cards and prohibited selective acceptance of cards from some issuers, or specific types of cards ..."

So we see a real parallel with the theory of harm advanced by the New Zealand Commerce Commission and the Claimants in this case.

A. Yes.

Q. Page 11, please, paragraph 42 {RC-J5/14.6/11}. We see the settlement with the schemes and the settlement starts at 44(a) referring to the MIF:

"... Interchange fees in respect of domestic transactions using New Zealand-issued Visa and MasterCard credit cards are now to be set independently by credit card issuers in competition with one another subject to a maximum rate set by the schemes, and these rates are to be made publicly available."

At (b) we see the no surcharge/no discrimination rule:

"The Visa and MasterCard scheme rules that previously insulated interchange fees from effective bargaining power ... have been disabled or amended in respect of New Zealand."

Then over the page to 12 {RC-J5/14.6/12}, at the top of that page:

"... the schemes have agreed not to enforce rules prohibiting merchants from surcharging or using other methods to steer customers towards other payment options ..."

Then at page 14 {RC-J5/14.6/14} at paragraph 47, we see what the settlement did not cover. Three lines down:

"The schemes' honour all cards rules were also left intact. Visa and MasterCard had argued that the honour all cards rules were necessary to ensure that cardholders have a seamless and predictable payment experience. This was especially important given the global nature of the schemes and the fact that many travellers rely on their credit cards to pay for costs incurred on their journeys."

Do you see that?

A. Yes.

Q. That was less of a concern for the Commission, as the Commission explains at paragraph 48, once they had agreed to remove the restraints against surcharge.

Now, Dr Frankel, could we turn next to your report, your first report in these proceedings, {RC-H1/1/1}. It is page 34 I need {RC-H1/1/34}. At section 3.4, you specifically considered the position in New Zealand; yes?

A. Yes, I did.

Q. At paragraph 76 on page 35 {RC-H1/1/35}, you quote Mr Taylor, the Commerce Commission's General Counsel. You quote from the same speech we have just been reading.

A. Yes.

Q. At 76, you refer to the fact that the interchange fees are now set independently in New Zealand. That was paragraph 44(a) of his talk that we saw a moment ago.

Then at page 36 over the page {RC-H1/1/36}, at paragraph 78 of your report, you say:

"Second, enforcement of the Schemes' No-Surcharge, Honour-All-Cards and No-Discrimination rules was relaxed."

You quote from Mr Taylor, referring to the schemes' agreement not to enforce rules prohibiting merchants from surcharging or using other methods to steer. Do you see that?

A. Yes, I do.

Q. As we saw a moment ago, here he is describing a change to the no surcharging rule and the no discrimination rule; is that not right?

A. I think it also sweeps in the -- the non-discrimination clause, at least of Mastercard's Honour All Cards Rule.

Q. That part of the Honour All Cards Rule --

A. Yes.

Q. -- for Mastercard, but the rest of the Honour All Cards Rule was left intact, was it not? That was not relaxed in the New Zealand settlement.

A. I think that is right.

Q. May we go back to Mr Taylor's speech, back to {RC-J5/14.6/13}. At paragraph 45, he describes the settlements with the banks. That is the heading. The detail of that we see at paragraph 46 on page 14. Paragraph 46 at the top of page 14 {RC-J5/14.6/14}:

"In addition to the unbundling and unblending commitments, the banks agreed to significantly reduce the average interchange fees charged on New Zealand credit card transactions, which will ensure that these fees in New Zealand are driven down from the rates that were centrally set by the Visa and MasterCard schemes."

Do you see that?

A. I do.

Q. So the banks were agreeing in their settlement agreements to reduce the interchange fee rates.

A. Apparently. Those parts of the agreements, as I recall, were redacted, the details.

Q. The details were confidential.

A. Yes.

Q. Indeed, Dr Frankel. But to the extent that the banks were agreeing significantly to reduce the weighted average interchange fee, that was confirmed by the Commerce Commission, was it not? If you go back to that {RC-J3/65/7}, paragraph 18.1.

A. What --

Q. Sorry, I should show you the first page. Do you want to see the first page so you can recognise the document? Let's go back to page 1 just so we see what we are looking at {RC-J3/65/1}. Do you see this?

A. Thank you, yes.

Q. So this is the Commerce Commission New Zealand. It is the evaluation of the 2009 interchange and credit card settlements from December 2013. Do you see that, Dr Frankel?

A. I do. The language is a little ambiguous, which is why I am a little -- I am thinking about it, but ...

Q. Which language is ambiguous, Dr Frankel?

A. If you could flip -- the language about reducing the interchange rates from the centrally -- the rates centrally set by Visa and Mastercard schemes.

Q. So now we are going to page 7, please, paragraph 18.1 {RC-J3/65/7}. This is where the Commerce Commission says:

"As a result of the Commission's investigation, the Commission entered settlement agreements with the banks and schemes. The settlement agreements included commitments to:

"... significantly reduce the average interchange fees charged on New Zealand credit card transactions, ensuring that these fees in New Zealand are driven downwards from the rates that were centrally set by the Visa and MasterCard schemes ..."

A. Right. That is -- what is unclear to me is the extent to which it was the process that the Commerce Commission was asserting would drive down the rates versus -- I cannot know the details because of the redactions -- versus commitments by the bank to achieve specific lower levels.

Q. On the face of what we see here, is the natural reading not that the banks are agreeing to reduce the levels?

A. I think so. I just cannot be sure.

Q. But, as you say, the precise reductions agreed were confidential, but Mr Jensen said, as Mr Taylor did, that they applied to average fees charged by the bank.

I will just show you that in Mr Jensen's evidence for the Claimants. That is {RC-F1/4/11} first.

A. It is really -- you are talking about paragraph 35(a)?

Q. Yes, indeed. I will start with paragraph 35(a). This is Mr Simon Jensen:

"The settlements involved the banks agreeing to:

"... reduce the weighted average interchange fee charged on New Zealand credit card transactions ..."

Do you see that?

A. Yes, it is the same language, but followed by:

"... (which was designed to drive fees down from the rates set centrally ...)"

I think, you know, my recollection -- well, actually, I do not have a recollection about -- I never did find out anything about the starting point. If the banks committed to a specific lower starting point, I just do not know.

Q. But the fact that the settlements involve the banks agreeing to reduce the weighted average interchange fee suggest they are committed to reducing levels.

A. It is plausible.
Q. Paragraph 36, please, on page -- sorry, yes, thank you very much. Page 12 {RC-F1/4/12}:
"It is important to note that whereas Visa and Mastercard gave commitments to set a maximum level of interchange fees, my understanding is that by contrast the banks' commitments related to weighted average interchange fees charged across each year."
A. Yes, I think your reading of this makes sense.
Q. Then paragraph 40(a) -- actually, could we go back, please, to page 12 {RC-F1/4/12}, because I did not read the next line. I think you were ahead of me, Dr Frankel, on paragraph 36 because after the sentence that I read, Mr Jensen went on to say:
"The levels of these settlements were confidential ..."
So the actual levels are confidential, but the fact it was reducing to a level was not.
A. That seems right.
Q. In paragraph 40(a) on page 13 {RC-F1/4/13}:
"As the banks' settlements provided for different (and undisclosed) levels of interchange fees to be paid and related to weighted average annual fees, the banks had the flexibility to charge different fees to different merchants ..."

Because they were committing to weighted average interchange fee levels.

A. Yes, I see that.

Q. Could you go, please, now to {RC-J3/65/1}, back to the document we were looking at before. Just again to confirm the date, it is in December 2013. Just to recall, the CC is evaluating the settlements that we have just been examining through the evidence of Mr Jensen.

Go to page 8 in this document, paragraph 24 {RC-J3/65/8}. Do you see:

"As part of the evaluation of the settlement agreements, the Commission undertook a survey of merchants."

Do you see that?

A. Yes.

Q. On page 9 {RC-J3/65/9}, paragraph 29, we see the findings. So overall, merchants paid over $70 million less in interchange fees between 2010 and 2013, the period of the settlements, compared to what they would have paid had fees stayed at the 2009 levels over that time period.

A. Yes, if I -- it may have been Mr Jensen who explains that once the settlements lapsed, fees went back up.

Q. Absolutely. We will come back to that, Dr Frankel.

So over the page {RC-J3/65/10}, we are just looking at the impact of the settlements made with Visa, Mastercard and the banks by 2013, the end of the period of the settlements. At paragraph 31, despite those reductions that we have just seen:

"On average, merchants were more likely to report an increase in their MSF [or MSC in our context] than a decrease. Almost half of all merchants surveyed reported a stable MSF."

A. Yes. It varies by size of merchant. So the number of merchants that experienced or reported experiencing an increase or remained stable were the same, but the -- if you -- the orange bar that decreased, that is the largest merchants and that is where the savings went to, apparently.

Q. Exactly. We see that illustrated in figure 1. At the bottom of the figure, we see the large percentage of merchants that saw their MSCs increase. As you said, Dr Frankel, those increases affected the smaller merchants more. The smaller merchants are the dark blue ones, the bottom bar, the bottom horizontal bar. Do you see that?

A. Yes.

Q. Then in the next section immediately above that, we see the percentages based on turnover of merchants that saw a decrease in their MSFs, and that is a smaller, much smaller, percentage of merchants that saw MSCs decrease. Do you see that?

A. I do.

Q. Again, it is disproportionately the larger merchants, the orange -- the top orange horizontal bar, that sees the rates fall.

A. That is correct.

Q. At paragraph 14, please -- sorry, page 14 {RC-J3/65/14}. It is page 43 [sic]. This is the question of what caused MSCs to decrease? We saw the extent of the decrease, but to what extent were merchants using their ability to surcharge and steer in negotiations with the banks?

At 43, paragraph 43, the Commerce Commission said:

"While the survey indicates only a small proportion of merchants are surcharging, merchants may be able to negotiate lower fees from banks in order for banks to avoid their card transactions being surcharged."

Then at 44:

"Of respondents that directly negotiate their card acceptance fees with the bank, only about 14% responded that they discussed with their banks the possibility of surcharging or steering in order to get a better deal on fees."

Do you see that?
A. I do.
Q. So this is not 14% of all surveyed merchants. This is just 14% of those that directly negotiated their MSCs with the bank.
A. I see that, yes.
Q. They added a health warning, did they not, the CC, at the rest of 44? Although they:
"... did use their ability to surcharge/steer in negotiations, they tended to get a lower or slightly better fee, although this particular result is from a relatively small sub-set of respondents, and as such the results are at best indicative."
A. Yes, my understanding is there are a number of merchants in New Zealand, like Australia, that are very large, really are stand-out large, and they were disproportionately the ones who were able to take advantage of these new abilities.
Q. Dr Frankel, we are trying to explore the extent to which it was the ability to surcharge that drove down the MSCs, and we see here the extent to which merchants actually even raised the possibility of surcharging in order to get a better deal. This was followed up, was it not, by the New Zealand Ministry of Business?
A. I am sorry, before we leave this document, just so I do

not have to flip back to it again --

Q. Of course.

A. -- paragraph 43 makes a point that reflects what I was saying a minute ago:

"... only a small proportion of merchants are surcharging ..."

But here is the phrase I just want to focus on:

"... merchants may be able to negotiate lower fees from banks in order for banks to avoid their card transactions being surcharged."

So it is not just the ability to surcharge, but it was being able to surcharge or promise not to surcharge by the identity of the bank, which was an unusual feature of the reform here.

Q. Indeed. That was the relaxation that took place here --

A. Correct.

Q. -- in New Zealand. But my point is that the evidential basis for that conclusion at paragraph 43 is what we see in 44; that, in fact, only about 14% of those that responded -- or of the respondents that directly negotiate their card acceptance fees, only about 14% even raise the possibility of surcharging to get that better deal to take advantage of that relaxation that you mentioned. They are probably the large ones, as you said, Dr Frankel.

A. That is correct.
Q. Moving on then to the Ministry of Business, Innovation and Employment report, this is {RC-J3/85/1}, just to show you the first page so that you can recall. You are familiar with this document, are you not?
A. Yes, I have seen this before.
Q. Could you go, please, to {RC-J3/85/7}. Here the MBIE is examining retail payment systems and they raised five issues, we see, at paragraph 10 on page 7. Issue 2, just above paragraph 12, is about the impact of interchange fees on prices.
So we go over the page, to page 8 {RC-J3/85/8}, paragraph 14, again, just looking at the impact of the ability to surcharge differentially:
"Credit card schemes have traditionally operated under this interchange business model, but there is evidence that the inefficiencies generated are increasing, with recent competition driving up interchange fees and the value of rewards. We are also seeing banks 'flipping' credit card users to higher cost premium cards that offer higher levels of rewards. All but the largest merchants hold little bargaining power over these fees ..."
Do you see that?
A. I do.

Q. "... with consumer demand giving them little choice but to accept payment via credit card."

If you go to page 36, page 36 of this document, {RC-J3/85/36}, this is dealing with interchange in practice. I would ask you to look at paragraph 131. Again, this is the question of the negotiating power of large merchants and it says:

"Issuers are free to charge interchange below the cap. We understand that generally, issuers charge the maximum allowable interchange, with two exceptions:

"In the case of whole categories of 'merchants' ... in which issuers notify schemes that they wish to charge a lower rate of interchange ...

"When large merchants negotiate directly with the issuing side of the merchant's acquirer to have them charge a lower rate of interchange on transactions made by the issuer's customers with the merchant. This is distinct from merchant-scheme or merchant-acquirer negotiations that may also take place ... and is not captured in the interchange figures that have been provided to us. It is unclear how often these negotiations actually result in lower interchange being applied."

That then cites footnote 18. If you go to footnote 18, you see why issuers have very little reason to agree in these negotiations to charge a lower rate of interchange. Do you see that, Dr Frankel?

A. Yes, this is essentially the "on-us" issue.

Q. At paragraph 132:

"While the two open credit card schemes appear to compete vigorously to attract issuers and merchants, this competition appears to have the natural impact of increasing, rather than decreasing, the interchange caps that are set by the schemes."

Then they go on to explain why that is. Could you read, just to save my voice, the five bullet points that follow under paragraph 132 where the Ministry sets out why lower rates are not, in general, being agreed, despite the ability to surcharge differentially {RC-J3/85/37}. (Pause)

If you see anything you disagree with, Dr Frankel, please let the Tribunal know.

A. Yes. Let me just finish reading it. I want to make sure I read this carefully. (Pause)

I disagree a little bit. The first bullet point says:

"Issuers prefer high interchange fees, because it makes it easier to attract cardholders through greater rewards and inducements, and allows them to recoup the costs of processing payments."

I would just add to that and it improves their profits. I think the economic literature, you know, recognises that not all these interchange fees are dissipated in this way that it adds to issuing bank profits.

Acquirers prefer low interchange fees; I would not quite put it that way. Acquirers generally appear to be more or less indifferent because it is generally understood that merchants fully bear the interchange fees. So high interchange fees, low interchange fees, because demand by merchants is so inelastic, it does not affect the volume of acquirers' business hardly at all.

Q. That point you are making, although we are just looking at a New Zealand document, is that analysis equally applicable to the UK, the analysis you have just outlined?

A. I would think.

Q. Could you go on, please, to page 53 {RC-J3/85/53}, and paragraph 201:

"... merchants do have some ability to negotiate down the MSF [or MSC] they ... pointed out that this ability to negotiate is largely limited to negotiating over the extent of the acquirer's mark-up ... In addition, large merchants are able to place some downward pressure on the interchange rates ... However, these efforts to date have not been large enough to make an appreciable difference to the overall price incentives faced by consumers."

A. I think that is essentially correct.

Q. Then paragraph 202:

"This is because, as long as credit card rewards exist at their current rates, many consumers will not see other payment methods ... as direct substitutes. In fact, the recent growth in rewards, to the extent that it is sustained, will serve to widen the distinction between credit cards and other forms of payment that do not attract rewards. The less that other payment products are seen as competitive substitutes to credit, the more consumers will demand the ability to pay with credit, and the less bargaining power a merchant will have over MSFs [or MSCs]."

Do you see that?

A. Yes.

Q. Then, again, if you disagree with anything, please tell the Tribunal.

203:

"As long as merchants feel compelled to accept credit card payments (due to consumer demand), the schemes will face little incentive to reduce interchange caps, because to do so would make other schemes' products more attractive to issuers and, in turn, consumers."

A. Yes.

Q. There is no suggestion here that the threat of surcharging differentially has had any appreciable impact on the interchange fee set by issuers; an appreciable impact.

A. I agree with that. I think there was -- well, let me say two things or three things. One is you are largely correct.

Two is experience shows that it takes time for surcharging, if it is going to work in a country, to get -- it takes time to get it going because merchants tend not to want to be the first to surcharge. Some merchants face less intense competition from other merchants, like a railroad, say, a commuter railroad. It might feel free to surcharge, but in general, there is an externality issue, a first mover disadvantage. So it gets easier and easier once your competitors are surcharging for you to surcharge. So it takes time and this was not -- they did not have a lot of time.

Second or third, my understanding is that the largest merchants did use these abilities to negotiate to improve their bargaining position, for example, by either selectively surcharging or threatening to selectively surcharge some issuers's cards but not others, but that only applied to a small number of merchants.

Q. You cannot show, can you, that it was that ability by the large merchants to surcharge differentially that actually led to any reduction, actual ultimate reduction, in the interchange fees that they paid?

A. Well, I mean, presumably they only negotiated and used those tactics because they thought that that was improving their results.

Q. Sure, but no evidence that they achieved those results.

A. I cannot tell you that that made a material difference to the average interchange rate in the country, but for those merchants that started or were able to use those techniques, it helped the merchant.

Q. But you cannot show that it helped the merchant, can you?

A. That is just my understanding from talking to people in New Zealand.

Q. Talking to people in New Zealand?

A. Five/six years ago, maybe. Maybe more.

Q. Which people in New Zealand, Dr Frankel?

A. Someone at the merchant association there.

Q. Who was that?

A. I do not remember.

Q. Dr Frankel, you said that the differential surcharging ability did not have time to bed in. You understand that that relaxation of the schemes' rules that allowed differential surcharging occurred at the beginning of 2010?

A. Yes, and some merchants in New Zealand did surcharge and I think still do surcharge.

Q. When I showed you the reference to the Ministry document and you said it did not have time to bed in, you are aware this Ministry document is from 2016, October 2016? That is {RC-J3/85/1}.

A. That makes sense.

Q. The relaxation of the no surcharging rule remained in place even after the settlements expired, didn't it? The schemes did not restore the old no surcharging rule. That relaxation remained in place even after expiry.

A. That is my understanding. So, again, my recollection is that some categories of merchants that are most likely to surcharge did get MIF reductions, such as petrol. I am pretty sure petrol was reduced.

Q. Staying with willing to surcharge, could we go please -- I am sorry -- just to page 42 in this document. Same document, the Ministry document from 2016, page 42 {RC-J3/85/42}. In paragraph 158 under the heading "Surcharging", it is dealing with the prevalence of surcharging. Bear in mind, Dr Frankel, this document is from 2016, six years of this ability to surcharge differentially in place:

"The prevalence of surcharging by merchants for switch-to-acquirer transactions is relatively low in New Zealand. In a 2012 survey of merchants ..."

So two years after the relaxation:

"... less than 10 per cent ... reported surcharging customers for credit card payments. Similarly, in Retail New Zealand's 2016 survey of its members ..."

So this is 2016, six years of the ability to surcharge differentially:

"... almost none of the respondents reported charging their customers extra for the use of certain payment methods. [But] there are some sectors in which surcharging for credit and card-not-present debit is more prevalent."

This is the point you made, Dr Frankel:

"... hotels, airlines, and central and local government. We are unaware of any merchant that surcharges for contactless debit ..."

Then at 159, the four main barriers to surcharging. I would ask you to read those, Dr Frankel, and again, please tell the Tribunal if you disagree with any of these as barriers to surcharging. (Pause)

A. Can you flip to the next page, just so I can finish?
Q. Page 43 as well, please {RC-J3/85/43}.
A. Now flip back.
Q. Back to page 42, please {RC-J3/85/42}.
A. Thank you. So I do not necessarily disagree. I guess I was trying to figure out what the status of Amex in New Zealand was at one point, because I noticed that Amex transactions were sometimes surcharged in New Zealand maybe just as often or more often than Visa and Mastercard. As near as I could tell, Amex -- I do not know if it was a private agreement or what, but they seemed not to be enforcing their no surcharge policies or non-discrimination policies in New Zealand with respect to surcharging.
I am not sure how technically difficult it is with modern point of sale terminals. I think that is a transitory issue. Lack of information and bundling is a problem with surcharging. If all your transactions incur one price, that can be a problem.
In American Express, of course, customers react negatively. You know, that has always been their position, as with the other schemes.
So I guess I do not really disagree in substance with these points.
Q. The reference to American Express in that bullet that

you mentioned, Dr Frankel, it is not clear, is it, that the reactions that were described were only about surcharging on American Express cards? The Ministry here is describing barriers to surcharging generally and says the customers react negatively to surcharging. That is not limited to surcharging of American Express cards, is it?

A. No, I did not mean to suggest that it was. The first paragraph was where I was noticing they seem somewhat confused by American Express, which was not part of the settlement. It still prohibits surcharges, although its success in enforcing this condition is seemingly limited. I think that is just because they must have agreed not to.

Q. But you obviously have seen the finding in the survey recorded by the Ministry that the negative reaction of customers to surcharging:

"... made all of the merchants we spoke to ..."

It is quite striking language:

"... incredibly reluctant to surcharge ..."

A. This is American Express' survey.

Q. Well, the Ministry saw fit to record it in its official Government document, did it not?

A. I am sorry, I just do not see that language. Where is it? On the next page?

Q. It is the top of page 43, please {RC-J3/85/43}:

"While these sorts of opinions ..."

You see it yourself?

A. Yes.

Q. Do you see that?

A. I do see that. Would you like my reactions to this?

Q. If you disagree with it, yes.

A. It is not so much a disagreement as much as context. My view is that there is a lot of market power reflected in MIFs, in the prices that merchants, as a result, pay to accept card transactions, and that increasing elasticity of demand through all of these kinds of chipping away, losing -- influencing a transaction here or there is important. It is precisely because customers react negatively to surcharging that it is such a powerful tool in the toolbox.

Q. But it does not mean merchants will do it even if they have the power to do it.

A. Exactly. No, I totally agree. That is why I said before it tends to be a snowball kind of effect. In Australia, after a couple of years, people were saying the same thing, but the percentage of merchants that surcharge grew and grew.

Q. But not in New Zealand?

A. Apparently not.

Q. If you go back, please, to {RC-J3/65/12}, you see in figure 2 -- sorry, yes, figure 3, merchants' reasons for surcharging. Then paragraph 39:

"For merchants that do not surcharge on credit cards transactions, the main reasons given by respondents as to why were ..."

Again, we see:

"... customers did not like it, competitors do not do it, or because it was administratively too difficult or costly ..."

Then we see there in figure 4 the proportion of response {RC-J3/65/13}. Do you see that, Dr Frankel?

A. I do. It all seems sensible.

Q. In terms of -- again, we are discussing here a negotiating dynamic where merchants are negotiating with their issuers and using the threat of differential surcharging to try and get a lower rate. It is true, is it not, that issuers would know about this consumer aversion to surcharging in the negotiation that the issuers have with the merchants?

A. There is two separate, but both important, channels for surcharging to work. One is to increase the constraint, the competitive constraint, on the schemes as to where they land with their MIF rates. There is plenty of recognition that surcharging, as Mastercard has pointed out in a number of venues, including it's a commission, that surcharging -- as surcharging picks up, it puts a constraint on how high MIFs can practically go for the schemes.

Then, as I think you are focusing on now, the negotiation between a merchant and an individual issuing bank --

Q. Yes.

A. -- and that generally cannot happen because of non-discrimination rules or policies, but this was an experiment and like we talked about a few minutes ago, only the largest banks were able to pull it off. I do not think -- if a small merchant calls their issuer and says, "I am going to surcharge your cards only", they are not going to get very far.

Q. Is that, I suppose, a long-winded way of saying "yes"? So issuers obviously know in this negotiation with their merchant that they do not need to take a threat, in most cases, of surcharging seriously because they know that the customer of the merchant will be averse to surcharging its card.

A. Yes, there is another really important dynamic that I think happened in Australia and in New Zealand, and that is the identification by the schemes of what they called strategic merchants. They instituted what they called strategic merchant MIF rates that were lower. You know, in the United States, what people say is, "If Walmart is not surcharging, I am not going to surcharge", that same kind of dynamic.

So the largest merchants, even aside from negotiated deals with individual issuers, I think were able to get lower MIF rates in general, and that reduced the incentive for them to surcharge or to threaten to surcharge. Their smaller competitors found it hard to surcharge when the big ones were not.

Q. This is New Zealand you are talking about again?

A. I believe it was New Zealand followed that pattern.

Q. But cannot point to any document that shows or anything that shows that is actually what caused lower interchange for large merchants.

A. Well, my recollection -- I would just have to go back and look at the MIF schedules, but my recollection is before the settlements, there was not a strategic merchant category. There may have been; like there was in the United States some special deals cut for very large merchants, but I think the strategic merchant and a lower MIF rate for petrol came after the settlements, if I remember right.

Q. We will see what my learned friends can produce in re-examination in relation to that, but what is much

more likely, Dr Frankel, is that the merchants' interchange fees fell because of the settlement agreements with the banks where the banks committed to reducing the weighted average interchange levels.
A. The negotiations may have ultimately involved who got the money among the merchants. That is quite possible. Without significantly moving the total lower, I cannot rule that out.
Q. So we know the settlement agreements expired in 2013; that is correct?
A. That is my recollection.
Q. Could we go back to the New Zealand Commerce Commission report, please. That is {RC-J3/65/8}. Bear in mind this report from the Commerce Commission is December 2013, so coming just after the expiry of the settlements.
At paragraph 22, we see the Commerce Commission noticing:
"... in some instances the average levels of interchange fees may be starting to increase again."
Do you see that?
A. I do.
Q. Then we go back to the MBIE report, {RC-J3/85/8}, paragraph 14. Again, this is 2016, of course, but the Ministry refers to, second line:

"... recent competition driving up interchange fees and the value of rewards."

That is the paragraph we saw previously.

So interchange fees in New Zealand started to rise after 2013 and 2016.

If you see Mr Jensen's evidence again, please go to {RC-F1/4/15}. At paragraph 45, he refers to the Commerce Commission's acknowledgement that the level of interchange fees may be starting to increase again. That is the middle of paragraph 45.

A. Yes, he is reporting on the same thing.

Q. Exactly.

In paragraph 46, please {RC-F1/4/16}, he makes the point that the settlements were not sufficient to effect the kind of change the Commerce Commission had hoped for, the implication being the settlements had secured this short term drop in the level -- the weighted average interchange fee level, but when they expired, the interchange fee started to rise again.

A. I agree. The Commerce Commission did not ask my opinion about the settlement.

Q. Now, actually, Mr Jensen, paragraph 48, please, he says -- it is the last sentence:

"So, while during the settlement period ... there was a reduction in interchange rates ... I understand these may have been lost once the settlement agreements expired."

A. Yes, I think that is right for the average. There was new variation, I think, that persisted that wasn't there before that is probably still in place.

Q. Mr Peterson, please, {RC-F4/1/4}, paragraph 12:

"... issuers have consistently chosen to set the maximum permissible interchange fee ... during the term of their settlement agreements, [they] operated rebate arrangements of some kind with acquirers and/or merchants with a view to reducing the net interchange fee revenue that they collected in accordance with their own individual settlement agreements with the Commerce Commission."

Do you see that?

A. Yes, I do.

Q. The MBIE made a similar observation, {RC-J3/85/41}. Footnote 22:

"The ... settlement, which expired in 2013, required banks to reduce the weighted-average interchange fee that was applied overall. Banks chose to comply with this by giving rebates to merchants."

Again, if you see anything you disagree with --

A. No, it all makes sense to me.

Q. I have been asked to take you to the next footnote:

"... merchants have the ability to negotiate directly with issuers to seek to reduce the interchange charged ... However the extent to which this actually results in lower interchange rates [again] is unclear."

A. It is unclear. I have not been able to find out.

Q. So can we go back to your first report, Dr Frankel, {RC-H1/1/37}, paragraph 81. You say at the bottom of paragraph 81, referring to New Zealand:

"... [while] some of the largest merchants were able to use to negotiate ..."

Sorry, you are referring to the relaxation of the surcharging rule:

"... which some of the largest merchants were able to use to negotiate lower interchange fees (or rebates) from the relatively small number of New Zealand banks in exchange for not steering adversely to an issuer."

Do you see that?

A. I do.

Q. Now, you attribute these reductions in interchange fee to the threat of steering. Do you see that?

A. That is my understanding. I think it is fair to say that to the extent that the banks had made side promises in their own settlement agreements to drive down the level of their weighted average MIFs or interchange fees, it is quite possible, as I said a few minutes ago, that these negotiations helped determine which merchants got these rebates as much as driving down the cost per se.

Q. Dr Frankel, you are more equivocal in your report. Can we go to page 144. Please, paragraph 357 {RC-H1/1/144}. You are here dealing with the Honour All Cards Rule and you refer to the relaxation, which we now understand you to mean the ability to surcharge differentially, and you say in the second sentence:

"This provided some (large) merchants the opportunity to credibly threaten to steer adverse to the use of cards from individual issuers, short of dropping acceptance ... altogether. This enabled those merchants to negotiate lower fees on a bilateral basis with that country's issuing banks."

Do you see that?

A. I do.

Q. Is it not more likely from what you have seen from the New Zealand documents that the reductions, such as they were, that the merchants secured was as a result of the settlements with the banks rather than this threat of differential surcharging?

A. Well, I cannot separate out these two -- I cannot quantify the separate impact of these two things. It could be that the negotiations by the big banks was completely offset by increases in other MIF rates. Well, I am sorry. They had agreed to reduce their weighted average, so whether that came solely as a result of who was pressuring them with these other tactics or whether they reduced their rates more generally, I just do not know. I do not have information.

MR KENNELLY: Thank you, Dr Frankel. I have nothing further on the rules for Dr Frankel and I hand over to Mr Cook, if I may.

Cross-examination by MR COOK

MR COOK: Professor Frankel, you explained in answer to Mr Kennelly yesterday that you take the view that positive multi-lateral interchange fees are inherently anti-competitive. That is fair, is it not?

A. That is fair.

Q. Okay. The reason for that opinion -- I know you have lots of reasons, but sort of the main reason is because you think payment systems should settle at par instead.

A. I think that is a tautology.

Q. Okay, fair enough, but with, as you described it, costs lying where they fall.

A. Yes, I think that is the more competitive structure.

Q. You give various examples of payment methods in your reports that you say operate or did operate at one time with settlement at par. I am going to come back to the detail of that, but I wanted to start with an example that you repeatedly refer to in your evidence, which is the cheque system. So you describe that as an example of settlement at par; do you not?

A. Yes.

Q. I just wanted to explore that. Now, with a cheque, if the transaction is fraudulent, so a chequebook is stolen and somebody else tries to make a payment with the cheque, the customer -- the merchant does not get paid, do they?

A. I am sorry, if a cheque is stolen?

Q. If a chequebook is stolen and somebody goes to a merchant and pretends to do the signature, the merchant does not get paid, do they?

A. If the customer brings evidence of a forged cheque to its bank, there is a process and often those cheques were -- the amount debited from the account was put back.

Q. Yes, and the merchant would not get paid.

THE PRESIDENT: Mr Cook, I wonder if the premise of your question is right. I mean, yes, if the cheque is stolen, the merchant does not get paid, but the obligation to pay will remain in the customer.

MR COOK: That is -- yes.

THE PRESIDENT: The merchant will, therefore, be able to demand payment from the customer again.

MR COOK: Well, no, if the fraudster goes into a shop with a stolen chequebook, then it may be they can technically chase the fraudster, but the bank is not required to make payment.

THE PRESIDENT: Right. So what exactly are you hypothesising? Are you hypothesising a non-genuine customer?

MR COOK: Non-genuine customer.

THE PRESIDENT: Right.

MR COOK: In those circumstances, the merchant does not get paid. The bank can return the cheque unpaid on the basis it is not their customer's signature.

A. Well, it has been a while since I have looked into this, but customers may have had an obligation to notify the bank and put a stop payment order on the range of cheque numbers that were stolen or missing.

Q. But if they go through that process, any cheque afterwards that is presented, the bank will simply not honour it to the merchant, will they?

A. The bank may return it to the merchant, which may -- yes, that is right.

Q. So it is returned unpaid to the merchant.

A. Correct.

Q. It is sort of obvious why the bank will not pay, which is the bank's customer is not the one who actually entered into the transaction.
A. Correct, although, like I say, in various contexts customers may be on the hook. Money may come out of their account if they fail to take appropriate actions to notify the bank.
Q. But as a general proposition, if it is a forgery, then the merchant does not get paid.
A. I think that is right.
Q. Yes.

THE PRESIDENT: Mr Cook, I am a little bit unhappy about these questions because I think there is a whole range of legal complexity which I do not think this expert, being an economist, will be able to deal with and which is probably going to be a combination of legal submission, to the extent it matters, and the expert's answers on hypotheticals, which ought to have extracted from them the legal complexity.

I mean, for example, we all know, at least if we are old enough to know, that for significant periods of time, cheques were accompanied by cheque guarantee cards.

MR COOK: I will go with some of those things, but the witness has repeatedly referred to cheques and I just want to establish the basic ratio of --

THE PRESIDENT: I completely understand that, Mr Cook. I am not stopping you making those points to the witness, but if we are to make use of your questions and his answers, we are going to have to close out these variables because otherwise, when we are writing our judgment, we will be saying, well, was the witness considering a situation where there was a cheque guarantee card situation, for example, or was it a particular fraud?

So you are going to have to, I think, be clearer in terms of the legal assumptions that you are making in terms of where the default or failure to pay lies so that the witness is not inadvertently opining on questions of legal significance rather than simply questions of economic significance as to how it works.

Otherwise, I think we are going to be at risk of losing the value of the answers to your questions, so I am --

MR COOK: So just keep a very simple historic cheque system. I appreciate there have been additional layers in recent years. So the historic 19th century cheque system I think you talk about in the various documents you cite. So in those circumstances, if it is not the genuine customer, as a general proposition, the merchant does not get paid. That is right, is it not?

A. It is actually -- I appreciate the President's cautionary note because I am not an expert, in the US, in the Uniform Commercial Code, whatever the similar legal issues are here, as to under what circumstances a bank is obligated to make payment or not make payment on a negotiable instrument.

A typical transaction between a consumer in the 1970s and 80s going into a supermarket and writing a cheque in the United States, say, without a cheque guarantee card, the merchant may be out on those funds, but I am not sure under what conditions the customer has an obligation, it might suffer that loss.

Q. If there was no money in the customer's bank account when the cheque is presented -- again, keeping it simple -- no cheque guarantee card or anything else, the cheque will, in common parlance, bounce.

A. Yes, that was -- my understanding is that was a far more likely occurrence and merchants often would post those cheques on a public board to shame the customer.

Q. But the end result was the merchant would not get paid by the bank --

A. Well, yes, and --

Q. -- but it might be able to chase the customer indirectly or directly.

A. Excuse me. That raises an interesting point, which is if they did not have a guarantee, they sometimes would have to chase, but they also would selectively accept cheques. So, for example, they might not accept a cheque from a distant out of town bank because it takes longer to clear and more likely that there would be insufficient funds in the account or the customer may be long gone and beyond the reach.

I remember a sign I saw at one merchant that said, "We do not accept cheques" -- people had their addresses printed on their cheques and "We do not accept cheques with addresses north of such and such a street". So I asked why. They said, "That is where all the college students live and they are itinerant. They disappear and never make good on their bounced cheques."

THE PRESIDENT: Mr Cook, Dr Frankel, I wonder if this might help.

The thrust of the questions that counsel is quite properly putting to you, Dr Frankel, is that there is a conceptual difference between the way in which the schemes operate and the way in which, say, cheque system operates. The essential point that is being made is that there is a distinction in terms of credit risk between the way the schemes work and the way a cheque system works in that, for example, to take the last example that was put to you, where there is an insufficiency of funds in the payer's account, the cheque will not be honoured by the bank and it is incumbent upon the merchant to determine whether the offer of payment by the cheque is good enough for the merchant to release the product to the customer or not.

These are questions which entail a degree of risk assessment on the part of the merchant, which, if I understand counsel's questions correctly, do not arise in the situation --

MR COOK: I will come to the later situation, sir. At the moment, I am just --

THE PRESIDENT: I understand, but what I am keen to do is to avoid the witness and you being dragged into all kinds of qualitative assessments of different cheques regimes across the world when none of us are able to answer those, some of us are able to answer them as far as the United Kingdom is concerned, but this witness is not even able to do that.

So can we try and work out what the risk differentiation is between the scheme and the cheques so that the witness can say, "Look, my understanding and the basis of my opinion in regard to chequing systems is that the risks fall in the following way", and then you can go through the differences between that scheme and others and we can then park the extent to which you have actually got a correct understanding of the cheque system to closing submissions because I really do not want to go there now.

MR COOK: So the first one I dealt with was fraud and there was a risk of fraud that merchants take in some circumstances. The second one is there is a risk of funds being not there and the cheques bounces. Again, the merchant takes that risk.

I think you also refer to it that sometimes the cheque, particularly in the US perhaps, would take some time to pass through the banking system. Historically, there might be a change of correspondent banks, so there will be a delay of settlement in practical terms.

A. That was how it could influence the other events.

Q. Yes, but also there was simply a practical point of often settlement would take some time.

A. Yes. In going back in time further, it was more likely to have an interchange fee on the cheque.

Q. So with cheques, the merchant bore some risk of fraud, the risk of default essentially, and there would be some delay in settlement.

A. Correct.

Q. So what I would suggest to you is it is --

THE PRESIDENT: Just pausing there -- sorry, Mr Cook, but in terms of a further issue, there would be a transnational question that if I were, let us say, a tourist in California and I tried to pay for a product using my UK chequebook, the chances are I would be told that was not good enough for a Californian retail area and vice versa for a London shop with an American tourist with an American chequebook. You simply would not have a general acceptability of a foreign chequebook.

I mean, is that something which you would recognise as a risk not in terms of non-payment, but in terms of the transaction going ahead?

A. Yes. I am smiling because I once demonstrated this exact point by going up to a hotel desk with an American chequebook and offering to pay that way.

That is -- the point I made in that context is the payment guarantee is often characterised as this great benefit to the merchant, but it helps both sides to this transaction.

THE PRESIDENT: Well, yes. I mean, in this case, if the transaction does not go ahead, and we can debate --

A. Yes.

THE PRESIDENT: -- whose problem that is, but it does again seem to me another -- it is not a risk of non-payment, but it is simply a problem for both sides that a deal they wanted to do fails because there is not a payment vehicle to achieve that.

A. Absolutely.
THE PRESIDENT: Okay.
MR COOK: So what I am suggesting to you is it is a misleading simplification to describe a cheque system as settlement at par because, in practical terms, there is actually only a settlement on a proportion of transactions, subject to finer points of detail, fraudulent transactions and those where customers do not have funds in their account. Even then potentially there is a delay on settlement even when they are valid.
A. No, I disagree. That is a separate concept. When settlement occurs between banks, it is for the full par value of the cheque, just like it was with banknotes before that.
Q. But only for a proportion of transactions.
A. It is only --
Q. I will give some simple numbers. If there is 100 transactions, and I have no idea what the numbers are, but it is illustrative, 98 of them may go through without problems, two of them may be blocked because no funds or fraudulent.
A. This strikes me as a semantic point, but I understand the point you are making about payment guaranteeing. We could discuss that, but I have never -- I have been studying this topic for 35 years or something. I have

never seen someone refer to a settlement system, a cheque settlement system, in the world as non-par for that reason.

Q. So we can chop words, but the reality is that actually there is going to be settlement on less than 100% of transactions.

A. As there will be in almost every settlement system.

Q. Okay. So let us take an example then. Let us assume that 2% of cheques do not go through for whatever reason; fraud, no funds, just as an average number. So a card -- a bank comes along and says, "I have this new product. I call it a cheque guarantee card." Again, let us not worry too much about the finer legal points on that, but the basic proposition with a cheque guarantee card is if you are within the limit of $100, then the bank says, "We will honour any transaction, fraudulent, whether the customer has funds or not, provided the transaction is accompanied by the cheque guarantee card and it is within the limit". So that is the situation I am positing to you.

What they then say to the merchant is, "If you accept those transactions, we will pay you on 100% of the transactions, but we will only give you 99% of the ticket value on that 100". Now, from the merchant point of view with those numbers, and you do not have to

comment on how credible the numbers are because they are not meant to be sort of realism -- they are meant to be examples -- that is a good deal for the merchant. He goes from getting paid on 98% of transactions to getting paid on 100% of transactions, but with 99% of the price.
A. I just have to push back a little bit. When you say a good deal for the merchant, any transaction that is voluntary is, by definition or assumption, mutually beneficial. Otherwise, there would not be a deal.
So if a merchant takes -- accepts this semi-insurance product for a cheque, they have revealed that they are better off doing it than not doing it. That is true of every purchase of every good or service.
Q. But from your perspective though, what we have moved from is what I described as an expensive and risky system, you can call it, at par settlement, which involves 98% of transactions being paid only, to a lower cost, lower risk system, which is settlement of 100% of transactions, but with a 1% deduction on all of them. You think there is a problem with the second situation, do you?
A. I did not say there was a problem with it. There is -- you are paying for an insurance. You are paying a discount with certainty on all the transactions instead of a random variable for the occasional

dishonoured cheque. Presumably, that is worthwhile to the merchants that accepted those cards.

Q. I mean, I do not know if you know, but there are companies that existed in the world when there were a lot more cheques that would provide that; third party parties that would provide that kind of insurance product anyway.

A. Yes, and I think there were some similar things in some of the debit card systems.

Q. Yes, so cheque guarantee companies.

Do you see similar things in debit card systems? Is that because they did not have a fraud guarantee?

A. My recollection -- I would have to go back and check more, investigate more -- is that the German system had multiple transaction types and one of them was -- had an interchange fee or a higher interchange fee that came with a guarantee in some way that another method did not that was cheaper. But the details I have been finding it difficult to re-find after all these years.

Q. Thank you.

Then we sort of move forward technologically a bit and the bank comes up with a card reading machine, which is essentially the move towards debit cards.

A. Right.

Q. You know, as compared to using the cheque guarantee card, which in my example it is charging a 1% fee for, it says, "If you use this card reading machine, then we will charge you again. We will pay you for 100% of the transactions, but I am going to deduct a 0.5% fee because using a card reading machine reduces risks of cost and fraud, etc." So, again, that is just simply paying a fee for insurance essentially. You are avoiding the risk in return for a fee.

A. No, that is not what it is, I do not think, because the difference with a debit card system in the brilliance of the technology and the innovation of it is that you can check immediately for two things. You could check for the identity of the customer, at least if you use a PIN, which sensible countries do, to verify the identity of the cardholder. The second thing you could do is check the availability of funds. I guess a third thing you could do is transfer those funds very quickly.

So it is not that you are paying for this risk that is avoided. You are avoiding the risk. The system avoids the risk altogether in those ways.

Q. Let us deal with that. That is a question of degree. You are never going to, sadly, eradicate fraud entirely, so there is always going to be some of those costs associated with it. So as long as the fee reflects the costs, then the reality is we are back to the same

point, which is the merchant is paying a fee to avoid a risk it would otherwise face, and that is a perfectly reasonable insurance product, is it not?
A. Well, this is all a little bit fuzzy. The merchant is paying its acquirer in a debit card scheme. They would be paying a fee to accept debit cards even if there were no MIFs, with the exception that they may get thrown in for free, like in New Zealand, for just having a banking relationship with the bank. But suppose there is a small acquirer margin even without a MIF. That is separate from the interchange fee, which I would argue is not necessary in a debit system.
Q. I am not asking whether it is necessary. I am just simply saying this is fundamentally no different, which is there is a risk which can never be completely avoided, but the merchant avoids it in return for payment of a fee. That is just a perfectly reasonable commercial transaction, is it not?
A. It is not a commercially reasonable transaction the way you are describing it, because the issuer is the one that is verifying the funds' availability, has issued the card, has the ability to detect fraud. The merchant does not.

If the card is being used in a pattern of transactions or the cardholder has not reported the card stolen, none of those things could be controlled by -- and stolen cards are not an issue with PINs. Those -- counterfeit cards are not a problem with chips. Those are not problems that the merchant can control. Sure, they value the ability to use a debit card. They are willing to pay fees, sometimes high fees, to accept debit cards. That does not mean that it is the competitive solution.

Q. I am just not -- you say "competitive solution". You may mean many different things by "competitive solution".

In terms of what the merchant would be willing to pay, from their perspective, they are getting something which means they have no risk of fraud in that example -- do not worry about the detail -- in return for a fee, which I suggest -- the fee is set to reflect the residual risk of fraud and the cost of that system. So you have a cost. That system is not going to be a free system. Then essentially what they are getting is an insurance product at a cost that will either be acceptable to them, in which case they will take it, or not acceptable, in which case they will not.

A. Well, I was ready to agree with you.

Q. Okay.

A. You combined two things there. You combined the willingness to pay by a merchant. Of course, like I said a few minutes ago, any voluntary purchase you observe happening, it must be happening at a price that buyers are willing to pay. So, of course, the merchant is willing to pay -- it is worth it to the merchant to pay for debit card services.

But then you slipped in costs of the system and then it gets all kind of murky. So if we could just stop at the first half of your question, that would be great.

Q. So the merchant is willing to pay because it values it. Otherwise, it would not do it.

A. Correct.

Q. Turning to costs, again, let us just use some numbers, and they are meant to be illustrative. If there is still 0.5% fraud and the system costs 0.2%, a total of 0.7%, again, that is an advantage the merchant gets. He avoids the risk of fraud entirely, but the cost of that happening is still 0.7%.

There is nothing wrong with a commercial deal which reflects those costs, is there?

A. When you say "the costs of the system", are you talking about the schemes' costs? Are you talking about the issuer's costs? Are you talking about the acquirer's costs? Whose costs?

Q. I am just simply saying -- we will come to unpick it by

reference to three or four-party models in due course.
A. Whether a merchant finds it a good deal has to do with the value to the merchant and the price. As long as the price is less than the value to the merchant of accepting the product, the merchant will accept the product. There is nothing to do with costs, but whether it is reasonable in some competition law sense is a completely different matter.
Q. You say in your paragraph 67 of your first report that the debit card example shows the problem with interchange fees. So that is {RC-H1/1/31}, paragraph 67. You say:
"... debit cards should have reduced costs compared to the cheques they replaced, debit cards incur an interchange fee while cheques did not."
I suggest to you in that example the difference was cheques were a system where, subject to fine points of detail, the merchant took the cost of fraud, the cost of cardholder default and some delay point, funding cost, whereas with debit cards essentially those risks were moved to the issuer in return for a fee. That is the reason you get interchange fees, do you not?
A. No. First of all, if a customer bounced a cheque, the customer paid a big fee to its own bank. The merchant often, pursuing the collection efforts, would charge

a big fee to the customer too. So there were a lot of extra costs and they fell on the person who wrote the bad cheque.

If they skipped town, the merchant might never collect, but often these were -- who accepted cheques? The people who accepted cheques the most were neighbourhood stores and bill-paying relationships where you would mail in a statement payment, a monthly payment. But in retail contexts, cheques were accepted typically for places like supermarkets and other retailers buying furniture where the store had recourse -- they knew where you lived. They could pursue payment if you -- if your cheque bounced on an expensive furniture set.

So those costs were not as prevalent as you are suggesting.

Q. I am not making any suggestion about the extent of the costs. I am just using some round numbers for simplicity. I am pointing out that it moved from a cheque system where they bore those risks for the costs. They might be able to recover some of them, but it was difficult and expensive to assist them where they got the costs taken over by somebody else in return for a fee, and that is a standard insurance product essentially.

A. But the costs plummeted and letting them lie where they fell was an efficient and sensible solution to that problem, rather than having the banks all decide, "We will charge the merchants a collective fee for this process". I am not disagreeing that this was great cost savings to the merchant. Of course it was. That is why they wanted to switch to debit cards. Everyone should have benefited.

MR COOK: Sir, that is probably a convenient point for a break.

THE PRESIDENT: Thank you very much. We will rise, in that case, for 10 minutes. Thank you.

MR KENNELLY: Sir, may I quickly --

THE PRESIDENT: I am sorry.

MR KENNELLY: Two reasons. First of all, I just read the [draft] transcript and I said -- I certainly implied that I had finished with Dr Frankel for the day. Of course, I do need to cross-examine on the --

THE PRESIDENT: I had understood that you were doing a comeback.

MR KENNELLY: I am obliged.

There is also our report, the most recent Holt report, the one I mentioned yesterday, has been sent to my learned friends. I will not formally apply until I know their position and then I will --

MR BEAL: We are happy for it to go in. I would like Professor Frankel to be able to read it now, if that is permissible, so that if any cross-examination is to be adduced --

MR KENNELLY: We have no objection, of course, to that.

THE PRESIDENT: How long is it?

MR BEAL: It is three or four pages of substance and then a top and a tail.

THE PRESIDENT: 15 minutes, Dr Frankel, rather than 10 --

A. Sure.

THE PRESIDENT: -- to review it.

MR BEAL: Thank you very much.

MR KENNELLY: I certainly do not propose to cross-examine on it until after lunch, so I would not try to ambush Dr Frankel.

THE PRESIDENT: No, I know that, but we will let Dr Frankel --

MR COOK: I mean, just to say --

MR BEAL: Sorry, I thought we were finishing at lunch.

MR KENNELLY: No. That is why I got up, because you may have been misled -- my learned friend may have been misled by what I said earlier. We are likely to go over lunch because we have to cover issues 4 and 5 and then I have to come back on the --

THE PRESIDENT: I understand your concern.

MR BEAL: I will do what I can. I will do whatever I can.
THE PRESIDENT: I do not want you to go that far. I want you to do what is appropriate.
MR BEAL: Of course.
THE PRESIDENT: I do not want the Claimants in any way disadvantaged. I know --
MR BEAL: Sir, with respect, you have been entirely fair with me, which is if I need more time, I will take more time.
THE PRESIDENT: No, I am very grateful to you for accommodating the delays.
MR BEAL: I had my moan yesterday. There is no point repeating it.
THE PRESIDENT: I am grateful. We will say 15 minutes.
(11.33 am)
(A short break)
(11.52 am)
THE PRESIDENT: Mr Cook.
MR COOK: Professor Frankel, just to look at another scenario, you will be familiar with the process of postdating cheques, will you not, as well? It is where you write a future date on the cheque and it does not become payable until you reach that date.
A. I believe that is not an accurate representation of the law on that, but I am not a legal expert.

Q. I mean --
A. I think if someone pays a postdated cheque, the cheque (inaudible - coughing) out.
Q. Sorry, the cheque?
A. Whoever drew the cheque, whoever wrote the cheque, is not entitled to the postdating treatment. That is a courtesy by the recipient if they do not deposit it yet.
Q. But ignoring sort of the basis for that, that is essentially one way for a merchant to provide credit, is it not, to accept that they will not cash the cheque for a month, say, whatever is the agreement?
A. Sure. Merchants are free to do that with their customers if that is what they negotiate with their customer.
Q. It is often attractive for merchants to provide credit because it makes customers buy today even if they cannot afford to do so.
A. Well, merchants provide trade credit for a number of reasons. One is to make the sale instead of having another competing merchant make the sale, who might be willing to offer trade credit.
Q. Yes. That kind of trade credit has a cost and we have heard about factoring, for example. In principle, a merchant might well want to provide credit, be happy

to take a lesser sum now in order to allow -- a lesser sum now in order get the money now rather than waiting for 30 days, say, for example.

A. That describes all borrowing in the economy, not just merchants. But I disagree with the analogy of factoring to cards, but happy to go there if you want.

Q. Just turn then to a four-party card scheme. I mean, there is no technical reason why you could not operate a four-party card scheme on the basis that issuers only have to pay for valid transactions.

A. I am sorry, I missed --

Q. There is no technical reason why you could not operate a four-party card scheme on the basis that issuers only have to pay for valid transactions, so they would not have to pay for fraudulent transactions. You gave the EC card example, did you not, where that was a situation where issuers did not have to pay in all circumstances?

A. Well, there is any manner of ways you could operate a four-party payment system. Whether the structure has anti-competitive features or not may depend on the details.

Q. But as a matter of, you know, technical/practical capability, there is no reason why you could not operate a four-party card scheme on that basis.

A. I do not know if it would survive. Some of the suggestions that we will wait 45 days to send the funds, if there were a competitive market and other schemes were willing to pay the money fast, that might not be competitively successful.

Q. The restraint you are posing/suggesting is a commercial one rather than any sort of technical or fundamental objection.

A. As a technical matter, they could try, you know, whatever they want. Whether it works or not in the marketplace and whether it is competitive are additional issues.

Q. Yes. Since there is no inherent reason to allocate cost of fraud to either side, it is equally possible to say, well, the alternative is we allocate the cost of fraud to acquirers or you pay a fee and issuers take the fraud. Again, it is just an insurance product, is it not?

A. So my view on fraud and efficiency is that it makes sense for fraud that could be -- just like credit losses, that could be controlled by the -- monitored and controlled best by the issuer to fall on the issuer and fraud that could be best monitored and controlled by the acquirer, such as who they sign up as a merchant and are they, you know, a criminal enterprise or something, any losses for that make sense to fall on the acquirer.

That would be an efficient way.

Now, to deliberately make it inefficient to sustain a net transfer of funds to issuers I might find to be anti-competitive, but just because I think it is most efficient to do it the way I suggested by itself does not necessarily mean that other arrangements are anti-competitive. But I would be wary of it.

Q. With a three-party card scheme, those generally do charge the kind of fees that would allow them to cover costs like fraud, for example, from merchant fees rather than cardholder fees.

A. Well, their fees cover their costs, so they would not survive. It is true that American Express obtains a lot of its revenue from merchant fees, but that is not its only source of revenue.

Q. What I suggest to you is what this shows is it is meaningless to talk about costs should lie where they fall, because the allocation of costs is fundamentally going to depend on how the scheme is set up; whether there is a guarantee against fraud, whether payment is now or in two weeks' time. That is all just how the scheme is structured, not some inherent political truth or not some inherent truth.

A. So you are -- it is true that the rules of the scheme can be changed to have more costs fall on the other side than they fall today. I would be suspicious of such changes, especially if they are designed to replace interchange revenue. Costs fall where they fall and that changes sometimes.

When the EMV standard was deployed, there was a liability shift, at least in some regions, where, if a merchant did not use the EMV card reader, chip reader, and they suffered a loss, they did not get a payment, a guarantee.

Just to make sure it is clear to the Tribunal, merchants do not always get a payment guarantee. You know, card not present transactions, if there is a fraudulent transaction, that often is -- that loss is absorbed by the merchant, not by the issuer. Sometimes in these discussions I think we lose track of that. Something like 30 to 50%, depending on the year, in the region of fraud losses fall on the merchants already, so --

Q. Where is that piece of information coming from?

A. I read a lot of articles on these issues. During Covid, it went up to 50%, I think, but it may be back --

Q. That is a Covid number, so where is the 35% number coming from?

A. The US Federal Reserve article I read, I think, was 30/35%. It depends on the source and the time and the region, but merchants absorb a lot of the fraud losses routinely, and that is going up with card not present.

Q. In terms of when the scheme allocates costs by its initial rules, it is going to take account of whether or not there are offsetting flows that go towards those costs, is it not, offsetting flows of funds?

A. I am not sure what you mean by offsetting --

Q. Well, if you are going to decide whether there should be a payment guarantee, you are going to take account of whether or not there is going to be a financial contribution to that cost from the merchant side or not, are you not?

A. My benchmark is thinking through what a competitive efficient market would look like. In a competitive market, you would expect schemes to adopt efficient rules. So it had the right incentives so they did not compensate issuers when their own conduct led to higher fraud rates and did not compensate merchants when their conduct leads to fraud, but instead sensibly allocate things like fraud to the locus of the conduct that caused the fraud or was in a best position to reduce fraud.

Q. But in reality, the question is ultimately: are merchants largely going to pay it or are cardholders going to pay it? A cardholder largely cannot influence fraud at all, can they?

A. Well, it could also be the issuer or the acquirer, depending on the nature of the incident.

Q. Yes, but ultimately, issuers and acquirers are only going to be profitable insofar as they can recover their costs from any form of interchange fee flows, but also the costs they charge their customers.

A. Well --

Q. So what you are really saying is cardholders should pay the costs of those frauds, not merchants. A cardholder certainly cannot control them, can they?

A. Cardholders certainly can help reduce fraud. The issuers earn a lot of profits and so it is not accurate -- what you just said suggests that there is 100% pass-through of -- marginal revenue flows to issuers flows on to cardholders. That is not true.

You know, there is going to be another trial about pass-on and efficient and yet another trial about efficiency issues, but just to make sure it is clear, the fraud losses -- if an issuer today has to eat a loss because it approved a transaction, it said, "You know, it is coming from Kazakhstan and it looks a little fishy, but we are getting all this interchange revenue, so we are setting our fraud rule here and we are going to approve that transaction", and then it is a fraudulent transaction, the issuer might suffer the loss on that transaction today, not pass it on to the cardholder.

Q. But in the Amex situation, that will also be covered by merchant fees. They will also have that income stream --

A. I do not understand -- Amex is obviously vertically integrated. It also has independent acquirers or entities that do -- that provide some of the acquiring functions. I do not know what those contracts look like, but it may well be that Amex itself does not incur all those fraud losses when it is -- when it falls on the merchant side. If there is a fraudulent merchant that was signed up by Elavon for Amex, Elavon may well suffer that loss. I would have to see their agreements, but that would not surprise me.

Q. I want to ask you about two-sided markets. Now, you agreed in the hot tub with the other experts that credit and debit cards are two-sided markets; is that right?

A. Yes, but they did not necessarily have to be.

Q. Okay. I mean, it is fair to say they did not necessarily have to be. I mean, that is based on your what I might call an economist's panacea of a world in which prices are fully differentiated and there is full surcharging.

A. So let me be more specific, because as Rochet and Tirole point out in one of their articles, every market kind of fits the definition of a two-sided market. So what does it mean if everything is a two-sided market? We have not really made any progress in understanding it.
The rules like the no surcharge rule and the no discrimination rule and the other rules that I have referred to as anti-steering rules are designed to ensure that the two-sided characteristics are not competed away.
Q. Okay, but you agree this is, in fact, a two-sided market and, in reality, it is going to be a two-sided market even without those rules because nobody is ever going to have fully differentiated pricing, certainly not in this market.
A. Well, it depends. You know, there could be some transactions that actually, as Mr Holt pointed out during the concurrent evidence and in his report, for some corporate transactions, they may fully take into account the payment cost differences. It may approach, in essence, a one-sided market even though there is two parties transacting. The features that we think of as falling out of a two-sided market analysis may disappear if it is very competitive.
Q. So you are saying it might be rare circumstances where

it is not, but as a generality, this is a two-sided market.

A. Well, it is a two-sided market. The practices have made it more so.

Q. Just to be clear, a two-sided market is one where you have a single product or service that is provided to two distinct groups of customers. Is that a fair description of it?

A. No.

Q. Okay. Go on then. Give me a better one.

A. Okay. So this is what I referred to as a casual description. The problem is it fits too many circumstances. The fish market example I think I gave during the hot tub. You know, someone sets up a market. Fishermen bring the fish. Restaurants and supermarkets come to the fish market. They meet over the fish market. They buy and sell fish. Is that a two-sided market? Well, by that definition yes, but every commercial real estate building is a two-sided market, bringing together tenants and customers.

So it is too general. I think what people have in mind with a two-sided market, and Rochet and Tirole make this point, is it is where -- in economics with the Coase theorem. It means where costs fall matters to the outcome, because they are not competed away. Having

more of the costs falling on the merchants matters because they historically and practically still tend not to be able to surcharge or discount to undo those effects.
Q. But what you also have is a set of joint costs, essentially. You have a set of costs that are not directly referable to providing a service just to one side rather than just the other side.
A. I do not think that matters.
Q. Well, as soon as you have a set of costs that you cannot allocate to one group of customer getting an additional unit of product, you have -- there is no sort of a priori way to allocate those costs, is there? You are going to be thinking about it commercially as: what is the best allocation for my two group of customers for me to maximise my business?
A. Well, for you to maximise your business, I suppose you mean your profits, of course you will do that. What makes it a two-sided market is not so much where the costs are incurred, because if prices adjust to reflect where the costs fall or people are given the right incentives, like a discount, to use the lower cost method, it does not matter where the costs fall. The two-sided market literature has very little to do with costs other than the constraint that total revenue has

to cover total costs.
Q. In a payment market, essentially you have a one-to-one relationship between the two groups of customers in the sense that every transaction, you must supply an equal amount of product to both sides simultaneously. Every transaction must have a merchant and a cardholder.
A. A lot of people described it that way. Our Supreme Court described it that way. There is one transaction from a cardholder and one transaction from a merchant. So this goes back to the early 80s and Bill Baxter described it that way.
I do not think that is quite right because merchants are not buying a transaction at a time. Cardholders are not buying a transaction at a time. The relationships -- and there is fees and some of the fees -- merchants pay fees with each transaction, but the cardholder does not. They may or may not get rewards with each transaction until -- well, I will leave it at that.
Q. But let us just go back to the three-party scheme example, looking at the costs associated with that, and the reality is the card scheme there is just going to try and recover obviously all of its costs, because it needs to do that to be profitable, but how much it recovers from each side is just going to take

a commercial view based on supply and demand, which also is heavily determined by competition.

A. It is going to maximise its profits. Given the world we are in today with the history of the market as it has evolved with various rules in place and business practices, they are going to have an incentive to load fees on the merchant side because that is the most profitable thing to do. The three-party scheme will change its calculus if the four-party schemes have to change theirs.

Q. We will come back to what might happen in a situation where the four-party schemes were hamstrung, but as a general proposition, when you are talking about willingness to pay in the sort of market, if a customer can buy equivalent product for $1, they are very unlikely to want to pay $2 for it from you, are they not? That is just common sense.

A. I think my quality is worth the premium.

Q. I said equivalent --

A. More than $2.

Q. Yes, I said buying equivalent quality.

A. Yes.

Q. If it is not equivalent, then you will not, but --

A. Presumably, that is correct.

Q. So when you talk about willingness to pay, willingness to pay is largely dependent not an absolute, but, "What is my alternative? Because everything else being equal, I am not going to be willing to pay more when I can buy it elsewhere."

A. That is all correct, but willingness to pay is not usually what we think of as competitive pricing.

Q. But that is what makes two-party -- well, two-sided markets unusual, because essentially you do have to recover all of your costs from two sets of customers and you are going to take account of the willingness to pay on both sides because that is what drives what is going to be the profit maximising outcome, is it not, unless we are in this world of perfect price differentiation, which simply does not exist?

A. I completely agree with you. That is the profit maximising solution so that, as Mastercard said and as Rochet and Tirole say and others, you have got to try to raise prices to the merchants to extract all that willingness to pay as revenue for the scheme and its members. So in the case of Amex for itself and in the case of Visa and Mastercard between its scheme fees and its interchange fees for itself and its member banks, its issuers.

Q. But, I mean, to some extent, Mastercard and Visa are doing no more in their pricing than Amex is doing, PayPal is doing, Clearpay is doing. They are all taking account of supply and demand on the two sets of customers and working out the right allocation of costs or right allocation of prices.

A. They are working out -- what they are all doing that is similar is figuring out how to maximise their profits. Sometimes they succeed, sometimes they do not, at staying profitable.

You know, we will get to these part debit networks, but banks would prefer to get interchange fees if they can get them. That is profit maximising for an issuer. We have heard -- not the first to say issuers have an incentive to migrate towards higher interchange fees. The question is: what is the competitive solution in the design of the market and does it include interchange fees or not?

Q. You talk about the competitive outcome, but that just shows -- when you talk about what someone like Amex is doing, that shows the competitive approach for a company is not to price down to zero for merchants. It is sometimes to price significantly more to merchants. That is the way it competes, is it not?

A. With the exception of the debit example that I gave, similar to cheques, where banks will allow you to deposit or write cheques, they will allow you use debit

cards or accept debit transactions. It was true in Denmark for a long time. It is still true in New Zealand and for many transaction types in Canada that -- but except for those situations, even with no interchange fee, I would expect merchants to pay merchant fees, acquirer fees, and put aside scheme fees.
Q. I went back and looked at your first report in these proceedings and I do not see a single reference in it to two-sided markets. Have I missed that or is it not there?
A. I did not set out to deliberately write about the two-sided market literature or not write about it. I did not think it was necessary to get into that for this purpose.
Q. Because essentially, it is -- first, it is a fundamental part of the economics of pricing and two-party or four-party card schemes, is it not, a fundamental part of competition?
A. You know, maybe it is just reflecting my age, but the indication of two-sided markets is sometimes used as a way of inoculating a serious competitive analysis. You could wave your hands and say, "It is two-sided. Therefore, all this conduct must make sense. If it is maximising the profits of the scheme, it must be okay." I do not view it that way.

THE PRESIDENT: Well, Dr Frankel, it may be that you need to give us your definition of a two-sided market so that we can understand or ensure we are talking the same language.

A. Yes.

THE PRESIDENT: I mean, how do you define two-sided market?

A. I think as a casual practical matter describing these platforms, whether it is a transaction platform or other platforms that people discuss as two-sided, is perfectly fine. I worry about the phrase "two-sided market" with the word "market", because that sometimes suggests relevant market in a competition sense.

But I do not mind the idea of two-sided market. I just -- the literature has been developed to -- in many cases with an agenda, a bit of an agenda, to rationalise what I believe to be anti-competitive conduct. Under what I think is the sensible definition of "two-sided markets" is the Rochet and Tirole definition, where it matters where the costs fall on one side or the other to the final equilibrium because there are impediments to effective competition.

THE PRESIDENT: Well, I quite take your point that "two-sided market" is not a very helpful label. Indeed, I think I have said so in a judgment myself that it is not very useful.

But can I see whether this fits your understanding of a two-sided market, namely that you have got a single platform or product base sold by a single undertaking, here Visa and Mastercard, which involves selling different products to different markets which are related because they are emanating out of the same platform.

So here we have got the same scheme selling an ability to pay to cardholders and an ability to be paid to merchants and you have got two sides, essentially two different markets, so "a two-sided market" is not a very helpful description. You have got two different markets which have their own internal dynamic, but also, which is what makes them unusual, a nexus between the two markets --

A. Yes.

THE PRESIDENT: -- such that the pricing on one side and the demand on one side affects the pricing and demand on the other side. Is that a definition that you can work with or do you disagree with it?

A. Yes, and I have used that kind of definition. The two different products are complements in usage. They work together. I think that is the reality of these industries. So I think that is fine.

THE PRESIDENT: Okay. I mean, the easier one is the free newspaper where you have got a market of readers and a market of advertisers. It is the same newspaper on each side, but the advertisers are paying for space in the newspaper because they have got lots of readers willing to look at it. In some cases, the free newspaper is the best way to assess or to disseminate advertising content more widely and so certain newspapers are offered for free to the readership because it is in the interests of the newspaper procedure to sell at a higher price to advertisers.

A. I think that is completely correct. My view is that where there are important two-sided effects, maybe not for a small community free newspaper that I would worry about, but in major industries that have these important two-sided effects, it is usually associated with market power either because of intellectual property that prevents competitors from directly copying the expensive side and undercutting your pricing structure or other impediments, or just -- it does not mean it is anti-competitive conduct that created it, but I think there is often an association, whether it is Internet platforms or other platforms, with important two-sided effects.

Putting aside actual matchmaking, sometimes people talk about matchmaking services or employment recruiters as a --

THE PRESIDENT: Yes, broking services, for example, in the insurance market.

A. Yes. Actual matchmaking services can have different issues, and I kind of set those aside.

THE PRESIDENT: Fair enough. I quite take your point that two-sided markets have an impetus to grow. Is that not because of the network effects that we have been discussing?

To go back to the newspaper example, the newspaper seller is going to want a maximal readership, a big readership, because that way, the same newspaper seller can go to the advertising market and say, "Look, you are getting a really good readership for this trifling price in my newspaper". So you need to be big on one side in order to be big on the other and if you get smaller, then the whole thing fails.

A. I think that is true. That reflects, one, economies of scale that result from these network effects.

Two, going back to newspapers, an interesting phenomenon with newspapers is newspaper readers tended -- not always, but they tended to read one newspaper or another if there were multiple newspapers in a city. So an advertiser to reach the population had to advertise in both newspapers, if there were two.

So that is another illustration of the single homing versus multi-homing that gives each newspaper in essence market power for access to its readers on the advertising side.

THE PRESIDENT: I am grateful. Thank you.

MR COOK: Just to explore the newspaper analogy, that is a situation where there is a sort of one-way network effect. In most circumstances, as a reader of a newspaper, I am not that interested in how many adverts it has in it, so I am not intrinsically interested in that. There may be examples --

A. Yes, I would disagree. I think if advertising was useless to consumers, it would be probably not so valuable to the advertisers.

Q. You --

A. There are some newspapers --

Q. -- (overspeaking), but every now and again my eye comes across it and I think, "That looks like a good product". The principle of advertising often is it steals upon you and your --

A. There are some newspapers that are exclusively advertising vehicles.

Q. Yes, some of the car newspapers, for example.

A. Right.

Q. Yes.

So with your definition of "two-sided market", you said -- in a two-sided market, one way it matters is where costs fall in the final equilibrium. That is the reason why it is absolutely essential in this area to discuss or consider that part of the economics, is it not? Because that is the reason why interchange fees have an important role to play in the ability of the schemes to compete and how effective they will be as competitors.

A. Well, I agree that it is important to understand the incentives. If interchange fees are allowed, that is how the market will evolve with that tool available to the schemes and to create competitive distortions, especially if the prices are the same for no matter how you pay.

Visa offers a bigger, a larger, interchange fee to a bank than Mastercard does. The bank has every incentive to take the higher MIF because it is not going to lose any transactions as a result of the merchant paying the higher price if the merchant is not discriminated.

So it is key to understand what is happening, but it is also important to understand that that is not describing necessarily an efficient outcome.

Q. But it is also what competitors will do, such as Amex; is price in that kind of way with those kind of considerations.
A. To the extent they can facing the constraints such as merchant steering.
PROFESSOR WATERSON: Can I just intervene in this discussion. Supposing that you had a scheme where a particular bank issued a card and retailers could decide whether to take that card or not. So Barclays Bank issues a card and retailers say or do not say, "We take Barclaycard". But another bank, say HSBC, could issue a different card and retailers could say, "We take that card or not".
So there are various different schemes. Would you see any competition issues with that framework?
A. So suppose all we had were three-party schemes. Barclays issued a card, HSBC issued a card. Each bank issued its own card schemes and signed up merchants. I think that could be a competitive market, but I would not want -- I would be very cautious if they had parallel sets of vertical restraints that did not allow merchants to treat customers differently depending on which card was used.
PROFESSOR WATERSON: Right. Thank you.
MR COOK: But it is likely, given everything we know about

lack of willingness to surcharge, matters like that, that even if there were not those what you call vertical constraints, the reality is that it is very unlikely that those card schemes would price down to zero on the merchant side, would they, in the same way that Amex generally does not today.

A. Well, I think this is one of those occasions where I need to distinguish what would happen today from how would the market have evolved until today. Going forward, I mean, Australia does provide a very good natural experiment into what happens if some of the vertical restraints are removed and Visa and Mastercard MIFs were reduced.

Amex's fees -- I know Mr Holt disagrees. He just got this one wrong. It is undoubtedly true that Amex was faced with differential treatment by merchants and renewal of contracts. Every three years, a merchant would say, "Do not want us to surcharge or differentially surcharge just Amex card. You are going to give us a lower price." It kept happening over time and that is why Amex fees gradually came down.

It has taken 25 years. It does not happen quickly, but it is the relentless pushing because merchants can treat those brands differently at the point of sale. It has had a continued effect downward.

Had the market evolved without any restraints, you know, in the United States, we had credit card networks form with no MIFs, others form with MIFs. Well, the banks opted for the MIFs because banks would rather get the MIFs than not get the MIFs, but had they not been allowed to in -- you know, I read this Mr Holt response to my list. Had banks been told, "You cannot have a MIF, no matter what, there is no MIF allowed", would they have not innovated? Of course they would have innovated. They would prefer to get the interchange fee than not get the interchange fee.

But banks also innovated with -- maybe you do not like cheques, but digitising cheques and imaging cheques. We used to ship cheques around. Until 9/11 happened, I think they were still shipping cheques by airplane. It was crazy. So now it is all digitally transmitted and we still use cheques in the United States. It is coming down now.

So innovation could happen. If banks -- if that is the way banks need to provide critical payment services to their customers, they will do it.

Q. You largely sort of in your reports make very little reference to the actual evidence in this case. Can I suggest to you that what you have done is your reports largely approach the issues from a perspective of general economic theory and your history of payment systems rather than looking at the specific characteristics of these specific markets?

A. No.

Q. Well, there is very little reference to the evidence, so how does that come about?

A. Well, I mean, maybe you think of evidence differently than I think of evidence. I read the witness statements. I am certainly aware of a lot of the evidence.

I think the issues that I see here -- I mean, you could read my report from -- my article in Australia from 2007, or my 1998 article. They are the exact same arguments and the same issues that people have been debating in every venue that I have been involved with for the last 25 years.

So it was not necessary to say, well, you know this witness -- first of all, merchants are great. I love talking to merchants, but there is a cautionary note because it is very difficult for a merchant to think of a counterfactual world. It is difficult for all businesspeople. Some of us are in the business of thinking of counterfactuals and we still struggle to keep our mind in the counterfactual world.

What I found is, you know, ask a merchant, "Would you surcharge?" They would say, "Oh, no. Our customers would go crazy. We would not do a surcharge." I said, "Well, would you surcharge if, you know, Walmart was surcharging or, you know, all your biggest competitors were surcharging?" "Oh, yes, then we would surcharge". So it depends how you ask the question.

Q. The question was, when I asked the question, the reality is you have looked at this from the perspective of general economic theory and the history of payment systems, and you disagreed with me. You really do not place any real weight or reliance upon the evidence on this market in this case, do you?

A. Well, you can disagree with me, but I think the evidence from Australia, and I think Mr Holt did it, is very relevant to this case. He called it a natural experiment. That is what I call it. So I view that as evidence. Looking at the facts and the evolution of these markets around the world has taught me a lot and where I need to use local evidence, I do.

Q. The bilaterals counterfactual, you have been through a lot of that with Mr Kennelly. Just to clarify a couple of points in relation to that.

You say at paragraph 33 of your report, so that is {RC-H1/1/17}:

"From an economic perspective, the counterfactuals the Schemes describe are inappropriate insofar as they are not competitive alternatives that remove the anticompetitive restriction ..."

So in the bilaterals counterfactual, you do not say what is the source of anti-competitive restriction that you think exists. Well, what is it?

A. I think I would -- I think I described it, but let me be clear in case it was not clear. The anti-competitive restriction, as I understand Mastercard's position, is, "We would not have any role. We just would be there to provide services if people want them." But that is not true. As I understand it, Mastercard would have a role that said, "If you want authorisation clearing and settlement services for Mastercard, you must enter into a bilateral -- you, the merchant, must enter into an agreement with all of our issuers, with each of our issuers, on a bilateral basis regarding the interchange fee. Otherwise, you cannot use our platform."

If I have that wrong, please correct me.

Q. So that is paragraph 86, if we could go to that. That is page 39 of your report where you say that {RC-H1/1/39}. You say:

"In effect, in a bilateral interchange fee regime, the Scheme refuses to provide authorization, clearing, and settlement services for any of a merchant's transactions unless that merchant (through its acquirer) reach an interchange fee agreement with every [single] one of the Scheme's issuing members, no matter how much an issuer demands ..."

So it is clear to you that is not -- we are not suggesting there should be a rule of that kind, but your view on the bilaterals counterfactual is, therefore, based on the premise that there is a rule in the terms you describe in paragraph 86.

A. If there is a rule that only says if you want to deal with this one issuer, you can only do so if you enter into an interchange fee agreement with that issuer, so the default is either -- is no longer the scheme-set MIF, it is you do not get to deal with that issuer. That is anti-competitive because you are telling each -- you are allowing the issuers to each hold out on surveying the merchant. It is a rule that says that, "You cannot obtain our services from Mastercard, network services, authorisation, clearing, settlement, unless you agree to that merchant's interchange fee". I am sorry, that issuer's interchange fee.

Q. So just to be clear, your view on the bilateral counterfactual is based on the notion that there is a rule in the terms that you describe.

A. Well, a rule or a business practice that has that effect. If I misunderstand the nature of the bilateral proposal, I would be happy to respond to some other characterisation of it.

Q. So (inaudible) situation where there is no rule at all. So from your perspective, if there is no rule, then you recognise that there is going to be no anti-competitive agreement.

A. If --

Q. (Overspeaking) concerted practice.

A. If there is no rule governing interchange, governing a payment as a condition for obtaining authorisation, clearing, settlement services to deal with merchant -- to deal with issuers in the Mastercard scenario, that is, I think, by having a default par settlement role, which I understand Mastercard to disavow.

Q. You keep on talking about there being a rule, but there is simply an absence of rules. There is simply nothing, no anti-competitive agreement, is there?

A. Will Mastercard provide services for a merchant's transactions with either one issuer or all the issuers if the merchant has not -- through its acquirer is not covered by an interchange fee agreement with either that issuer or all issuers?

Q. There is no rule to that effect.

A. There is no rule.

Q. If that is the case, then you have a problem with it.

A. So you are describing a settlement at par counterfactual, but then you are pivoting to say you get to the same interchange fee as -- or your experts saying that you would get to the same interchange fee under a bilateral agreement. That can only be true if it is a mandatory bilateral rule or practice that, "We are not going to allow the merchant to submit transactions to clear to that -- to settle with that bank, that issuer, unless there is an interchange fee agreement between the two of them to the --" is that -- am I right about that?

Q. Am I right in thinking that in this analysis, you are sort of ignoring the role of the IFR caps?

A. I am not ignoring it.

Q. Do you think we should take account of the existence of the IFR or not?

A. Sure. I agree with the other experts, with some caveats, that the general result of the bilateral counterfactual, as I understand it to be a mandatory rule, not just -- will implement a bilateral agreement if you reach one, but you must enter into a bilateral agreement if you want to deal with that issuer about fees. If you want to deal with that issuer to accept transactions, then you get to the IFR cap or any other cap that is binding from another source like the scheme cap.

Q. So I am suggesting if there is simply no rule of any kind, there is simply no problem there, is there? That is simply the same kind of negotiation that merchants do with Amex. They agree a fee, obviously subject to the cap.

A. No, it is not the same at all.

Q. Why not?

A. If I am a merchant and I approach an acquirer and say, "I would like to accept Mastercard cards in my store" and the acquirer says, "Great, you know, our fee is 5 basis points on all transactions", and the acquirer says, "Great" and then it submits the transactions to Mastercard, without there being any agreement in place between that issuer and -- between that acquirer and an issuer governing that merchant's transactions, my understanding is Mastercard's proposal is that it will not process those transactions.

Q. It will not process the issuer's transactions either. It is a matter for them to agree and transact with each other. What is problematic about that? It is the same as the relationship with Amex. You have to have an agreement and they come to a deal and they transact with each other.

A. In this hypothetical, this counterfactual, does

Mastercard continue to have an Honour All Cards Rule?

Q. Well, those are the two scenarios that are being considered, so both with and without. But I am simply clarifying for these purposes there is simply no rule requiring settlement on any particular terms.

A. Well, my -- I want to think a little bit more, but my opinion as I sit here is that if you did it issuer by issuer, so if you do not have a rule that says, "You need to settle -- you need to reach a contract with all of our -- governing all possible Mastercard transactions", that is a more restrictive rule.

So if there is no Honour All Cards Rule and I could -- and I am a very large merchant in the UK and I could say to each bank, each issuer, you know, "Give me a lower fee or I am not going to accept your Mastercard", that is clearly less restrictive than having an Honour All Cards Rule in effect, so I have to reach agreements with every issuer covering every possible transaction.

In that counterfactual, maybe fees would, at least for large merchants -- small merchants would not have much ability to negotiate with Barclay or something. But that might be an intermediary step, but I would want to think about it. If there is an Honour All Cards Rule, so I have to reach agreements with all issuers in order to do business to accept Mastercards, I think you just get back to the IFR.

Q. Okay. If you look at paragraph 48, page 23 {RC-H1/1/23}, of your report, we went through these briefly. I think just to clarify, you accept that there is a practical way of getting sufficient bilaterals in a small market like the UK. That is your first potential --

A. I am sorry, which --

Q. So paragraph 48.

A. Yes.

Q. It is potential problems identified by Small and Wright.

A. Yes.

Q. The first one is transaction cost problem. We saw the article you had written. You think there is basically a practical way of dealing with this, particularly given the sums of money in dispute.

A. I do not know. I know, you know, banks have done this in other contexts and in markets with relatively small numbers of banks, having a web of bilateral or hub and spoke kinds of structures like in Canada and just have the big banks have direct negotiations and contracts with each other. That problem -- it is going to be more costly than just doing it all at once, but that might be solvable.

Q. Then the hold-up and escalation problems, you agree that those are sort of resolved by the IFR caps, are they not? I appreciate you say it is mitigated, but we are not going to get an outcome that is going to damage the viability of the scheme, are you?

A. Right, the IFR -- the way I say it in my report, I think, is that the IFR limits the ability to exploit these problems to the IFR level, not to what otherwise might emerge below that.

Q. Okay. If we go to paragraph 57 {RC-H1/1/27}, you say there:

"There are no competitive constraints to the level of interchange fees under the BIF and the UIFM."

Then at the end:

"However, as stated ... the IFR caps do not (and were never purported to establish) competitive levels of interchange fees ..."

What you mean do you mean by "competitive level of interchange fee"?

A. My belief is that a fully competitive market -- had the market evolved in a fully competitive way, there never would have been interchange fees. If merchants could always have multiple networks to process transactions, multiple schemes available with every transaction, the whole practice of interchange fees would not have

evolved.
Q. So basically, what you are saying is you think the level should be zero in a world in which there is sort of basically full product differentiation pricing, which is simply --
A. Yes.
Q. -- which is just not going to exist, is it? So in the real world, the UK world that we are in, the reality is, as we see from Amex, PayPal, Klarna, if that was negotiated, there is going to be a willingness on merchants to pay significantly above zero, is there not?
A. I am sorry, a willingness by the issuers?
Q. There is going to be a willingness by merchants --
A. Oh, merchants.
Q. -- to pay significantly above zero in a world where they are demonstrably willing to pay it because we see what they are willing to pay for other payment methods.
A. Well, of course, as I have explained already a couple of times today, merchants are willing to pay a lot. I am willing to pay a lot to Microsoft for an operating system. That does not mean that there is no market power being exercised.
Q. This is not a market power case. There is no Article 102 case here.
A. Well, competitive level of interchange fees, as I use

the term, would be if the market involving Visa, Mastercard and other schemes or potential schemes that might have entered or survived that did not enter or survive because interchange fees had the effect -- in the scheme rules had the effects they did, in that environment, there would be a well-functioning marketplace with at par payment networks.

Q. Just to be clear, what you suggest, which is a scheme rule requiring settlement at par, that is not establishing an interchange fee set by competition, is it? It is simply imposing a result, is it not?

A. No.

Q. It is. It is a scheme rule that says, "You must settle at par". That is not process of competition, that is an imposed outcome?

A. Well, I would not put it that way. I would allow voluntary bilateral agreements, but I explain --

Q. But the MIF allows voluntary bilateral agreements.

A. I am sorry?

Q. The MIF allows for voluntary bilateral agreements. It always has.

A. Correct. I would have the default settlement be -- Mastercard should not be in the business of saying, "If you want to get services from Mastercard and participate in our scheme, you have got to pay all these other members of our -- all these other issuers in our scheme. As their cards come to you, you have got to send money to them or through us to them, not just pay us." I would not allow that kind of rule and I think a settlement at par, as I have hopefully described clearly, is not the same thing as imposing a MIF.

Q. It is imposing a financial outcome, is it not? It is not a result that comes from competition. It is an imposed outcome.

A. So the way I described this in my report and I think it is the best way I can think of or I have thought of so far to describe this, it is whether there is a revenue sharing agreement among the member banks or there is not a revenue sharing agreement among the member banks and those are fundamentally different things. One is a costs lie where they fall and negotiate, each bank posts fees or negotiates fees with its cardholders, its merchants or both and not subject to a scheme imposed rule saying that you must pay the other members of the scheme.

Q. Let us go back to the newspaper example, advertisers and readers, the two groups of customers there. In the competitive market, you get different models, do you not? You get some newspapers which are free to readers. You get some newspapers that charge both and in

principle, you could have a scenario where it was free for advertisers but the reader would pay and you might get that for a directory or even potentially the car magazine you were talking about. I mean whether it happens in practice I am less interested in. As a matter of principle those are potential options in a competitive market, are they not?
A. They are and the mere fact that they are two-sided marketplaces with two-sided effects and two-sided pricing issues does not automatically mean, in my view, that there has been anti-competitive conduct to achieve that.
A single a publisher that is, you know, scrapping along and tries to publish a new newspaper that might be perfectly fine as a matter of competition. It may have market power as a result in that small niche of a market that it is has carved out, that might not be a competitive problem just because it has market power if it gets market power. I view having market power over payments which affect virtually --
Q. Just keep on my example rather than going off.
A. Okay.
Q. I note what you want to say about payments.
A. Fair enough.
Q. So on my example, there are -- the competitive outcome

has a variety of ways in which people could price for their two groups of customers and let us imagine a scenario now where all the newspapers get together and collectively agree that they are all going to become free newspapers, so they are all going to not charge readers. I mean, that is just a cartel, is it not?

A. Probably.

Q. Because the competitive outcome is differentiated, but it is placed with a single collectively determined outcome instead.

A. I mean, I guess I would be more concerned if they all agreed to set a positive price on either readers or advertisers and agree on that price than say we are all going to agree not to charge a fee, but you would want to look into it carefully.

Q. But the result of that is going to be that if they agree to charge nothing onto one group of customers they are going to have to recover 100% of their costs from the other side. So that is going to push up the cost to advertisers, is it not?

A. It depends on the nature of competition and costs in that industry if there are positive variable costs. So I mean a newspaper has physical printing costs and the like. Those are costs. Whether they end up getting absorbed by the publisher or passed on to the advertisers is a pass on question that would depend on the facts and circumstances.

Q. But the reality of what you are suggesting is no different here. You are simply saying there should be a requirement that all issuers recover 100% of their costs from cardholders and nothing from the other side. It is exactly the same, is it not?

A. No, the acquirers would cover 100% of their costs from merchants.

Q. Well, you are basically trying to have a scheme rule which cuts off the possibility of issuers doing what anyone normally does in a two-sided market, which is take account of the possibility of getting some of its revenue from the other side of the market.

A. Well, you could do that as long as it is voluntary. If you could provide value, identifiable value to an issuer like some merchants do, they have co-brand arrangements, they deliver -- they help in the issuing functions by bringing a pool of customers that may borrow or that may run up interchange fee of profits to the issuer, they get cut in on the profits. If you could bring profits or save costs to an issuer a bilateral deal might still happen.

Q. The reality is if you tell a merchant he can have something for free, you know, everything else being equal, he is not going to want to pay more money for it and that is why any default is always likely to be the result for most people.

A. Well, okay, so this is important. I have heard many times that merchants want to get valuable services for free, but that is going back to this cost allocation methodology idea. Interchange fee is not reasonably described as an allocation of any identifiable specific cost. I do not think for many years it has even been defended that way. Instead it is this overall balancing argument of moving money from one side to the other to benefit the scheme and its output. So I do not think the idea -- there is nothing that the merchant is getting for free. It is paying its acquirer in a competitive marketplace.

Q. But in a competitive marketplace, we saw with Amex it would take account of recovering from both sides.

A. I am sorry?

Q. That is what you are cutting off; the possibility of taking account of recovery from both sides and you are trying to cut off intrinsically what could be recovered from one side.

A. Amex will have to deal with competition on both sides of the market in a counterfactual in which there is settlement at par, which I understand has already been accepted for pre-IFR. So what does that mean? It means going up to the IFR, if there was settlement at par. That is our thought experiment.

What would happen to Amex in that framework? I know that the argument on the other side is: nothing would have been different than in the actual world. Amex would still have just as high fees, it would be just -- it would have more merchants, more issuers, more cardholders. It would take over the world. But in reality, Amex would face more competition on the acquiring side. We have seen that in Australia.

As I described a few minutes ago, Amex would have had lower fees. To get into the every day spend categories, Amex cut its fees around the world. It was in the T&E segment, I think that is a reasonable characterisation, success and travel and entertainment. But to get into supermarkets, it had to cut fees. To get into other categories it had to cut its fees.

Q. It is in those places in the United Kingdom, is it not?

A. I am sorry?

Q. It is in those merchants in the United Kingdom.

A. It is. Well, in some of them.

Q. If we could go on to paragraph 118, it is page 53 of your first report {RC-H1/1/53}. You say there because MIFs -- and we are talking here for the section dealing with inter-regional MIFs. You say:

"Because MIFs were intended to prevent MSCs falling to low, competitive levels near zero, and MIFs are not necessary for the operation of an inter-regional [over the page] card payment scheme, I conclude that the purpose of inter-regional MIFs - the object - is to restrict competition."

Can I just be clear here that when you say -- you make two points. The first is the purpose of presenting MSCs falling to near zero and then the lack of -- the second one is objective necessity, and I will come back to that.

So looking just at the first one, the purpose that you say or the intention. Am I right in thinking you were looking at the subjective intention of the schemes or not?

A. Well, MIFs were used -- banks joined networks that offered them MIFs instead of networks that did not -- schemes that did not offer them MIFs and some schemes imposed MIFs over time that started out without MIFs because it attracted banks. It gave them more fee revenue.

So my conclusion, having looked at the whole history of the industry, is that the purpose of MIFs was to maintain -- to prevent fees from eroding. As competition emerged in the acquiring side of the industry, merchant fees started to fall and originally each bank had a local -- most banks had a local monopoly. They were territorial. They were free from a lot of territorial competition, so they could charge a lot to their merchant clients, they could charge a lot to cardholders and only infrequently were there inter-regional or even within a country interchanged transactions.

As banks filled in the gaps and more acquirers entered, especially specialised acquirers, they drove down the merchant fees and the issuers did not like that. They were getting competition that they used to enjoy and so MIFs were adapted, changed, imposed to keep fees higher. I do not see how you could read it any other way than the purpose of MIFs being -- I mean, it is defended on the basis that it is efficient to get all this revenue from the merchant.

Q. What you are doing -- this is, again, your analysis based on sort of the history of the 19th century cheque system. That is the basis on which you are saying this, not looking particularly at inter-regional MIFs and the motivations that underlie it.

A. Look, the history of 19th century cheque systems in currency markets in gold coins are what I looked into to understand the roots of these economic phenomena and it helped me understand that, and I spent seven years, without anyone paying me, in my spare time doing that research, so I am very close to it. But that has nothing to do with what I am talking about here.

When these network -- when the schemes formed for credit and debit cards, they very deliberately -- they could have gone par and they very deliberately chose to use MIFs and some of them have more recently adopted MIFs and when they did not have to do that and that is why I view it as the purpose of MIFs because they did not need them.

Q. Going back to paragraph 114, you say your historical analysis was not important. It is page 52 {RC-H1/1/52}. You have set out your historical analysis just there. So this is very much the basis on which you come to your views is the history, not looking at the issues actually present in this market. That is right, is it not?

A. No, that is deeply unfair. The history has been important in shaping my understanding of what I observed in today's modern marketplaces, including the UK.

Q. The reality is an interchange fee is just a fee for a service, which is exactly the same kind of fee Amex charges, PayPal charges, all these alternatives charge.

A. For what service?

Q. In terms of where it is going to the merchant, the merchant ends up paying a charge which reflects the value it gets from that particular payment method, which is how merchants evaluate their charges.
A. But what service is the interchange fee covering that is in addition to the acquirer fee?
Q. We have been through that. It is getting the guarantee against card, against fraud, against cardholder default. It is getting immediate settlement even if the cardholder is only going to pay two months later. That is of value, which is the reason why merchants are, in principle, willing to pay for it, are they not?
A. Well, it is why merchants are willing to pay for it, but it does not explain why there is an interchange fee or at the level that we see it. I do not think there has been a serious defence of interchange fees as being an accounting-based exercise tallying up these specific costs, but what I have seen in the last few years when interest rates were -- fell to extremely low levels, the MIF did not fall. As fraud went down, the MIF did not fall in most countries.
    These elements that are attributed as justifications for why we need a MIF, the MIF in some countries did not change for 10 years in a row, even though each of these factors changed.

Q. It is a fee -- basically, merchants get a service of value, which in principle they are willing to pay for, which is what they do with all the other payment services they pay for.
A. A merchant presumably gets -- expects at least to get more than they pay for for every service they buy.
MR COOK: Sir, if that is a convenient moment. I mean, I am now going quite rapidly through inter-regional and commercial cards. I hope I will be done by about 3 o'clock. Well, 3 o'clock if we start at 2 o'clock.
THE PRESIDENT: Yes. We were thinking, again, if we can prevail on both you, Dr Frankel, and on the transcriber, should we start at 1.40. We will do that and see how we go.
(1.02 pm)
(The short adjournment)
(1.40 pm)
THE PRESIDENT: Mr Cook.
Good afternoon, Dr Frankel.
MR COOK: Professor Frankel, it is right, is it not, that in neither of your reports do you conduct a detailed analysis of how the schemes would fare without MIFs in terms of loss of market share or the effect on the market-wide average MSC?
A. I definitely do not speculate about -- you know, the

amount of any changes to those things. The market-wide MSC -- well, I do not predict the quantities of those things.
Q. Okay, fine, just a clarification. So the detail of that kind of analysis Mr Dryden has done, but you have not; is that fair?
A. Well, let me say this about Dr Niels' switching analysis and cost analysis --
Q. I just simply want to know whether you have or have not done it. You have not, have you?
A. I just want to say I have not, but it was not possible to do a thorough analysis of that in the time that was available. It would have taken me weeks more to adequately do that.
Q. Okay. In various places -- so I am talking about inter-regional cards still. In various places in your report, you suggest that issuers can charge fees to their cardholders instead to make up for lost interchange fee revenue, but, again, you just have not looked at the detail of how far that is possible in markets, have you?
A. Well, when I talk about the inter-regional MIF point, I address that issue in some detail.
Q. You have not looked at how far it is practical to increase those charges to recover lost revenue in any

particular markets, have you?
A. When you say "market", are you talking about geographic?
Q. Geographic markets.
A. It is a general point. I think it spans across geographic markets, but what I have -- what I think I tried to convey in that discussion is that there is so much additional profit available on inter-regional transactions that some issuers for some of their cardholders forego that as a kind of reward. They do not charge any foreign transaction fees, international transaction fees. But, you know, through a combination of reductions in the scheme fees, increases in issuer fees to their own cardholders, there is plenty of money to make up that loss, especially if the loss is limited to the UK, but even UK and Europe.
Q. You say there is plenty of profit. You have not actually looked at profit. You are talking about revenues streams, are you not?
A. Well, the incremental profit -- the revenue streams, yes, I have definitely looked at the revenue streams, but there is nothing to suggest that the loss of -- now, you know, I come here. I have been using cards. If it is card present, it is 30 basis points per credit card because I am here. The issuer -- I have been trying to use a card. I keep forgetting and failing, but I have

been trying to use a card that has no foreign transaction fee. When I use the other card, there is a 300 basis point foreign transaction fee on top of the 30 basis point MIF. The card I am trying to use has zero transaction fee.

The issuer is losing money on each of those transactions now. Well, why does it do that? I am confident of that because they are paying 1% to the scheme and they are giving me 1% value of reward, so that is 2% out and they are only getting a 30 basis point MIF. Well, why would they do that? Because they are earning MIF revenue on all the transactions on that card domestically as well as when I am travelling.

Q. But you are trying to tease into a tiny little segment, which is the one segment where commitments led to very substantial reductions in inter-regional MIFs. The reality is card not present represents the vast bulk of inter-regional transactions, do they not?

A. Well, the vast bulk -- during Covid, it was certainly the vast bulk. Post, it is still a pretty high share.

Q. Yes. The reductions in inter-regionals for those card not present transactions was relatively small, was it not, under the commitments?

A. Much smaller than on the card present, yes.

Q. So looking at the tiny or small proportion of

transactions where there has been a substantial cut is misleading. No one is going to tease out just -- you know, not have card not present but allow card present, or that way round.
A. No.
Q. So it is the general bulk of inter-regional transactions which is relevant to whether that is a profitable line of business or not.
A. This is another area where the weighted average is what makes sense. What is the weighted average revenue they get on all my transactions versus the fees and costs that they charge to me and other cardholders?
Typically, in my experience, issuers look at portfolios of cards. They sometimes look at individual cards. If it has been dormant for five years, they may tell you, "Hey, if you do not use the card, we are not going to renew. We are not going to reissue it." But it is usually a portfolio of cards in a card programme that they aim to see if it is profitable.
Q. You say at paragraph 202 that in order to make up for loss of inter-regional MIFs, the schemes could reduce their international transaction fees, and you refer to that as being 1%. You are not suggesting that is pure profit, are you? The schemes obviously incur costs in relation to inter-regional transactions?

A. Well, they incurred those costs before they imposed the 1% fee, but the costs are trivial compared -- the costs specifically related to international transactions that they do not incur on all transactions are trivial compared to the 1% they are getting from the issuer and the much higher fees they are getting from the acquirer on international transactions.
Q. Average inter-regional MIFs are well above 1% even now, are they not? So simply even if the scheme sacrificed 100% of that transaction fee, that is not going to make up for the loss of inter-regional MIFs, would it?
A. No, I said it would be a combination of things, but certainly the suggestion that the schemes will have an incentive or an issuer will have an incentive to not permit its cards to be used internationally at all makes no economic sense.
Q. But it is going to have an incentive if it is not profitable to do so.
A. Well, obviously if they were losing $1 billion or something in the United States on a card programme, they would stop, but that is not what we are talking about. We are talking about on the relatively few international transactions as it is, among those, the few of those that happen in the UK, if they lose the MIF income on that -- like I said, I have got a card that charges me

no international transaction fee. Well, they could start charging me 50 basis points. Mastercard could reduce its fees by 50 basis points. There is a combination of things available that make a lot more sense than shutting down all international transactions and losing the customer.

Q. Ultimately, whether you can do these things, it is about the alternatives. We have talked about if you can buy it from Amex for zero, you are not going to buy it from Mastercard for $1, are you?

A. Well, Amex has -- I looked. I think they are offering zero international transaction fee cards now. I do not know if the exchange rate is the same as Mastercard's, but Amex is promoting zero international transaction fee cards already.

Well, you know, they used to charge 2% on many of their cards, so these are promotional. These are ways -- like rewards, these are promotional things to give a cardholder something they might value, in this case international transactions, which are a small percentage of the total cardholder transactions, in exchange for all the other revenue they are getting from merchants all the time.

Q. If Amex was able to keep doing that and Mastercard and Visa issuers would not, anyone who wanted to do a substantial number of inter-regional transactions would obviously be best switching, would they not?

A. But I have been trying to use my Capital One card. Capital One does not have the whole market of international transactions. So there are different dimensions in which issuers try to make cards attractive or not attractive; you know, more attractive for particular groups of their customers. If it is really important to Mastercard to continue to incentivise issuers to issue cards that do not charge a lot to foreign -- for foreign travellers or purchasers, they could do a number of things to accomplish that.

Q. Amex has, certainly in the United Kingdom, very high acceptance rates in the key sectors for inter-regional transactions such as travel and hospitality. You are aware of that, are you not?

A. Yes.

Q. In terms of its acceptance, you put in -- it is at page 93 of your first report {RC-H1/1/93}. You put a figure in which shows Amex's acceptance across the EU as a whole, but we are interested in the UK and Ireland and Amex has much better acceptance in the UK, does it not?

A. I do not recall.

Q. Let us look at Mr Holt's reply report, which is

{RC-H4/3/114}. We see there the RBR data taken from the RBR in the UK. He said that an estimated 82% of merchants accepted Amex as of 2018.

A. I am sorry, which paragraph?

Q. Paragraph 352.

A. Okay. I have no reason to dispute that.

Q. We can then go to {RC-J5/41.04/292}, this is the more recent RBR report. It is the RBR 2021 report and we can see it shows us Visa and Mastercard. This is the column on the left-hand side or the chart on the left-hand side, bottom left. Visa and Mastercard had 1.648 million merchant outlets whereas American Express had 1.384 million outlets.

A. Have you done the division?

Q. I have done the division, which is 84%.

A. Okay. I trust your math.

Q. Thank you very much. That is very kind.

But if we then go back to Mr Holt's report at {RC-H4/3/114}. So at that point, there was a difference of about 260,000 outlets. We see at paragraph 352 Mr Holt refers to an Amex release which indicates they had added 311,000 new UK merchants.

Obviously, some of that could be churn, but it shows that Amex is very much narrowing the ground in relation to Mastercard, does it not?

A. It would not surprise me if that is correct. It is a little ambiguous whether there is a churn, whether that is net new. I assume it is net new or an increase of 311 which would make that accurate, but I am just not certain on the details of that statistic.

Q. The RBR report also explained that Amex acceptance was concentrated on large multinational chains, urban areas and traditional T&E outlets. So the reality is from the perspective of the international, regional -- (inaudible) international and regional transactions, its acceptance is basically on a par, is it not? It is going to be very much an acceptable alternative.

A. Well, just looking at these numbers, they look close. You know, I know in the United States they are essentially at par now. It is a very slight gap, but so is Discover, and I think both American Express and Discover have found that the perception of their coverage is still affected by the existence of merchants that do not accept their cards disproportionately to the actual transaction volume of those merchants. But over time, I would expect that perception to catch up with the reality.

Q. When we talk about this, the fact that somebody like Amex might have a relatively small market share in a competitive market where Amex and Mastercard -- sorry,

where Mastercard and Visa are able to compete effectively, I mean, that does not tell us very much about what would happen if Mastercard and Visa were not able to compete effectively, does it?
A. Well, in a counterfactual world without MIFs, Amex would have a lower fee as well.
Q. We will come to why you say that. So in relation to that, you say there will sort of more pressure on Amex, but ultimately, if Amex -- well, Amex would become more attractive to cardholders, would it not, in those circumstances, if it can maintain higher -- or lower fees, higher benefits?
A. What Amex has said -- for two or three quarters in a row when the IFR went into effect, they told analysts that their fees would fall to re-establish the spread, the premium they have over Visa and Mastercard as the interchange fees fell.
Q. Well, the difference about the IFR was the IFR was one that capped Amex's GNS model as well, did it not?
A. This is nothing to do with the GNS model.
Q. Well, it is. The GNS model is the most obvious way for Amex to capture substantial parts of market share and it lost its competitive edge over Mastercard and Visa in that business model, did it not?
A. Its merchant fees -- the level of its merchant fees were

not affected directly by the IFR. The amount it could pay to independent issuers was affected, but Amex controls its merchant side, and that came down in both Europe and in Australia where there is much more data available.

Q. I mean, ultimately, in a two-sided market, if Amex had been able to capture a lot more cardholders, its negotiating position would have been stronger to maintain its fees, would it not?

A. It did not anticipate that that would happen even before it ended its GNS programme. In Australia, its fees fell before it had a GNS programme operating there, and it continued. They continued to fall throughout having the GNS issuers and after they left.

Q. We will come back to Australia in a moment.

You refer to, in paragraph 225 of your first report, the commitments decision. You presumably accept there is -- in terms of switching, a total loss of MIF income is a lot more significant than a reduction in that income.

A. In the UK, credit card interchange fees have fallen. Originally, they were, I think, 1.2. They were at 0.9 for a long time and now they are at 0.3. That is a pretty big percentage reduction and I do not see Amex taking over the UK.

Q. That is because Amex's most obvious model to grab issuers, the GNS model, simply was no longer in a position to out-compete Mastercard and Visa, because it was subject to the same caps, wasn't it?
A. The GNS model is a pretty recent invention by Amex. It traditionally did not use that model and, you know, I think the same argument used to be made before there was a GNS model, so I do not think it is GNS-specific.
Q. In terms of the commitments decision I was asking you about, actually, the reduction in overall interchange fee, weighted average interchange fee, revenue for inter-regional transactions was quite small, was it not?
A. You asked me this before. I do not know the number off the top of my head.
Q. In which case, if you do not know, I can move on.
In terms of Australia, which you have referred to, if we could go to {RC-H1/1/98}. You refer to -- talking there about in relation to the Australian position. To be clear, Australia was again just simply a reduction in MIFs. It was not an elimination.
A. It was a reduction by about half.
Q. That was not specific to inter-regional transactions.
A. I think it excluded inter-regional transactions. Commercial were included in the weighted average.
Q. That was a weighted average, so what that meant was that

schemes were free to choose to impose lower interchange fees on some transactions types, but allowed them to still have much higher interchange fees on other transaction types where they were more likely to be competing with Amex. That is right, is it not?
A. That was modified in 2018. There is still flexibility, but each fee type is capped at 0.8%, which -- again, there were predictions that this would end all commercial card issuing by Visa and Mastercard issuers and they are all still issuing commercial cards.
Q. If we could bring up the Reserve Bank of Australia report. That is {RC-J5/22.1.2/23}. We can see in Graph 8 what happened, which is if we go for the red, you see -- look at Mastercard. Pre-reform, there are probably two categories of credit card interchange fees and post-reform, that went as high as 25.
So the Schemes basically -- Visa did something similar, not -- sort of 15 -- 23 by the end. So there went from being a very small number of interchange fee categories to a much wider, much larger number, did it not? There was a lot more differentiation.
A. That is true. The original two categories were for electronic transactions versus non-electronic transactions and the weighted average was about 0.95.
Q. If we then look on Graph 9, we can see that pre-reform,

basically there was a 0.8 and a 1.2 spread for Mastercard.
A. Right.
Q. But by the end of the period, this is looking at -- the spread has gone as high as some cards. It was a 2% interchange fee, was it not?
A. Correct, although they are all capped now at 0.8.
Q. I appreciate this is pre and I will come on to that period.
So looking at this period, Mastercard ended up actually having a far more compelling card proposition for premium cards or commercial cards for the ones it chose to adopt higher interchange fees than was the case before the reform, did it not?
A. It could -- to me, the weighted average -- there were some other computational issues, but to meet the weighted average obligation, it was able to direct more of the MIF revenue into a smaller bucket of cards and get higher net rate for those cards, yes.
Q. As you said, in response to this, in 2016, a cap of 0.8% was imposed for any individual category. There was still a weighted average, but 0.8. But at the same time, Amex's GNS model was subject to the same cap, was it not?
A. Yes, as I sit here, I do not remember whether the dates

were the same. That I would have to check.
Q. Around the same time.
So I suggest to you what you actually have is a regulation that is very carefully designed to actually allow Mastercard and Visa to still compete effectively with Amex, was it not? Maybe it was not designed, but a regulation that certainly allowed Mastercard and Visa to --
A. Many meetings and conversations with people in Australia and I never heard it put that way, so you surprise me a little bit, but I put it this way. American Express opposed the caps on interchange fees before it had a GNS programme. I think that tells you a lot.
Q. As you said, the caps on interchange fees was only one part of the regulation. There was also surcharging that was permitted in relation to all the card schemes, was there not?
A. Yes.
Q. I think you have answered in relation to Mr Kennelly that, actually, surcharging in Australia was something where -- I think you have said previously that that was -- one reason why Amex and Diners were not able to take over the market was the change of the surcharging rules.
A. Well, I never thought they were going take over the

market, but the combination of the lower scheme MIFs and the ability to surcharge Amex without having to surcharge other brands together had a very compelling effect. Some merchants were able to negotiate very dramatic reductions in their Amex fees.

Q. If we could go to RC-J5/10.1/64, which is a paper that you wrote. Page 64. That is page 6. (Pause)

In which case, I will quote it back to you and see if you recognise it. You wrote a paper that said one reason why Amex and Diners could not take over the market is that the RBA eliminated the no surcharge rules. Do you remember writing that?

A. Sure. I have said that more than once.

Q. Australia was a market in which there were a small number of very large merchants who were willing to surcharge; is that right?

A. It is a little bit subtle because Amex -- well, Visa and Mastercard created low interchange fee tiers for the biggest merchants and for some other surcharge-prone merchants like petrol, like I described before. But certainly there were important merchants like Woolworths. Woolworths had made multiple submissions describing how they invested a lot to get ready to push the button and start surcharging, and that brought Amex to the table and they got a big reduction in fees.

Q. In the UK, there has never been a prohibition on surcharging inter-regional cards. Are you aware of that, during the period we are talking about?
A. I am sorry, I missed --
Q. There has never been a prohibition on surcharging for inter-regional transactions. Are you aware of that?
A. For inter-regional? I looked into the current state of the law and regulation in the UK about surcharging. I am not sure what I knew about inter-regional. I understand, I think, about the commercial card exception and the rules on consumer cards, but I just -- I would have to refresh myself about inter-regional.
Q. Are you aware that when the RBA, Reserve Bank of Australia, considered in 2021 whether or not to reduce interchange fees further, one factor it took into account was that reducing interchange fees might result in switching to more expensive payment methods such as three-party schemes and buy now pay later products?
A. They have taken -- they have considered those and other reasons and there is a lot of domestic political issues in Australia about this as well.
Q. If we go to {RC-J5/42.1/1} --
A. Can I just add to my last answer? On more than one occasion, the RBA has published their belief that MIFs should probably be zero.

Q. Let us see what they have actually done. Page 41 of that, please {RC-J5/42.1/41}. The paragraph at the top of the main paragraph that starts properly:

"The Board noted that there could be risks associated with further reductions in the weighted-average benchmarks. Lower interchange on debit transactions could make it harder for new debit issuers to enter the market and disproportionately disadvantage small issuers, which may have fewer other sources of revenue to offset any interchange fee reduction ... a risk [it] could incentivise issuers to promote greater issuance and use of (higher-cost) credit cards."

Then:

"In relation to the credit card benchmark, a further reduction could provide an advantage to both the three-party card schemes and things like [buy now pay later] arrangements ... [they] are not subject ..."

So those were the reasons why the RBA thought there was actually a risk to further reductions, let alone going down to zero.

A. They have not always been consistent on this message. They have said multiple times zero. They have told me they think it should be zero, but that they also believed in compromising on a variety of issues. To get regulatory relief on other issues, they have compromised on MIFs.

Q. That is precisely the kind of dynamic that Dr Niels and Mr Holt are exploring, is it not, in relation to a zero MIFs counterfactual?

A. This I understand.

Q. I suggest to you that looking at what we see in Australia, it really provides very little indication of what would happen in a world in which Mastercard and Visa were at zero and other competitors were free to price in the way that competition drove them to.

A. The spread -- Amex's premium or Visa and Mastercard's is far lower today than it was before the MIFs fell in Australia. So I do not have that kind of data from Amex available in Europe, but what they have said publicly is they have reduced their MSCs to maintain the spread.

Q. You placed a lot of weight on other schemes, which you say operate with settlement at par, and that was your new report we received from you on Friday.

If we could have that up, it is {RC-H1/3/2}. This is the table that you put forward now. Just to be sure we understand it, I mean, essentially what you have gone through is you list various card schemes and then you have ticks based on what you said about them at various times, so what you said in your first report, what you said in your reply report. You refer to a Visa document from 2006 and then updated is your current view; is that right?

So essentially we should sort of ignore, to some extent, what you said previously. Your current evidence you are giving the Tribunal is in the right-hand column; is that right?

A. Mostly. Let me just try to be as clear as I can. There were other published lists at various times. The Commission twice, maybe more than twice, published lists of par debit, other -- previously par debit schemes that the Federal Reserve bank -- one of the Federal Reserve banks in the United States did so. The lists were not always consistent and so I dug as best I could into the facts and sometimes it is a judgment call as to whether it is fair to characterise it one way or the other, but what I put in the updated column is my best available information as of now.

Q. Thank you. To be clear, I only have to look at the ones that are in the right-hand column?

A. The right-hand column is my best available information.

Q. Fine.

A. Now, just to be clear, because you are not showing the text, so it is not misleading to the Tribunal, some of these are check marks that had par settlement for a number of years; sometimes not that many years, but sometimes for 25 years or more. So if it had a sustained period of par, I included it in the list.

Q. I mean, one of the documents you rely upon, if we can bring that up, is {RC-R/29/13}, which is the Visa 2006 document that you flag.

A. I did not rely on this document. I showed it as a comparator to show that even Visa had a list of par debit that -- you know, they got some of them wrong, I think.

Q. If we could bring it up, it is {RC-R/29/13}. If we go to the final bullet at the bottom of the page, it says:

"Some domestic debit systems may have arrangements that operate by way of an alternative to interchange fees ..."

So they share the profits of the operating company, and you are familiar with that. Essentially, some schemes operate a structure whereby there is some kind of centralised company, whether that is an acquirer or an operating company, and it essentially makes profits and distributes them to the issuing banks.

A. Yes, I gave evidence in a case in Chile on that very point.

Q. If we could bring up. {RC-R/9/12}, which is an ECB report, and if we go down to footnote 5. We are just dealing with Dankort, which is one of the examples

I think you give as being an example of a scheme working without a MIF, settlement at par. Do you see what is said there?
A. I am sorry, what is the date --
Q. Footnote 5.
A. What is the date of this document?
Q. That is a good question. 2011. So if we go back to that page. So it explains that while Dankort operates without a MIF in the traditional sense, it has a sole acquirer. All merchants pay a fixed fee and then the sole acquirer pays issuers a fee per Dankort transaction. Basically, it says it is quite similar to a MIF, does it not?
A. No. Maybe at this time period it was, but for many years, Dankort -- I do not remember how many years, but Dankort had no merchant fee at all, like New Zealand, and there was no MIF. This is a more recent change.
Q. But it shows you that essentially when you look at something as being settlement at par, that is quite simplistic if there are actually other flows that provide essentially a transfer of value, do they not?
A. I agree with that, especially -- so often there are acquirer joint ventures where all the issuers own the acquirer. Now, you have to be careful. That could cause competitive problems, I think. But in some cases,

those processors or acquirers operate on a non-profit basis. They just are on a cost recovery basis. Other times, they are used as profit centres and dividend back to their owners profits, and I think that runs a fall of exactly the point you are making.

Q. So we could bring up your original table, which is {RC-H1/1/32}. The reason I am pulling this up, I know you have moved a bit from it, but actually, what it does do is helpfully tell us which of these schemes are debit or credit in a way I do not think your more recent table does perhaps at all, actually.

Just to be clear, the only schemes that you say still operate with settlement at par are debit card schemes, are they not?

A. I believe that is true.

Q. If we go down the page here to paragraph 70 of your first report, you say:

"As indicated in Table 3.1, some early credit card schemes had no MIFs ..."

In fact, the only one you identify is the Midwest Bank Card scheme, so just the one.

A. Yes, David Evans and Dick Schmalensee in their book refer to a number of US -- early US credit card four-party schemes that had no MIF, but they do not name them all. It is something I meant to chase down and

I never figured it out.

Q. Okay. If we see -- if we go over the page, we can see that the Midwest Bank Card scheme was basically sold in 1969. So essentially, the only example you found of a credit card scheme operating with settlement at par was a small regional scheme which ended over 50 years ago.

A. Well, it had 600 member banks, I believe, so --

Q. But geographically, the US banking market has always been extraordinarily diverse in that regard. It was basically operating in the Midwest, so part of the US, a regional card scheme which ended over 50 years ago.

A. It had some large banks as members. It is a long time ago, but there was nothing inherent about it being a credit card scheme. What -- also, the case that I cite makes it pretty clear that what they were looking -- the reason they liked this merger in part was because Mastercard or Mastercard's predecessor had a MIF.

Q. If we could go back to your new table, {RC-H1/3/2}. So look at -- go quickly through the schemes that you do still say.

So the third one Canada, Interac. I understand from what you say over the page with the footnotes that you acknowledge that Interac does now have positive

interchange fees, does it not, in some categories?
A. Yes, so on contacted card present -- traditional debit card transactions for 25 years or so, Interac had no MIF on any of its transactions. Going to contactless and some card not present transactions, it now does, on those transactions, have a MIF.
Q. That is as high as 0.6%. Are you familiar with that number?
A. I believe that is for, like, Apple Pay where the banks are paying Apple a fee, so they have got to cover that fee.
Q. If we look at the next one, it was Denmark. That was Dankort. So I think we have seen already that was something that had an equivalent for a long period of time, did it not?
A. I am sorry?
Q. It had an equivalent to an interchange fee because there was profit payment going back from the monopoly acquirer to issuing banks.
A. I remember, yes. I think when I was here in -- when I was at the Commission in 2002, Dankort had no MIF or MIF-like payments at all. It had no merchant fees.
Q. But since then, it has had -- basically, it is an equivalent to an interchange fee; you would agree?
A. I believe it does now, at least somewhat.

Q. The next one is Finland, Pankkikortti scheme. I mean, that is a scheme that has failed, has it not?
A. Well, a lot of these schemes have been shut down. Banks preferred to join Visa or Mastercard and have a MIF than to upgrade their no MIF scheme, their national debit schemes. I agree with that.
Q. So if we can go to {RC-R/9/1} and that is the ECB paper from 2011. If we go to page 23 of that {RC-R/9/23}, this is the section dealing with alternative approaches. If we go to page -- there are various alternatives. If you go to page 24 {RC-R/9/24} and then it talks about, on the left-hand page, the paragraph that starts:

"What is known as a system of balanced participation of issuing and acquiring banks is a third alternative and means a situation in which the business share of each of the banks participating in the scheme is equal on the issuing side and on the acquiring side ... This was the case in Finland, within Pankkikortti."

So that was just a situation in which essentially everyone had broadly the same market share on both sides.
A. This is an economic fallacy that they are not the first to make this mistake. This is a mistake that goes back to Baxter's paper in 1982.

The mere fact that banks -- suppose banks are both acquirers and issuers and on average, they have as much outgoing and incoming interchange transactions. People used to say, well, they do not care what the MIF is because the amount they are paying is the amount they are receiving, so they do not care what the MIF is. But there is a key difference.

When you are paying a MIF, it forms a floor, as we have discussed, to the MSC. So you are collecting that MIF from your merchant customer, and there was no equivalent rebating of the MIF revenue they were getting to cardholders for many, many years. There were no rewards and the like.

Q. If we go on with that, you see:

"At the time of the launch of the scheme, fees were not deemed necessary, given a good balance of issuing and acquiring activities ..."

So the ECB is saying that was the reason, not your explanation:

"This cooperative model is no longer in place."

Pankkikortti introduced interchange fees, did it not?

A. So a couple of points. I want to try to be clear about why I think this is useful and what they got right and what they got wrong.

First of all, even if that was the reasoning of the member banks, they had not thought, "Well, we could, you know, gin up revenue for all of us if we tax each other's customers". It does not matter to me why they decided they did not need a MIF. They did not have a MIF and it still worked fine for a long time.

Some of these schemes operated for decades without MIFs successfully and now are gone. There was an effort in Europe to create more European-wide compatibility. It did not generate a European network, at least yet.

So I totally agree that they can use other methods to replicate the economic effects of interchange fees. That is why I went through it as carefully as I could to identify which of these could fairly be characterised as having no MIF-like method.

Q. Go back to {RC-H1/3/2}, which is your list. So Germany you said POZ scheme, you thought it was, but I think you now do not pursue that. Iceland you do not pursue. Luxembourg you do not pursue. The next one is the Netherlands, the PIN scheme in the Netherlands.

Again, if we can go back to {RC-R/9/23} and it is under the heading "Alternative Approaches", the second paragraph:

"The first alternative arrangement is the model of a single acquirer, where the card scheme provides for a single processor as acquirer."

You see the next paragraph:

"In the Netherlands, the PIN scheme followed a single-acquirer policy until 2004 ... Classic interchange fees were then introduced as a result."

So that is a situation where the PIN scheme did not operate originally with interchange fees, but that is because there was a profit centre which could distribute to the banks and then it introduced interchange fees.

A. This description is incomplete. There was a six or eight-year period where the jointly owned acquirer that was owned by the issuers did not earn or pay out any profits to its owner/issuer banks. Then when the competition authority ruled that their existing system was not acceptable, I think it was a three or maybe four-year period where they had no MIF, but in response to -- well, what they ended up saying in competition proceedings is, "We are going to have bilateral MIFs and we are going to make that retroactive to when the old system ended".

So there was a period of time -- and I used my judgment. There were six years where they were not earning any profits at the acquiring stage and then there was few years where there was no known MIF that was going to apply to current transactions, even if there was a lump sum paid later. They had no way to know how that was going to affect things later, let alone factor that into the current MSC. So I thought it fairly should be put in this column.

Q. That scheme ceased to operate in 2012, did it not?

A. I am sorry?

Q. The PIN scheme ceased to operate in 2012.

A. I think that was one of the casualties of SEPA.

Q. Then, I think, back your list, the next one is the EFTPOS in New Zealand, which we have talked about before. That is a domestic debit only scheme, is it not? It cannot be used for online payments and cannot be used for contactless.

A. That is correct. The banks have not made those investments, but they certainly could have.

Q. They could have with revenue, but there is not any revenue.

A. Well, had they needed to make those investments without a MIF, they certainly could have made those investments even without a MIF.

Q. The next entry, which is Bank-Axept in Norway, again, it is debit only domestic scheme. They are co-badged with Mastercard and Visa for international acceptance. Are you aware of that?

A. Yes.

Q. They need to use Mastercard and Visa for online

purchases and mobile payments. Are you aware of that?
A. That is true, similar to other countries.
Q. So, again, this is not a full-functioning payment scheme from a consumer's perspective, is it?
A. Again, there were no online purchases when these schemes were introduced. There was no Internet when many of these schemes were introduced. There was certainly no Internet commerce and there was no contactless. There were no mobile phones.
So I take the existence of these schemes for a long period of time as useful information. The fact that they chose to get an interchange fee and shut down the domestic scheme and just join Visa and Mastercard does not surprise me. That kind of consolidation may have been sensible even aside from MIF issues, but certainly to get a MIF as well is a bonus.
Q. Portugal I think you do not pursue any more.
Switzerland, you have raised that for the first time in this report. That is a situation, is it not, where no MIFs are charged on certain types of debit card transactions in Switzerland because the regulator prohibits it, but the regulator allows competing debit card schemes to charge MIFs, does it not?
A. Well, a couple of things. There was testimony in this case that Switzerland -- there were Mastercard

transactions that settled at par in Switzerland. So I looked up the Mastercard MIF list online and sure enough, there were -- a lot of the transaction types for Maestro had no MIF. If they could define and succeed and survive without a MIF on those transactions even when competitors get a MIF, I do not see how that contradicts my use of this information.

Q. It shows that the regulators allowed new entrants to charge MIFs and that is not going to be a maintainable situation where you have competitors with different pricing regimes for longer term, is it?

A. Well, I mean, I do not know. If Mastercard exits Switzerland, I would be quite surprised.

Q. If we can go down to -- the next one was Visa Electron, which I think you do not pursue any more, the Midwest Bank Card and then the various regional US schemes.

I think the origin of your material in relation to this, you see that from footnote 14 of your table over the page {RC-H1/3/3}. It is the reference there to an exhibit from a Visa case.

A. Yes.

Q. That is at {RC-R/38/1} and if we can go to page 2 of that document {RC-R/38/2}. Do you know what this document is or who prepared it?

A. Here is what I know about this document in the context.

I was actually studying the industry when these events were happening. In the US in the 1980s and early 1990s, these various -- as you mentioned, we had a fragmented banking system, so we had fragmented debit schemes, regional debit schemes, local merged inter-regional. Most, but not all of them -- there is a page here that has a pie chart. Maybe, if you are willing to do that for me, you could flip ahead.

Q. Page 20, I think, or 21 it might be. No, 18, I think, is probably the one --

A. I appreciate that.

Q. 18 is the heading. If we go over the page {RC-R/38/19}.

A. Yes, this is it. So this was the situation. The PIN debit networks, the PIN authorised debit networks, grew out of ATM networks. Now, ATM networks sent money to the terminal owner because when a bank's customer got cash from another bank's terminal, it seemed logical that that owner needed to be compensated. Now, I have written about how there are other ways to compensate those banks, but they had interchange fees going to the acquirer who operated the ATM.

What they did was connect that debit network to a petrol pump or a supermarket POS terminal and sold other goods and they called it a debit card transaction; the same card. Because they had fees flowing to the ATM

terminals, many of the networks continued having fees flowing to the acquirers of now debit card transactions.
Q. You say "many". That shows one.
A. No, the issuer -- I am sorry, there were four -- when they first started adding debit functionality, many of them had an existing interchange going toward the acquirer or the merchant. Merchants even were receiving fees. What happened is most of them went to a par model. They just stopped doing interchange fees at all, which is my main point from this.
Then Visa acquired, meaning bought, the largest US PIN network called Interlink and they imposed an interchange fee flowing to the issuers and then started pushing the industry towards the positive interchange model.
Q. So this document is 1991, 33 years ago --
A. Yes.
Q. -- and most -- I mean, are any of these schemes left on a settlement at par basis?
A. Yes, if you -- well, on my list, or if you go to the next couple of pages, there has been a lot of consolidation. These are now -- we now have probably have a half dozen national or almost national networks instead of 20 or 30 regional networks. Some of these brand names are still alive; NYCE. Honor, I think, is

still active. But there has been a lot of consolidation.

Q. I suggest when you look at the evidence overall, you have identified a small number of largely either regional or small country schemes settled at par and almost all of those have failed or have introduced interchange fees for at least some transactions ever since.

A. Well, that is putting a bright light on it. I should not joke when it is being transcribed, I know. I do not think that is a fair way to summarise this evidence. Canada had 25 years with no MIFs, I think.

Q. Once it moves to -- unless you have a binary choice here, things either end up being a sort of legacy scheme that does not have functionality like contactless or it introduces that functionality at a cost. So as soon as you move to the sort of modern world, Internet transactions, contactless, those tend to result in either the schemes do not have the money to make those adjustments so they limp on, or they introduce interchange fees, do they not?

A. Well, you say the schemes do not have the money. Do you literally mean the scheme or do you mean the issuers?

Q. The investment is not there to make those kind of investment decisions without revenue that is going to fund them.

A. Sure there are. If England tomorrow declares there is no debit card MIFs in the country, but all banks are required to continue to accept debit cards -- I am not suggesting that is a wise policy -- or issue debit cards, they would make that transition because, I am sorry, even without being required to issue them, they are not going to go back to cheques.

To operate as a successful bank in the modern world, you need to issue debit cards to your customers, to your depositors, so they can access their funds. They are not going to go back to cheques or cash or pulling out/withdrawing cash. So it is in the bank's own interest to facilitate payments, including by issuing debit cards, even if there is no MIF revenue.

Q. I will move on to commercial cards briefly. Now, you say at paragraph 259 of your first report -- that is at {RC-H1/1/110} -- Visa and Mastercard's -- at 259, you say transactions -- we are talking here about migration to Amex.

Now, in those circumstances, we are talking about Visa and Mastercard no longer having positive interchange fees. Cardholders would have a much stronger preference for the Amex offering, would they not, because there is no longer a competitive offering

from Mastercard or Visa?
A. I am sorry, if there is no MIFs on commercial cards --
Q. Cardholders are going to have a much stronger preference for Amex, are they not?
A. It depends how Amex is treated by merchants.
Q. The reality is that merchants are going to be even less likely to refuse Amex if it is acquiring a substantial increase in cardholders or business.
A. This is the identical argument that Visa and Mastercard made in 2001 and 2002 in Australia; that nothing is going to pressure Amex to reduce its MSCs and, in fact, it is going to take over the market. There would be a death spiral collapse of Visa and Mastercard. It is the same argument.
Q. We saw in Australia that Mastercard was able to have interchange fees of up to 200 basis points. That was a very competitive offering compared to Amex. We are talking about a situation where Mastercard and Visa issuers would receive nothing in interchange fees. That is not a competitive offering, is it?
A. Well --
Q. Business would undoubtedly be lost.
A. The UK interchange rate is, what, three quarters lower than it was 15 years ago? I do not see Amex taking over here. So I just disagree. I do not think that -- now,

we could talk about what is the right -- I mentioned this during the concurrent evidence.

Planning the implementation of a move from where we are today to a no MIF world might be complicated or more complicated than had it just emerged -- had that world emerged over time without a MIF; without MIFs being used by Visa and Mastercard. So I would agree that thought should be given as to that transition and how to make sure there is not, you know, a collapse -- an instant move over to Amex or something, now that it is better situated to do that maybe than it would have been 20 years ago.

Q. Okay. Thank you very much.

You say in your second report at paragraph 176, and that is {RC-H1/2/76}:

"It is important that the counterfactual ..."

This is the section dealing with commercial cards. You say:

"It is important that the counterfactual be constructed as a thought experiment beginning without the competitive restriction, so that one may analyse to the extent possible how the market would have evolved without the restriction and then compare that counterfactual evolution to the actual market history."

Am I right in thinking here you are assuming that

essentially there never would have been commercial MIFs?
A. Yes, first of all, I want to make clear that this is how I approach it as an economist. I have no view as to the way the law looks at it or should look at it.
When I think about a counterfactual, I often go back in time to before the conduct occurred, even if it is a long time ago, and ask the question: what would be different today? Sometimes it is hard to do that and sometimes it is easier to do that, but that is what I try to do.
Q. Okay. Did you take the same approach for inter-regional MIFs?
A. That is how I approach this issue generally with regard to MIFs; if Visa and Mastercard spread around the world without MIFs. That is how I approach the question.
Q. Okay. To be clear, I am going to be saying that is not legally correct, but that is not a question I need to put to you.
A. Correct.
MR COOK: Sir, I think I have no further questions.
THE PRESIDENT: Mr Kennelly.
Further cross-examination by MR KENNELLY
MR KENNELLY: Dr Frankel, just on the -- I will begin, if I may, with the points that have been put to you about the zero MIF settlement at par schemes and just take up

a couple of points.

Have you had a chance to read Mr Holt's most recent report replying to yours?

A. Quickly, yes. I did during a break.

Q. In relation to that, could I ask you to consider again the Pankkikortti, if I am pronouncing that properly, Finnish example, and look at Mr Holt's statement or his report, sorry, paragraph 10(c), {RC-H4/7/4}. He makes the point that:

"The Finnish Pankkikortti scheme was introduced in 1979 ... From the mid-2000s it experienced a decline in usage ... Rather than implement EMV technology as required by SEPA, the member banks chose to close the scheme and instead switch to SEPA-compliant international schemes (MasterCard and Visa)."

Do you see that?

A. Yes.

Q. A casualty of SEPA, I think you described it in your own words to Mr Cook.

A. I think what the Commission was hoping was that there would be a consolidated new European network that was SEPA-compliant, but Visa and Mastercard were there to join and that is what a lot of the banks did in these countries.

Q. Because SEPA required enhanced technology, did it not?

A. Well, it was not just enhanced technology. It is that the various national schemes had different data protocols and processing systems and they could not talk to each other even under the current technology because there were different current technologies. So it would have required aligning their systems in other ways, plus they had the bonus of getting the interchange fee revenue.

Q. But in order to update the technology to become SEPA-compliant, investment was required. That was a costly exercise, was it not?

A. Well, I am not sure. You know, an issuer had to reissue its cards, so it had to issue debit cards that had chip and PIN functionality, but it was going to have to do that whether they were Mastercard or Mastercard co-badged with the national system.

Q. Could I show you {RC-J5/162/1}. This is an article from Finance Finland dated 2016 just about the fate of Pankkikortti. If you go to page 2 just above the heading, so you see the heading {RC-J5/162/2}:

"Change in the card market ..."

Just above that:

"After 33 years, pankkikortti is now a part of payments history. It was migrated to SEPA compliant MasterCard and Visa debit cards, and the only thing remaining in common with pankkikortti and an international debit card is that both card types are connected to the cardholder's current account."

Can you see that?

A. Yes. Can you scroll up to the top of that page, though?

Q. Certainly.

A. So it was launched in 1980. Technology was very different. It became a success story, was in the wallet of nearly every other Finn. It sounds like it was a great success for 33 years and then it switched to -- the bank switched to become fully Mastercard members.

Q. Because they needed to become SEPA-compliant, they needed to invest in order to become SEPA-compliant. It was costly for the banks to do that.

A. Yes.

Q. For that reason, they switched (inaudible - coughing) Pankkikortti, the issuing banks.

A. I am just not sure. I am not sure -- I would have to research it -- whether those costs were any greater to become SEPA-compliant for their cards just to stay with Mastercard and Visa.

Q. Could we go then to PIN, another -- this you did describe as a casualty of SEPA. Your words, Dr Frankel. This is the Dutch example.

Just to take you to the reasons again,

{RC-J5/176.1/9}. Yes, and if you skip down to the very bottom of that page, it is about six lines from the bottom. Sorry, I need the bottom of the page, please. Yes. It is six lines from the bottom:

"Because of the competition with the international debit card schemes in the SEPA context, Dutch banks decided ... to replace ... PIN by the European debit card schemes Maestro or V-Pay ..."

Do you see that?

A. Yes, but, again, it says above that the aim of SEPA is to enable consumers and businesses to use a single set of payment instruments in the European Union. So they were trying to make a European-wide -- as I recall, a European-wide scheme preferably that was not Visa and Mastercard. I think at least that was the goal of some people. The simplest thing for the national groups of banks was just to say, "Let us vote to close our domestic scheme and just be -- just use Visa and Mastercard". That is my recollection.

Q. Yes, because, and again, I am repeating myself, SEPA -- Mr Holt's evidence -- you have seen it -- is that SEPA made certain technological developments like chip and PIN and intra-Eurozone cross-border payment compulsory.

A. Right, and if I am -- so I believe he says that the -- not all the cards -- some of the cards operated under the old Maestro standard and could not be adapted and so investments would have had to be made. I agree with that. I just do not think that means that you could take that as evidence that you need a MIF.

Q. No, indeed, but where investments are required, the issuers' incentives take into account the existence of the interchange revenue stream.

A. I totally agree that if a banker has a choice between making the decision to have his bank join a scheme that gives him a MIF versus staying in one that does not, the MIF creates an added incentive to --

Q. That was not my point.

A. -- join the scheme.

Q. That was not my point, Dr Frankel. You heard me loud and clear.

Where investments in innovation are required, financial investments are required to innovate, it is highly relevant to the issuer's incentives whether or not he is receiving an interchange flow because -- sorry, answer that question first, please.

A. Okay. I want to make sure we are communicating and I am also thinking in real-time here, but it seems to me that whether there was a MIF or not a MIF, if European regulation, SEPA, says you must move to a chip and PIN standard and the banks in the country have a system that cannot readily adapt to that requirement, or it would be very expensive, then whether or not there is MIF in Mastercard or in the domestic scheme, they may well have an incentive to migrate to a different scheme that is already SEPA-compliant. So I think those can be separated, those issues.

On the other side, if you can migrate or if you are going to incur cost to become SEPA-compliant or you are already SEPA-compliant with Mastercard and Mastercard says, "On all your debit transactions, you can have MIF revenue, not just your international ones or your online ones", I could see why a bank would want to opt for the interchange fees.

Q. Because, as a matter of theory, if by innovating there is going to be greater card usage, let us say contactless, for example, and the issuer is losing money on each transaction -- are you with me so far?

A. Well, I disagree with at least two premises so far.

Q. If the issuer is losing money per transaction, just from the card usage in the narrow sense, do you accept that if that is the case, the issuer has a weaker incentive to invest in that innovation to increase card usage if he is losing money on each and every usage of the card or if he is losing money through card usage?

A. Not meaningfully. First of all, it is not clear that

you get more transactions with contactless.
Q. That is not my question. Dr Frankel, I am asking to you assume an increase in usage.
A. Well, okay, fine. Whether usage goes up or not, the -- I am sorry, I have lost the thread now. If you are not getting a MIF or whether or not you are getting a MIF, the main reason that banks offer debit cards overwhelmingly is part of their current account business. That is how they generate funds to run their bank to lend and to invest. That is why banks have always --
Q. Dr Frankel, I am sorry. I am asking a really simple question. Assume that the card usage is generating a loss for the issuer. I am not saying it is right. Just assume that.
A. Okay.
Q. If that is happening --
A. Close the bank.
Q. No, just through the usage of the credit cards, if the bank is losing money through that, on that business line --
A. Credit cards?
Q. Credit cards.
A. Okay.
Q. If the bank is losing money on credit card usage --

A. Well, what do you mean by "credit card usage"?
Q. I mean for -- again, just to assume, I mean exactly what Mr Steel said when he said that the issuers were losing money now on credit card transactions in the UK under the IFR cap. I am not asking you to agree with that.
A. I do not even know what it means is the problem.
Q. Indeed. It does not matter. Just assume that there is a loss being incurred. Whether there is or not is not for you. Just assume there is a loss being incurred. If there is a loss --
A. Well, I can't answer your question that asks me to somehow agree that I understand that it has a meaning to say you are losing money on a transaction. Credit cards are sometimes used as a transactional thing. They are often used as a lending device and fee generator and other fees. It is part of a -- it is a business unit of the bank. It is not a transaction.
THE PRESIDENT: Let us try and approach it slightly differently. Let us suppose in the same jurisdiction we have got two schemes. One has got an interchange fee structure where money is migrating across from the acquirers to issuers and constitutes a revenue flow to issuers. The other chooses not to. We are not talking about legality or anything like that. We have just got a structure. There are other revenue streams as well,

which we have been discussing. They exist in relation to both, but this is difference between the two.

A. Right.

THE PRESIDENT: We have got essentially identical customer bases throughout and the reactions of cardholders and merchants is the same to increased costs, whatever those might be. But we have got these two systems and they are different in this one regard.

We then get a cost, and let us assume it is a big cost, regulatory compliance, that hits both schemes exactly in the same way. So they are both going to have to fork up a significant amount of money in order to be regulatory compliant. I do not care what the cost is. It does not matter. It is something that they have to do.

A. Okay.

THE PRESIDENT: Now, we do not need to worry about loss-making or profit-making. There is this cost that has got to be borne.

Now, in that scenario, would you say that the scheme that is operating the interchange fee has got a more robust model to deal with the increased costs, the unavoidable costs, that both are facing than the one who voluntarily eschews the interchange fee or, to put it another way round, do you think that in those circumstances, the non-interchange fee operating scheme might be inclined to go for an interchange fee, assuming it is lawful?

A. So you have made it harder for me because you are positing side by side schemes competing -- offering an interchange fee, which I think at the margin will stimulate a choice to go to that scheme no matter what, all else equal, whether you have a new cost or not.

If you think of it as two states of the world, one in which you have got a scheme in the UK that has MIF. In another state of the world, you have got one scheme in the UK that does not have a MIF and the bankers are told there is a regulatory requirement you have got to spend a lot of money to get compliant with. The decision is going to be driven by: what is the profitability of remaining a credit card issuer in the UK?

You know, each bank will make that decision, and some banks might have such a low profitability. If they are a small bank and the costs are a big fixed cost, they will just say, "We are out". Whether the MIF by itself adds enough revenue to make the key difference in that decision, it is possible for some banks at the margin that they will be affected.

THE PRESIDENT: Well, I mean, it is a perfectly fair point you are making, Professor. What you are saying is that I have not given you any information about the relative attractiveness of these two schemes given that one set of acquirers are paying one set of issuers the interchange fee, whereas in the other scheme, they are not. That may very well have effects in terms of how the schemes attract both issuers and acquirers into them. Fair point.

A. Yes.

THE PRESIDENT: But the point I am putting to you is that whereas the scheme that chooses not to have an interchange fee will be obliged to recover its costs through other charges, there is an extra option open to the scheme operator to say, "Look, the issuers are being faced with this additional cost. The way we will deal with it is by increasing our already extant interchange fee."

The point I think that is being put is that this might be a more efficient or more competitive way of dealing with a shock to the system like an unavoidable cost, which makes the interchange fee a good solution. I do not want to go into the language of pro or anti-competitive or anything like that. Let us talk about good and bad solutions.

The point I think that Mr Kennelly is making, and he will tell me if I have got it wrong because he will not shy away from that, is that there is an additional route by way of discharge of these additional costs which is advantageous.

A. I think it is a fair point. I would -- first of all, if there are scheme-level costs, it does not have anything to do with the interchange fee. Scheme fees could be raised either temporarily. Scheme fees in Canada keep going down because it is a non-profit-making scheme. Scheme fees could be bumped up to cover a one-time cost that the scheme has to absorb.

If each member bank, each issuer, say, has a one-time large cost that it must cover -- well, let me make two points about that.

I think the most defensible explanation for MIFs and rationalisation for why a MIF could be useful -- we will get to this in Trial 3, I guess -- would be to create incentives if there are externalities, if there is something that the merchant could do or the issuer can do that affects each other's costs at the margin, and there is various policies you could do to adjust that.

If there is one-time technology cost that you need -- that each issuer needs to adopt, I think they will have an incentive to do that as long as the profits of being a credit card issuer remain strong enough to cover that cost, whether or not they are getting a MIF. Obviously if they get a MIF, it will be easier to cover that cost and at the margin, it may tip the balance and make a bank stay in the network instead of exiting, but that is the main effect that occurs to me.

THE PRESIDENT: That was a very helpful answer, if I may say so, but can I ask a follow-up and just crystallise the example a little bit more.

Let us suppose that this is a cost which unequivocally falls on the issuing banks. So let us suppose they are imposed -- required to communicate with each and every cardholder in a manner that is spectacularly expensive. So for every cardholder, they have to write a regulatory note which costs £5 a cardholder, so a very big cost.

Now, that cost obviously has got to be recovered somehow by the issuer. Now, if you look at the issuer without the interchange fee, they can do, I think, one of at least two things. One is they can say, "Well, I am terribly sorry, cardholder. You are going to have to pay for this. I am going to pass the costs down to you and you are going to have a charge, an annual charge, of £5 a card in addition to whatever else you are paying." It may be that the elasticity of demand is such that all the cardholders say, "Well, thanks very much. I am not doing it. I do not like this £5 charge." That is something which you have to factor in as to whether you can effectively recover that cost.

The other way of doing it is to say to the scheme, "You are going to have to cut your scheme fees by the aggregate amount of £5 times the number of cardholders. I am not paying any more because my costs have increased and I am not interested in incurring that additional cost."

Now, depending on whether the schemes are prepared to do that or whether the fees are enough to cover it, that may happen, but those essentially are the two options. I mean, there may be things like interest charges, that sort of thing, but let us keep it simple.

Now, if you cannot cover that cost, then you may think about exiting the scheme. The point -- it is a long introduction to the point -- is that in the other scheme where there is the interchange fee, the scheme can say, "Hello, the issuing banks are sustaining this additional cost. It is a necessary cost for the scheme to run as a whole. What we can do is, keeping all other things equal, we can cause money to flow from the acquiring market to the issuing market to hold them harmless against all or some of this additional unavoidable cost."

The question -- again, leaving out of account all the questions of competition law and things like that and I am sure market power is a relevant part of your answer because you have got to ask yourself: how are the acquirers compelled to pay? But what is wrong with that as a way of ensuring that the scheme as a whole operates?

A. With respect, I think there is an important omitted option, and that is to look at the broader context in which this card is issued. Debit and credit have different contexts, so let me deal with them one at a time. I will do it quickly because I have already said it.

THE PRESIDENT: No. Thank you.

A. Banks offer debit cards to attract deposits, which are the honey that keeps the bank operating; right? They have low cost deposits, retail deposits, which then they lend out or invest in a positive spread. So that is why -- that is the main reason that banks issue debit cards, whether or not they have a MIF. They might like MIFs on top of that.

So if you have a big cost to become compliant with a new technology requirement -- you know, banks are faced with this issue all the time. Whether it was to image cheques and then to adapt to faster payments or whatever it is, they make a decision whether to participate. If it is to attract deposits or to attract merchant accounts, current accounts and broader commercial banking businesses, debit cards are a part of that.

The credit cards, it is hard to just look at a transaction and a MIF as the revenue source. Credit cards are offered as a package of costs and revenue. The revenue includes interest payments for cardholders who incur balances and it includes international transaction fees that I have talked about, and other fees that are charged if you are late paying or so on.

So it is quite possible that it is a burden on many banks. You can imagine a cost that must be covered and it is a huge burden, in which case does it make sense to tax the acquirers or merchants and is there a less restrictive way to do that?

But I think my main answer would be to look at the package of costs and revenues and can it be covered from the existing bundle of revenue that comes to the bank?

PROFESSOR WATERSON: Just on this point of the package of costs and revenues, would you agree that many innovations have both costs and revenues? In other words, an innovation which improves security of the payment scheme has costs to implement, but also revenues

in the sense that there is a lower degree of fraud?
A. They may attract additional business by being a safer bank. Yes, another one that comes to mind is Internet banking when banks all headed -- set up Internet sites and then to create apps for smartphones.
I actually did business with a bank and had to stop. My company stopped doing business with the bank because it could not keep up with the technology that the big banks were offering, and I was sad because I knew the President of the bank. I said, "Your technology just is not keeping up". He merged into a bigger bank.
But those kinds of costs of setting up Internet sites, apps, bill pay, all these things, why do they need those? To attract deposits like my company's to do our banking with that bank instead of the bigger, you know, money centre banks.
PROFESSOR WATERSON: Yes, and possibly without having to go to a place.
A. Yes.
MR KENNELLY: Dr Frankel, just finally on your zero MIF or settlement at par schemes, could I ask you to go to Mr Holt's report again at page 5 this time {RC-H4/7/5}. I think you have it in hard copy. Paragraph 10(d). Now, he is referring to some of the US cards that you referred to. Do you see that?

A. Yes.
Q. He describes how card networks evolved in the United States and he says in the second line:
"MAC, Most, Avail, Honor, Alert, BankMate, Explore ..."
PROFESSOR WATERSON: This sounds like a quiz.
MR KENNELLY: It does. Banal names.
A. One of those wordless memory challenges.
Q. Anyway, the material factor is they were acquired by STAR and, therefore, did not exist autonomously. Money Station was acquired by Pulse. Do you see that?
A. Yes.
Q. You are aware, of course, that both STAR and Pulse charge a positive interchange fee.
A. I am, yes. Visa started that trend in the US and I do not want to go down that rabbit hole, but it managed to get all the banks moving in that direction.
Q. But the fact is that these schemes, these cards you refer that charge a zero MIF, they were all acquired and now are subsumed to STAR and Pulse that charge a positive MIF. Then, finally, do you accept, as Mr Holt says, that in your list, there is no example of a card scheme operating, currently operating, with full functionality without some form of positive interchange fee?

A. I am sorry, in the world?
Q. No, in your list of --
A. Oh, in my list.
Q. We can only work with the ones you have given us.
A. Yes.
Q. The shorter list that you narrowed down for Mr Cook.
A. By "full functionality", you mean has contactless and has Internet?
Q. Yes.
A. It has international acceptance.
Q. Yes.
A. No, because for credit cards, Visa and Mastercard represent most of the world, aside from China UnionPay and a few other small ones worldwide. But there are no examples. They have -- it is mostly Visa and Mastercard.
Q. Thank you, Dr Frankel.
I want to move on, if I may, to the cross-border acquiring rules and begin -- and I am afraid for this, because of the time, I am going to skip much of the introductory scene-setting. I am going to take as read that you, Dr Frankel, are familiar with the underlying rules, and you must be because you have addressed them in your reports. I will begin on cross-border acquiring with the 2010 debit commitments decision.

I suppose just by way of very brief introduction, you are still of the view, are you not, that both Visa's old CBA rule and its new CBA rule restrict competition by object and effect?
A. That is my view.
Q. So we will begin then with the 2010 European Commission commitments decision, {RC-J5/14.8/6}. This is from 2010, so the Commission is here considering Visa's old CBA rule; is that not right?
A. I think that -- yes.
Q. Recital (21), please, on page 6. This is referring to the Statement of Objections, which is like the charge sheet or list of allegations that the Commission issues to the addressee. The first part of recital (21) concerns the allegedly anti-competitive nature of the MIFs themselves. If you skip about halfway down recital (21), do you see the sentence beginning:

"The restrictive effect in the acquiring markets is further reinforced ..."

Do you see that?
A. Yes.
Q. "... by the effect of the MIFs on the network ... as well as by other network rules and practices, namely the Honour All Cards Rule ... (the 'NDR'), blending ..."

Then this:

"... and application of different MIFs to cross-border as opposed to domestic acquirers."

Do you see that?

A. I do.

Q. So the Commission's concern is that the restrictive effects of the MIF and the acquiring market are reinforced where cross-border and domestic acquirers are subject to different MIFs.

THE PRESIDENT: Mr Kennelly, I probably should have said when you moved to a different topic, but when you reach a convenient moment, we probably ought to have a transcriber break.

MR KENNELLY: Oh, I see the time. Of course. I am happy to stop now actually. I see that it is a long stretch.

THE PRESIDENT: That is helpful. Thank you. We will rise then for 10 minutes. Thank you.

(3.14 pm)

(A short break)

(3.26 pm)

MR KENNELLY: Thank you, Dr Frankel. We were in the 2010 European Commission commitments decision and we were on page 6. We had got to the end of recital (21) and within that, we see footnote 8. I would ask you to look at footnote 8 at the bottom of page 6, which first explains what cross-border acquiring is and then goes on to explain the Commission's competition concern with Visa's rules. Second sentence:

"Visa Europe's rules prescribe the application of the Intra-Regional MIF to cross-border acquired transactions even if they constitute domestic transactions, unless domestic MIFs have been registered with Visa Europe. In the Statement of Objections the voluntary registration of domestic MIFs ... was considered as increasing the anti-competitive effect of the Intra-Regional MIFs, since it puts cross-border acquirers at disadvantage vis-à-vis their domestic competitors in case the unregistered domestic MIFs are lower than the Intra-Regional MIFs."

The concern there was, was it not, Dr Frankel, that domestic acquirers could evade competition with cross-border acquirers by failing to register the domestic MIFs?

A. That is my recollection.

Q. The Commission was concerned to level the playing field by ensuring that the cross-border and domestic acquirers were subject to the same domestic MIFs for the same domestic transactions.

A. That seems to be the concern expressed here.

Q. At page 13, we see that expressed again. It is recital (49) at the top of page 13.

A. I am sorry, can I just go back a second? I had not remembered this language, but it seems to me their main concern is that banks did not have -- the member banks in each member state could opt not to post their domestic MIFs, in which case a higher MIF might have applied, making it impractical for them to compete for merchants in that country.

Q. Well --

A. I think that is the main concern.

Q. Well, if you go back, Dr Frankel, to page 6, footnote 8, the point was being made -- the same point you are making was made, but if you see in the middle of recital -- sorry, footnote 8:

"Visa Europe's rules prescribe the application of the Intra-Regional MIF to cross-border acquired transactions ..."

This is the bit that I am emphasising:

"... even if they constitute domestic transactions, unless domestic MIFs have been registered ..."

So the concern was that unless the domestic MIFs were registered, the foreign acquirer could be stuck with the higher -- potentially higher inter-regional MIF even though they were --

A. In a low MIF country.

Q. Well, they were doing domestic transactions.

A. Yes.

Q. They were competing for domestic transactions, but they were not getting access to the domestic MIF unless they had been registered and that registration was within the gift of the domestic acquirers.

A. Yes, I think I understand.

Q. So at page 13, recital (49), second sentence {RC-J5/14.8/13}:

"The Commission's concern that certain cross-border acquirers could be foreclosed from competition with local acquirers due to different MIF rates applicable to the two groups has ... been removed by the mandatory registration ..."

It was voluntary before:

"... and application of domestic MIFs agreed by local acquirers."

We see the actual commitment itself on page 8 {RC-J5/14.8/8}. If you go back to page 8, please, recital (26)(b), this is the commitment on the part of Visa to continue to require Visa Europe members to register all MIF rates and apply them to cross-border issued and cross-border acquired transactions.

To take up the point, Dr Frankel, that we were discussing a moment ago, the Commission's concern appeared to be that the same MIF ought to be applied to

the same -- the same domestic MIFs ought to be applied to the same domestic transactions in order to ensure a level playing field in the national market between the domestic acquirers and the cross-border acquirers.
A. Yes. Well, their concern, as I understand it, was that a cross-border acquirer might be faced with having to charge a higher MIF which would preclude it from entering or succeeding in that market. So it is a level playing field giving access to the local MIF so it could not be disadvantaged, and I think we will get to sort of the other side of the coin in a minute, I would guess.
Q. Well, indeed, but certainly the Commission did not say anything in this decision about cross-border acquirers needing to access additional rates which were not available to their domestic competitors.
A. Yes, I recall this episode. I recall First Data trying to enter Europe and not knowing what the rates were that it could even be required to charge.
Q. That concern that you just described now was addressed here because after 2010, a cross-border foreign acquirer did get to see the post-domestic MIF rate and then could take the benefit of that and compete for the domestic acquirers --
A. Yes, at a minimum, it could not be disadvantaged to compete with the local acquirers. I agree with that.

Q. It would be able to compete, according to the normal parameters of competition, alongside -- against domestic acquirers, both facing the same domestic MIF for the same domestic transactions.
A. Well --
Q. Putting to one side whether the MIF itself can be defended, but in terms of the competition that the cross-border acquirers were facing and the domestic acquirers, it was level to that extent.
A. So like I said in another context in the last day, it was a good first step; right? It made sure that the cross-border acquirers could at least access -- it would not be -- it would not be hamstrung by only having available a higher MIF.
Q. Now, this concern and the solution that the Commission produced, it would be surprising, would it not, if this rule which Visa was required to adopt was actually a restriction of competition by effect and object? It would have been an odd outcome, would it not, Dr Frankel?
A. Well, you know, I am here as an economist and confronting the reality that competition authorities sometimes change their minds and sometimes make mistakes, what economists later, you know, even agree are mistakes, there might not be any consensus about

this particular one, but I did not let -- you know, whether legally that immunises Visa I have no view on, obviously.

My view is that this role was still restrictive in a broader context and, you know, if this was a compromise, it was a compromise, but going further would have been even more pro-competitive.

Q. So then we see, Dr Frankel, the 2014 credit commitment decision where the Commission did indeed change its mind. Go, please, to {RC-J5/20/31} at paragraph 6.1. We see that now Visa is required to change its rules so as to allow cross-border acquirers to offer either the domestic immediate debit MIF or domestic credit MIF applicable in the location -- that is what they had anyway -- or the immediate debit MIF of 0.2% and a credit MIF of 0.3% for domestic consumer cross-border acquired transactions.

Do you see that?

A. I do.

Q. That new CBA rule gave a competitive advantage to foreign acquirers, a potential competitive advantage depending on the levels of the MIFs, simply because they were not based in the same country as the merchant.

A. Yes. I think that is sort of the point of creating that kind of competition.

Q. But it is competition by reference only to geographic location.
A. Yes, because the MIF rates were separated by geographic location and -- well, let me just stop there.
Q. If the UK domestic MIF was higher than the special cross-border rate, all the UK acquirers would wish to establish a branch in that other country to get the benefit of the lower cross-border MIF.
A. At least some of them would have an incentive to do so.
Q. Well, the ones that could, that could afford to, would definitely have incentive to do so, would they not?
A. Yes, if you can offer a merchant 10, 20 basis points or more or less, you will do it.
Q. So that creates an incentive to encourage domestic acquirers to incur the expense of locating outside the UK or establishing a branch there to take advantage of this lower regulated MIF.
A. Yes, I think it has been referred to in this litigation as an arbitrage opportunity.
Q. That is exactly what domestic acquirers did.

Can I show you Mr Holt's eighth report, {RC-H4/3/193}, paragraph 622. You see what Mr Holt says:

"... the primary way merchants took advantage of [this] was not by switching to genuine cross-border acquirers whose core operations were based outside of the UK ..."

There is various disclosure and witness evidence from the Claimants.

I would ask you to turn over the page to paragraph 625 {RC-H4/3/194}, where we see:

"The scale of the effect can be seen in the figure ... which plots acquirer market share of Visa transactions (by volume) for 2015 (the year the new ... rule was introduced) and the previous two years."

These are confidential figures. I am not going to read them out. The colours, Dr Frankel, if your eyesight is as bad as mine, are hard to discern, but you can see between 2014 and 2015 the two columns and the very marked shift in market share, looking first at Worldpay.

A. I have got nothing on my screen.

Q. I am so sorry.

THE PRESIDENT: We have a similar problem here. Ah, it is up.

MR KENNELLY: So you had the text at 625, but not the figure 7.3?

THE PRESIDENT: It is all up now. Yes, thank you.

MR KENNELLY: I am very grateful.

So what you can see here, Dr Frankel, especially in

the second and third column for 2014 and 2015, is the shift in market share between Worldpay UK in 2014 to Worldpay Netherlands in 2015. That is the dark blue and slightly lighter blue, NL being the lighter blue. Do you see that?
A. Yes.
Q. Barclays UK, dark red; Barclays Ireland, pink. Do you see that?
A. I do.
Q. So, really, the incumbents in substance stay the same. They simply set up a branch, relocated an operation. This did not facilitate the entry of any new market participants, did it?
A. Well, I am not sure I agree with saying this is not genuine competition. A genuine acquirer --
Q. No, it is just market participants, new market participants, for the moment.
A. I do not know if any new market participants entered at that time or not. Perhaps not. I do not know if there is some in others.
Q. Well, you can see here, Dr Frankel, who makes up the market.
A. Well, there is an "Others" category. I just do not know if it has remained constant.
Q. But that "Others" category is less than 10%, is it not?

A. Yes.
Q. There is no evidence of any substantive change in the quality of the service being provided between Worldpay UK, Worldpay NL or Barclays UK and Barclays Ireland, is there?
A. There is a lower price.
Q. Indeed, but there is no new creation of value or anything like that; no efficiency being created apart from the lower regulated MIF being potentially --
A. It is purely price competition, I agree.
Q. By reference to the regulated intra-EEA MIF.
A. Yes.
Q. These strategies, these relocation strategies, were costly and inefficient.
A. Well, the way I describe this in my report, I believe, is it is a form of bypass competition, or you could think of it that way, which often look inefficient. If there is an incumbent that has got -- that is protected from competition, has a high price, there may be an inefficient way to compete with it and maybe undermine some of that market power that looks inefficient, but it could be pro-competitive nevertheless.
Q. But the arbitrage that we see here is not arbitrage arising from greater efficiencies. It is arbitrage

arising from a regulatory imposition. This is an arbitrage deriving entirely from a regulatory difference.

A. No, it is not entirely from a regulatory difference. It is half from a regulatory agreement or order and half from the existence of a MIF; of MIFs that differ around Europe that were set originally by banks that get the MIFs.

Q. We will come back to what goes to the setting of the MIFs in a moment, but on any view, larger merchants were in a better position than smaller merchants to take advantage of these changes that arose as a result of the new CBA rule.

A. I saw that written. It does not surprise me. I do not know if over time it has become easier and easier for smaller merchants to access or not.

Q. Have you any evidence that it ever became easier for smaller merchants to access it?

A. I do not know. This was not a long period of time, but I just do not know.

Q. But do you not see, Dr Frankel, the problem that under the new CBA rule, a domestic acquirer with a quality advantage, a significant quality efficiency advantage, would find it harder to compete with a cross-border competitor, less efficient, who is winning simply by

virtue of the EU-imposed lower cross-border MIF?
A. Well, sure, if you have a low priced competitor that does not have as high quality product, some buyers will opt for a low price, low quality solution instead of the high price, high quality solution. That is part of the competitive process.
Q. Moving on to whether the CBA rules had distortive effects, whether the old CBA rule or the new CBA rule had restrictive effects on competition depends on what would have happened in the absence of the old CBA rule or the new CBA rule.
A. As a general matter, I think that is right.
Q. Could we go to your first report, please, {RC-H1/1/123}, paragraph 295. You point out -- yes, it is on page -- 295 is on 123, but we need to go over the page to the variations in the MIFs between member states of the European Union in 2012 {RC-H1/1/124}. Do you see that?
A. Yes.
Q. When the old Visa CBA rule applied, and we see the variation in average MIF rates. Do you see that?
A. I do.
Q. You are not suggesting that variation in MIF rates between member states is necessarily anti-competitive, do you?
A. Well, it is hard for me to answer that question because

I think all the MIFs are anti-competitive.
Q. No, I understand, but let us assume this is the variation. The question is: do you say that the variation between the MIFs is necessarily anti-competitive?
A. The variation is just a form of price discrimination, or it might not be that sophisticated. It could just be the groups that chose the interchange rates in different countries chose different rates even if it was totally random. Then the question is: do they then compete or act together throughout Europe to make sure that those who chose lower rates cannot export those lower rates to a high rate country?
Q. But prices -- forget about MIFs for a second, but prices can vary between countries for a number of reasons, can they not?
A. Well --
Q. Difference in market conditions, local taxes, supply, the cost of alternative payment methods.
A. As a very generic statement, prices can vary across countries for any number of reasons. I agree with that, but these are, in my view, prices that are reflecting the actual delivery of a service or a good to the merchant via its acquirer.
Q. You are not suggesting that the market conditions

relevant to the price of acquiring services are exactly the same in each of these jurisdictions, are you?
A. Well, no, and I recognise that the defendants' position is they set these MIFs to take into account the local differences in market conditions. I do not think you need any MIFs to take -- you know, let alone to take into account local market conditions. But even if you believe the MIFs are otherwise justified, the fact is that there were some banks that -- you know, national groups of banks that established low -- lower MIFs than others.
Q. So just to be clear, your view is that under both the old CBA rule and the new CBA rule, there was a restriction of competition because they protected merchants in high MIF countries from obtaining acquiring services from acquirers in low MIF countries.
A. Well, under the new CBA rule, they could acquire -- they could obtain acquiring services under the cross-border -- under the 0.3/0.2 cross-border rates, but they could not go to Malta, if I am looking at that right. They could not -- if there was a member state that had an even lower MIF, they could not obtain acquiring services at that rate.
Q. So your view is that if merchants in high MIF countries had been permitted to obtain acquiring services from

acquirers in low MIF countries, the MIFs would be lower. The MIFs available to the merchants in the high MIF country would be lower.
A. If the banks in each country -- even if they acted as a bloc in voting on or deciding what MIF rates to have in their country, if they then competed as a country bloc to offer acquiring services with that MIF, that could have generated competition on the level of the MIF.
Q. So staying with this idea of what would have happened absent the Visa cross-border acquiring rules in the counterfactual, let us go back to paragraph 296 of your report on page 123 {RC-H1/1/123}. You refer at 296 to the experience in Poland and skipping down that paragraph:
"The potential for expanded cross-border acquiring that would apply lower cross-border interchange rates (rather [than] domestic [ones]) led Polish legislators - reportedly concerned about the potential for lost acquiring business in Poland - to reduce domestic MIF rates in Poland."
Do you see that?
A. Yes, that was my understanding.
Q. But the question for these proceedings is: what would happen if the Visa rule was removed and whether there

would be -- and how competition would operate in the absence of the Visa rule?
A. So if in Ireland there is a 0.1% MIF on debit and an acquirer, an Irish acquirer, could access that rate, it could offer lower MSCs to UK merchants than if the local UK merchants could only access the UK national MIFs.
Q. Indeed, but the point I am making to you is this Polish example. This refers to regulatory intervention, legislation to reduce domestic MIF rates in order to encourage more cross-border acquiring. This is not relevant to the counterfactual, is it?
A. That might not be -- that may not have been, in hindsight, a very good illustration of this particular issue, which is -- it is an illustration of the more general point that cross-border -- increasing cross-border competition can put competitive pressure on the MIFs and cause countries -- banks in each country to lower their MIFs.
Q. Indeed. So the acquirers would have an incentive to relocate to low MIF countries to offer their acquiring services at lower MSCs to merchants in countries with higher MIFs.
A. That is one option. Another option is to pressure Visa and Mastercard and the local banks to reduce the MIFs in

that country.
Q. Indeed, but what did we actually see happening, Dr Frankel, when this -- it is an actual experiment. It happened here. What happened in reality?
A. There, because these -- at least several acquirers set up operations to access lower cross-border MIFs.
Q. One other possible outcome in the counterfactual is that the schemes could react to this what I call arbitraging behaviour and impose a single MIF.
A. Well, exactly. What one witness said -- I am afraid I can't recall who as I sit here, but one witness said what Mastercard would have done -- I think it was a Mastercard statement -- Mastercard would have caused the rates to go up uniformly or coordinated an increase throughout Europe in MIFs to at least the UK level.
Q. For that reason in part, have you seen that Mr Dryden concludes that there is insufficient evidence to find that the CBA rules restricted competition? Did you see that?
A. I am aware of that.
Q. Because he does not find the factual MIFs were higher than those that would have been set in the counterfactuals that we are discussing.
A. Well, there is -- first of all, my view is that an action by the scheme to increase MIFs throughout

Europe intensifies the anti-competitive conduct. Instead of allowing national level competition over the MIF rates, they are imposing a uniform Europe-wide MIF, which seems anti-competitive to me.
Q. But we are focusing here, Dr Frankel, on whether a cross-border acquiring rule is an independent restriction of competition on object and effect. So we are asking ourselves: in the counterfactual, would there be greater competition than in the actual --
A. I think --
Q. -- in the absence of the CBA rule?
A. I am doing my best to answer the question. I think the answer is yes, because there would have -- it would not have -- the lower MIF would not have been -- there would not be a floor at the cross-border Visa and Mastercard MIF levels. It could have gone even lower.
Q. What, lower than the cross-border acquiring, 0.2 and 0.3?
A. It could have.
Q. How could that have happened, Dr Frankel?
A. If the banks in a member state of the EU, say, lowered their domestic MIFs.
Q. What, voluntarily? The issuing banks?
A. Yes. Well, the issuers and acquirers.
Q. Well, in the counterfactual, you have not been able to

estimate what would have happened if the CBA rules had been removed, have you, in your reports at least?
A. I have seen the statement that the schemes would act to create uniform MIFs. I don't believe that is a competitive counterfactual and so I do not think -- again, it is up to the Tribunal to decide what is legally relevant. This is a legally intensive issue. I am quite aware of that. It makes it harder for me as an economist, but my view, as I understand it, that there was -- that there were different MIFs around Europe. Whether that was a benefit or not we could debate, but there were different MIFs around Europe and these rules were designed -- there was a no issuing without acquiring rule at one point. These rules were designed to insulate issuers in member states from lower rate competition -- lower MIFs that may have been set in other countries.
Q. One possibility in the counterfactual, Dr Frankel, is the scheme, and it is for the Tribunal to decide if this would be a lawful counterfactual, sets uniform MIFs in all the countries or some of them to avoid what we are calling arbitraging.
A. Right. If they did that at or above the UK rate, there would be no -- in that counterfactual, there would be no harm.

Q. Similarly, if all or the vast majority of acquirers moved to the same low MIF jurisdiction, ultimately, all the acquirers would be setting the same or very similar lower MIF; is that not right?
A. Lower MSCs, yes.
Q. Yes. So either by scheme rule or economic effect, the same MIF would be charged by all the acquirers.
A. But it could be at a lower rate.
Q. Of course. A lower rate, but the same MIF.
A. Uniformity per se, if it is at a lower rate, sounds like a good thing to me than non-uniformity at systematically higher rates.
Q. But we are talking about the intensity of competition between the acquirers and the acquiring market. If they are all charging the same MIF, the intensity of competition between them is the same as it would be when the MIFs were higher.
A. I am familiar with that argument in a slightly different context. I disagree that -- you know, that argument suggests that as long as you are all applying the MIF, the same MIF, that it is all fine, but if it was at a lower rate, it would make no difference or if it is at zero it would make no difference. I disagree. I think zero is the competitively consistent -- the rate consistent with a competitive market, so movement in

that direction I view as pro-competitive.

Q. You are aware that Mr Dryden does not agree with you in that respect.

A. I understand we disagree.

Q. Moving on then to whether the CBA rules restrict competition by object or artificially segment the EEA market, could I go to your first report again, section 6.2 {RC-H1/1/119}, yes, paragraph 284.

You say here that, historically, Visa and Mastercard and the banks made cross-border acquiring difficult or impossible. You refer to conduct in 1994 and 1999 and decisions in 2000 and in 2001. That is what you are citing at footnote 257. Do you see that?

A. Yes.

Q. You are aware that the claim period, the claims against Visa in these proceedings, begins in 2011. Are you aware of that, Dr Frankel?

A. Yes, although I keep forgetting what year it starts, but that sounds right.

Q. So what Visa was doing in 1994 or 1999, that is really significantly before the relevant claim period for our purposes.

A. Maybe, as in other things, I more than others think history is relevant to understand the context. There was a -- it was not until 2005 that the no acquiring without issuing rule was abandoned, and that is before the claim period, but that is a very clear way of seeing what the intent was by the schemes.

Q. But, Dr Frankel, in order to work out what the schemes' intent was in 2011, we need to look at what the schemes were doing in 2011; is that not fair?

A. I agree with that. It is here for context to show that Europe was carved into national level geographic markets and the process of integrating and getting competition across borders came in steps and I think, you know, would have been more intense in the counterfactual.

Q. You are aware, are you not, that since 2000, Visa member banks have been permitted to acquire merchants cross-border without having to establish a subsidiary or branch in another territory?

A. Acquire -- my recollection is the no acquiring without issuing rule was in effect until 2005, but they may have changed how they -- that is my best recollection.

Q. I am talking about cross-border acquiring. We are discussing now restrictions on member banks' cross-border acquiring.

A. Okay, right. So you could acquire cross-border. You just could not set up an operation in another country --

Q. So --

A. -- (overspeaking) 2005.

Q. But certainly since 2011 acquirers have been free, under Visa's rules, to provide acquiring services to any merchant cross-border.
A. That sounds right.
Q. There would be no special authorisation regimes or subsidiary requirements in place.
A. No, there were just these rules about MIFs and which got applied.
Q. So next, you refer in your report, paragraph 286, to a 2012 European Commission Green Paper -- I am on {RC-H1/1/120} -- which you say identified continued obstacles to cross-border acquiring. Do you see that?
A. Yes.
Q. Could we have the full paper, please, {RC-J5/15/1}.
First of all, this is a Green Paper. This is a consultation document, is it not, Dr Frankel?
A. Yes, I understand.
Q. Its purpose is to stimulate discussion, seek the views of consultees.
A. Yes, that is my understanding.
Q. It is not setting out the Commission's final view, its conclusions. It is not finding final findings of anti-competitive conduct.
A. Not that I am aware of.
Q. Can we go to the passage that you cite at page 8, please

{RC-J5/15/8}, 4.1.2. Over the page, please {RC-J5/15/9}. This is the bit that you rely on:

"However, a number of problems hinder the development of cross-border acquiring. Apart from the difference in technical standards ...a series of rules and arrangements applied by international card schemes can make cross-border acquiring less attractive for merchants ..."

So let us take a closer look at these by the bullets. First of all:

"International card schemes apply special authorisation regimes and special scheme fees/license fees ..."

You just accepted, Dr Frankel, that does not apply during the claim period.

A. Well, let me just be clear that I do not know this in enough detail to know whether there were any special authorisation needed to start offering cross-border acquiring. I know it was prohibited, but that is really the extent of my knowledge as to the issuer. I do not know whether there were -- it was permitted but there were roadblocks to actually doing it.

Q. Next bullet, Dr Frankel:

"Cross-border acquirers must pay issuing PSPs the domestic MIF applicable in the country of the point of sale. This prevents merchants from shopping for the cheapest acquirer, although the cross-border PSP has typically not signed up to the domestic MIF concerned ..."

Do you see that?

A. Yes.

Q. So this, on the one hand, appears to be referring to the old CBA rule concern about cross-border acquirers not having access to the domestic MIF, but it also suggests the problem that the Commission later settled on in the 2014 credit commitment decision.

Then we have the third bullet:

"Cross-border acquirers may also be at a disadvantage in countries where domestic PSPs have parallel networks of bilateral interchange fee agreements."

But we know that is not relevant for our claim period either in the UK and Ireland.

A. That sounds right.

Q. Then in the green box we see questions that the Commission had. So that suggests there is a basis for further investigation, does it not?

A. Yes, it would seem.

Q. Back to your report at page 121 and at paragraph 289 {RC-H1/1/121}, this is the substance of your analysis.

You say:

"... prior to the implementation of the IFR, MIF rates prevailing for domestic transactions in individual countries ... were sustained by the Scheme's member banks ... (which issued cards and ... acted ... as acquirers). Even if the MIFs were permitted (in the counterfactual), it might have been possible absent the [cross-border acquiring rule] ... for those national subsets of Scheme ... banks, to compete cross-border for merchant acquiring transactions by setting lower MIFs, and in any event acquirers in low-MIF countries could have won business from merchants in high-MIF countries."

Do you see that?

A. Yes.

Q. The consequence of that, you say, is at 290 {RC-H1/1/122}. You say:

"Under these challenged rules, Visa and Mastercard divided and allocated acquiring market territories along national lines to prevent cross-border competition to protect what were ... national bank cartels that agreed among themselves what MIF rates to charge acquirers ..."

Do you see that?

A. Yes.

Q. But you have already seen, Dr Frankel, that through the claim period at least, Visa's rules did not prevent acquirers from offering their acquiring services anywhere in Europe.

A. Well, it is about an agreement on price. It is like a territorial division with prices set in each territory. I understand the rules liberalised the process so that the cross-border rate could be applied, which, you know, partially solved the problem, but did not fully solve the problem.

Q. But you are describing strict national market allocation run by national bank cartels, are you not?

A. Well, when I say, "Under these challenged rules", I think what I am trying to do in this paragraph is describe the sweeping pattern throughout. I may be going before the claim period, but including the claim period, where there was a division along national lines that has been liberalised, but was still in existence, even partly in existence, through the second rule.

Q. But it is a curious kind of strict market division where cross-border acquirers had so many different routes open to them to acquire in other member states, which they used.

A. They -- I agree there is competition cross-border, including this kind of arbitrage competition, but there were restrictions on the rates that could be charged.

Q. Sure, but do you agree there was an extraordinary amount

of cross-border acquiring -- extraordinary growth in cross-border acquiring?
A. It grew from close to zero to a lot.
Q. But there were -- yes, to a lot in our claim period.
A. Yes, I think that is fair.
Q. In fact -- well, that shows you, that extraordinary growth in cross-border acquiring, that the CBA rule, the old CBA rule in particular, facilitated a level playing field and that was demonstrated by the influx of cross-border acquirers who did enter new markets and compete with domestic incumbents.
A. Well, I disagree with this concept of level playing field defined in this way.
Q. But you do realise, Dr Frankel, you are the only expert in these proceedings that takes the view that Visa's CBA rules artificially segmented the acquiring market along national lines.
A. That may be.
Q. I move on, if I may, to the co-badging rule.
Actually, sorry, just for the sake of completeness, on the Honour All Cards Rule and the no surcharging rule, I need to put two things to you.
First of all, on the Honour All Cards Rule, we covered that already, but what I did not put to you is the question of a by object infringement. I will put it

this way, Dr Frankel. If the legal test for by object infringement is that a restriction is by object if the effects are so obvious -- of the rule or conduct are so obviously harmful that any effects analysis would be redundant, if that is the test for by object infringement and if the evidence shows that the Honour All Cards Rule ultimately had very little effect, very little appreciable effect, in the UK and Ireland over the claim period -- are you with me so far? Those two big assumptions. Not accepting anything. I am just asking you to assume those things.

In that context, do you maintain your position that it is a by object infringement of the Honour All Cards Rule?

A. Conceptually, if I understand the question, conceptually, you could have an act that appears to be a by object violation, you know, a conspiracy to raise prices by two small farmers. Maybe that is a by object violation that may have no effect. I have no opinion as to whether the law would, you know, not conclude that is a by object infringement.

Q. But as an economist.

A. As an economist, you know, this is that interface of law and economics that I am trying to be sensitive to. My view is that the honour all issuers aspect of the Honour

All Cards Rule, especially with the non-discrimination rules laid on top of it, mean that there is -- it is very difficult to stimulate intra-system competition among the member banks.

Doing bilateral deals is not going to help if you cannot win more transactions as a result; the Honour All Cards Rule as being part of the reason, maybe a big part of the reason, why you cannot generate that kind of competition.

Q. But that is an effects question. I am asking you to assume it does not produce any effects.

A. I understand you asked me to assume that. If I am told that, you know, there is a bunch of sellers that have gotten together an association and they have all agreed that I have to charge -- no one of them can charge a lower price than any other or I cannot charge a higher price to my customers who use one of them versus another one and I just have to pay the same price to all of them, it is literally an anti-competitive rule. It is that there may not be competition on that dimension.

Q. I think that is also effects analysis, but I will move on. Ultimately, it is a question of law for the Tribunal.

A. Okay. If it is a legal question, you do not need me.

Q. Co-badging, Dr Frankel. You are aware that Visa has permitted the issuance of payment cards that also display the brand of domestic payment cards throughout the claim period.

A. Yes.

Q. Cards that are co-badged with Visa and domestic payment schemes are widespread throughout Europe.

A. Yes.

Q. So Visa's co-badging rule has had no restrictive effect on the emergence of domestic payment cards in other jurisdictions.

A. I have not investigated each jurisdiction. Some of them go back a long way, as we have already discussed today, so I do not know if any of them were hindered, but not that I know of as I sit here.

Q. But until June 2016, Visa's rule did prohibit co-badging with international payment card schemes deemed by Visa International to be competitors.

A. Correct.

Q. Since June 2016, pursuant to the IFR, Visa's co-badging rule has been altered to permit issuers in the UK and Ireland to co-badge cards with international payment schemes regardless of whether Visa regards them as competitors or not.

A. I believe it says "with Visa's permission".

Q. Well, do you accept that the IFR requires them to co-badge with international -- do you want to see the IFR?

A. No, it is not necessary. I agree that Visa has modified the language of its rule. All I just pointed out is that I believe it has the phrase "with Visa's permission".

Q. Are you suggesting that Visa is maintaining -- to be fair to you, take it from me. If I tell you the IFR imposes a prohibition on Visa even hindering co-badging with international schemes -- not just preventing, but even hindering international schemes -- regardless of whether Visa treats it as a competitor or not, do you accept if that is the scenario --

A. Yes.

Q. -- we are concerned with the period before June 2016 when the IFR came into force?

A. Well, this again is one of those issues where the going forward effects of changing this policy are, to me, quite different from the counterfactual versus factual effects of the policy, which I would be happy to go into, if you are interested.

Q. So do you not accept then that the relevant counterfactual for testing the legality of the co-badging rule is the world in our claim period absent the co-badging rule?

A. Yes, but as a logical matter, like some of the other issues we have discussed, I would probably go back further in time and say "had the rule never been there" or "not for a long, long time".
Q. I see. So we are going back to the point you made before, which is, in your view, to have a legitimate counterfactual, one must exclude not only the restriction during the claim period, but the effects of the allegedly restrictive rule, if necessary, from the very beginning of the rule itself.
A. Yes, as I understand it, a claim period is a legal limitation on recovery for -- on liability and on recovery of damages. But if the conduct -- if the rule is anti-competitive and is unlawful, it is found by this Tribunal to be unlawful, my counterfactual would say, well, let us assume that it was always, therefore, unlawful and should not have been there ever.
Q. Logically, you do not just exclude that allegedly unlawful rule. You must also exclude all of the effects, the market-wide effects, that were created by that allegedly unlawful rule, if necessary from decades ago.
A. At least the main effects. You know, tracing out all the indirect effects is probably beyond anybody's ability, but the main thrust of the idea is: how would

the market -- how would the main features of the marketplace look today and how would they look differently than they actually are had this rule not been in place?

Q. How long has this rule been in place, Dr Frankel?

A. I think this rule -- well, this is -- this rule or in effect a rule like it I think has been in place at least since the 80s, but I am not sure.

Q. It is likely, is it not, that since the 80s, the operation of rules like this produce effects in combination with other allegedly restrictive rules in your case?

A. Yes.

Q. Sorry, in your view, in your expert view.

A. I understand, yes.

Q. So you say all that must be excluded to construct a legitimate counterfactual; the main effects.

A. The main effects. So yes, there was a time when not all merchants accepted both Visa and Mastercard ubiquitously, especially in some countries where there was non-duality. Canada is a good example. The US before that into the 70s, but Canada until surprisingly recently. So there were many merchants that accepted one but not the other. There were separate acquirers. There were separate issuers.

So having a card if you are travelling to Canada that could be used on both schemes would have been useful for a cardholder. But competition at the merchant level for processing transactions -- you know, I have got a debit card in my pocket that can probably access four or five schemes. I do not know which they are and I do not need to know which they are. It is a back office operation. The merchant makes the choice about which of those debit schemes to use.

Q. But one thing that is clear is that in a counterfactual, you cannot assume that co-badging would be required by legislation, can you?

A. By the IFR?

Q. No, just by legislation, positing a requirement that co-badging would be required in the counterfactual. We are looking at the pre -- just to be very clear, we are concerned with the pre-IFR period since the IFR overrode Visa's co-badging rule and required changes.

A. My view is that the co-badging restriction is and always has been anti-competitive. So you could -- I guess logically, that would -- it would make sense if you said competition laws would have mandated or would have prohibited the enforcement of a rule that prohibited an issuer from issuing a multi-badged card.

Q. Okay. Just to be clear, Dr Frankel, in the counterfactual -- I think we are on the same page -- you must assume the rule is not there. So the Visa rule that prohibited co-badging between international schemes, that rule is assumed to be absent, so issuers are free to co-badge.

A. Correct.

Q. What you cannot assume is that regulators or national legislators would have required issuers to co-badge, to force them to have more than one scheme on the card.

A. Oh, I understand now. Thank you.

Q. The reason why I was confused was because if you go to your report at {RC-H1/1/142} at paragraph 350, you refer to legislation being introduced that would have required the same multi-scheme access on each credit card issued in the US.

At 351, you say, over the page, page 143 {RC-H1/1/143}:

"Least-cost routing has also been introduced on Australian debit cards."

I think also, and you can correct me if I have misread this, by regulation. Do you see that, Dr Frankel?

A. I see it and what I was -- I used these examples to illustrate that there could be significant competitive effects of a ban on co-badging.

Q. You are not saying in the counterfactual that you assume that the legislator would actually require co-badging.
A. No, but, again, going back in time, I think there would have been issuers who would have issued such cards and if there was a time when they would have had a competitive advantage of doing so, then that would become the very low-key ubiquitous norm; to have multi-network cards that would work everywhere.
Q. So let us look at those examples, Mr Frankel. In the United States, the one you cite at page 142 is {RC-J5/48.3/1}. The second page, please {RC-J5/48.3/2}.
The first paragraph describes the US legislation Durbin 2.0 and it describes -- it says it:
"... would require every credit card transaction to have two networks - one of them not Visa or Mastercard ..."
Do you see that?
A. Yes.
Q. So that is not what is contemplated as an outcome in your counterfactual in this case, because we are concerned here in the counterfactual with: would there be co-badging between international schemes, Visa and Mastercard?
A. Well, I mean, let me not try to get in the heads of legislators, which is a dangerous and scary place, but

the point I was making here was that by getting routing competition across networks available on an individual card, merchants can get lower fees as a result, and these examples illustrate that in action.

It could be a new -- there could be five international schemes today competing for merchant transactions in the UK. There could be 20. I do not know. But this rule was one of the things that made it hard for that to happen.

Q. Let us look at the Australian example you gave at {RC-J5/92/1}. Under "Background", third paragraph:

"Most debit cards in Australia have a functionality that enables a payment to be processed via either EFTPOS or one of the two international networks."

Do you see that?

A. I do.

Q. That is, again, very different to the debit card market that we have in this country and in Ireland currently.

A. Currently, that is true. It could have been different.

Q. That is your point; it could have been different if we constructed a counterfactual assuming that the main rules and their main effects never happened at all.

A. You could have had Visa and Mastercard and maybe with third or fourth scheme available on each card, and maybe those schemes would not even be identified. You would just have the bank name on the front like I have on my debit card.

Q. Just coming back then to reality and this jurisdiction and the period before the IFR, after that date, the co-badging rule permitted co-badging with international schemes; was required to permit that by the IFR.

A. That is my understanding.

Q. It is instructive, is it not, to look at what happened after June 2016? That is seven years ago.

A. Not so much, but --

Q. Well, it is -- I know when we are thinking about things that happened in the 1980s --

A. Yes.

Q. -- it might not seem long ago. It is seven years, Dr Frankel.

A. So seven years, I do not know if that is a long time or a short time. I have been doing this a long time, I guess. But it still could happen. It may happen. The problem now is incentivising an issuer; giving the issuer a reason to have a multi-badged card.

The main reason to do that would be for an entrant. Just like Visa wanted to get co-badged on Interac cards to enter the debit market in Canada, I can see an entrant coming along and saying, "We are going to enter worldwide, but here is how we are going to do it.

We are going to start in Europe, take advantage of this rule that lets us -- we are going to open an issuer of both the new scheme and of Visa and Mastercard."

Q. But in these seven years, we have not seen anything like that, have we?

A. We have not.

Q. Visa has not received any request from an issuer to approve a co-badging arrangement with another international scheme in that period.

A. Not to my knowledge.

Q. You are aware of the technical difficulties with international co-badging, are you?

A. I have read witness testimony about technical difficulties and I have seen experts who have repeated those statements. I am sceptical, I think is the right way to put it, that this is not a difficulty that could be overcome if the desire was to overcome it.

Q. Have you any technical evidence at all to justify your scepticism?

A. Well, what I observe is that this is a problem that is routinely solved for national debit schemes. It is routinely solved for multiple national debit schemes in the United States, where we still have a bunch of networks. I understand there is an issue with the BIN numbers and the first digit keying through Visa or

Mastercard, but that is a problem that is solvable. You know, it maps back to the issuing bank ultimately, which -- I am sure there is ways. Visa is very talented. Mastercard is very talented. I am sure they could solve this.

Q. You accept, do you not, that the issuer incentives are different for co-badging with domestic schemes and co-badging with two international schemes?

A. Yes, that is why I said an entrant might see an opportunity to launch a big new card brand piggybacking on existing Visa and Mastercards that are issued by banks or that it could issue, but it would take a big investment. This is not a rapid growth phase. It was for a while in Europe, but it is getting to be a more mature market and it is more difficult to get people to switch into a new card.

Q. Particularly in the United Kingdom and Ireland. We are only concerned with those countries.

A. You know, I am just -- I am trying to draw a parallel to 1985 and '86 when Discover made its entry in the United States. I think it is harder now. I do not doubt that, but the main effects that I am thinking about are how the market would be today had the rule not been in place for decades, not, you know, since 2016.

Q. But right now, for better or for worse, issuers want cardholders at a single home, do they not?

A. Yes, very much so.

Q. Because issuers want interchange revenue, they have no incentive to issue cards which co-badge high MIF and low MIF schemes that could lead to them getting lower MIF revenue.

A. That is generally true, although, like you said, Discover entered with lower MIFs or lower merchant fees and it offered rewards. It really started the whole reward process, so cut the price on both sides of the industry.

Q. But, again, over the claim period, consumer demand is relevant, and there is no sign of any consumer demand for these co-badged cards to have Visa and Mastercard on the same card.

A. I cannot say that consumers give it any thought at all. This is a pretty inside industry issue. It is not until someone actually launches such a card that consumers might show interest, like they did in several other examples of big, big entry events that happened in the industry.

Q. But those events were long ago. Right now, Dr Frankel, you can have electronic payment cards on your mobile phone, different cards on your phone, and lots of card owners do in fact have multiple cards from multiple

payment schemes.
A. Well --
Q. They can have them in a single wallet.
A. They can. As I keep finding out, you can only make one the default card at a time and it is actually harder for merchants to get people to use a different card now.
Q. Again, just to complete the picture, you say that this co-badging rule was restriction by object. Just to put it to you again, if, contrary to what you have been saying, the co-badging rule had legitimate purposes and, for that reason among others, it was not obvious that it produced harmful effects, do you accept even in those circumstances that it should be treated as infringement by object?
A. Well, you have told me, "Assume the law is X and then assume the facts are X and do you agree that X equals X", and I would have to say yes, you are right. If the object of the rule is the way you describe it and the facts of this issue are such that it is not obvious that there are not pro-competitive benefits or just -- or effects and that is enough to make it not a by object infringement, then it is not a by object infringement.
MR KENNELLY: Thank you, Dr Frankel. I have nothing further. I think perhaps my learned friends have a question. I have no further questions for you,

Dr Frankel.

Further cross-examination by MR COOK

MR COOK: Yes, Dr Frankel, just very, very quickly indeed. It is just in relation to Mastercard's non-disclosure rule and non-discrimination rule, so the NDR. If I could ask you to be shown the joint expert statement, which is {RC-H5/1/16}.

So it is common ground, is it not, that whether the NDR relates -- that is the first bullet, "Areas of agreement". You agree that whether it relates to co-badging with domestic payment card schemes or had a broader application is a factual matter. Then the areas of disagreement, you say there you consider there was an appreciable effect.

If the rule was as we say -- not asking you to decide that -- just that it only related to co-badging with a domestic payment card scheme and there was no domestic payment card scheme in the UK and Ireland during the relevant period, the rule clearly had no effect at all during that time period, did it?

A. In that set of circumstances, I think the effects, if any, would be indirect and remote; too remote for me to conclude that they are appreciable.

MR COOK: Okay, thank you very much.

Questions by THE TRIBUNAL

THE PRESIDENT: Before you rise, Mr Beal, I think Mr Tidswell and I have some questions.

MR TIDSWELL: Dr Frankel, yesterday in the context of a discussion about surcharging, you referred to merchants discounting. I think, as I understood it, but I just want to check if I have got this right, you were talking about discounting in the world where the costs lie where they fall and so the purpose of that would be the merchant signalling to the customer a preference in relation to, say, the means of payment which had a benefit to the merchant. Have I got that right?

A. Exactly. So there is a benefit to the merchant. If there is no MIF, the merchant can still incentivise the customer to choose to use that card or whatever payment method saves the merchant money, not by surcharging, but it could offer a discount if this is a significant benefit, or give the customer something else of value.

MR TIDSWELL: Are you aware of any examples of that happening? Do we see that happening in practice?

A. I have seen examples in the United States of discounts for debit cards, occasionally. I have seen discounts for using new -- there is a number of smartphone apps that allow payment applications and you sometimes see a restaurant, you know, giving you a small discount,

a 3% discount or whatever, for using their app.
MR TIDSWELL: Okay.
A. It is a pay by bank system. It is a --
MR TIDSWELL: Yes, I understand. Thank you. That is very helpful.
THE PRESIDENT: Thank you.
Can I go back to the costs lie where they fall point? Is the real question not costs lie where they fall, but to what extent can costs incurred be recovered by way of revenue so that you can make a profit?
A. Sure. You know, costs -- first of all, all banks issue debit cards now.
THE PRESIDENT: I mean, keep it at a level of generality if you like. We do not need to go to the schemes yet. We will be, but ...
A. Okay. As a general matter, you have got to have some revenue stream; right? You have to have some benefit that you are getting to cover or justify incurring any cost.
THE PRESIDENT: Yes.
A. So it is either a direct source of revenue -- you are selling an item that you make or you buy and sell it at a higher price to cover your costs of selling it -- or you get some other benefit; cost savings or extra revenue in an indirect way.

THE PRESIDENT: Sure. No, I get that. Let us park cost savings. Let us assume for all the questions I am going to be asking you an organisation that has pared things back as much as it can and when we are talking about costs increasing, it is an increase that cannot be ameliorated by savings. So we are looking at either direct or indirect revenue streams to cover those costs.

A. If a cost falls on a seller and it cannot be ameliorated through cutting some other cost, it has got to pass on those costs somehow to its customers, and if it cannot do that and it cannot do that in a sustained way, it is going to fail.

THE PRESIDENT: Well, I want to avoid so far as possible references to pass on, but let us just keep it at the level of abstraction of a need to cover your costs by some sort of revenue stream from someone.

A. Okay.

THE PRESIDENT: So what you are really saying when costs lie where they fall is that you consider that the entity, and here that is postulated as the issuer, the issuer should be able to recover those costs in any way except by way of the interchange fee. That, in your view, is a route by which costs should not be covered, for reasons that you have given.

A. By a collective interchange fee.

THE PRESIDENT: A collective interchange fee, fair enough.

A. Right.

THE PRESIDENT: Okay. For the reasons you have given, you say that should not be the route by which costs are covered. There should be other routes.

A. Yes.

THE PRESIDENT: Okay. The question whether you can recover your costs in this way depends essentially on the elasticity of the demand to whom you are selling or the responsiveness of others to the costs that you increase in your direct and indirect prices.

A. To the prices?

THE PRESIDENT: Indeed.

A. Well, I would say if you can increase a price, whether it is, you know, a vertical, reselling something -- I do not want to talk about pass on -- you could increase some fee to somebody. Competition in the market -- if all the sellers are incurring the same additional costs they did not use to or they have all lost the same revenue stream that you lost, competition will tend to allow you to collect -- to recover that just like -- because all your competitors are dealing with the same issue. If only one bank or one seller loses a revenue stream, it is a very different issue, I think.

THE PRESIDENT: Entirely fair enough. If you have got a universal cost, then everyone is going to have to react in some way, and I accept that. I was making the -- I suspect it is too trite a proposition to warrant disagreement; that when you are seeking to recover your costs by adjusting the revenue streams that come in, you will always keep an eye on whether that increase that you have created is actually beneficial or not. You will look, therefore, at the reaction to see whether it is worth a gamble.

A. Yes, if I could bring it back to MIFs for a moment, in the US, we had debit card MIFs on average fall by two-thirds or something, half to two-thirds. You know, a lot of the people who object to that change have done studies and argued that banks raised other fees. They require higher deposit amounts to have monthly charges waived and that sort of thing. So it is, you know, what we have seen it is the waterbed effect.

THE PRESIDENT: Yes.

A. Sometimes you lose one source of revenue and other sources of revenue adjust, but that can be in a healthy way to avoid distortions in a market.

THE PRESIDENT: Well, what you are saying -- again, I do not think there is any disagreement here -- is that one needs to look at the ecosystem there -- I am using the word -- as a whole and one needs to be alive to the abilities to recover one's costs in a multiple of different ways.

A. Yes.

THE PRESIDENT: We are not just talking about a simple transaction where I am buying something from you and you are selling something to me.

A. These products and these business units are a bundle of revenue and cost items.

THE PRESIDENT: Thank you.

Can we bring up, and you will have seen this before, {RC-R/41/1} in the RC file set. Thank you. You will have seen this before from the hot tub.

A. Brilliantly drawn.

THE PRESIDENT: I apologise, it has not been tidied up and flattery will get you nowhere, Professor.

Now, I want to start by saying this is a rather over-simplified diagram in at least two respects. First of all, it is temporary static. It is a snapshot at a point in time. What point in time does not matter, but as you said in cross-examination with Mr Kennelly, we are talking about periods of decades here and how the relationships that are mapped out here actually operate may very well depend upon the point in time in which one is looking at it, because we have moved from vouchers to chip and PIN to cardless transactions to transactions that are done through your mobile phone, and that is something we will have to be alive to. This says nothing about that. It is, however, a snapshot at a point in time.

A. Fair enough.

THE PRESIDENT: Secondly, and Mr Cook picked me up on this quite rightly, it is incomplete in that it is only showing a single scheme, a single issuer, a single acquirer, a single merchant and, indeed, a single cardholder customer. So what it is is in fact a snapshot at a point in time of a single transaction. That is really what we have got here.

Do you understand what I am saying?

A. Yes. I think that is fair, understanding that individual transactions get aggregated up to -- to do the movement on the money.

THE PRESIDENT: You are absolutely right. What I am doing is I am highlighting an over-simplification and one of the things that one is going to have to do when one is analysing what is going on is to be aware of this point about aggregation; that there are many more than the single players here.

So it might be useful to understand how a single transaction works with, obviously, by definition a single issuer, a single merchant, a single acquirer and a single scheme, but we have got to be very alive to the fact that there are many other players involved in the context in which the scheme operates and sits.

A. Yes.

THE PRESIDENT: So accepting those two qualifications to this scheme, can we go through the sort of aggregation question that you have quite rightly touched upon? As we discussed in the hot tub, we have got, I am going to suggest to you, two products being sold by the scheme at the apex of this particular pyramid. Can I just articulate them again for you to see whether you agree?

A. Sure.

THE PRESIDENT: We have got, on the right-hand side of the diagram, the side with the merchant on it, a product that is being supplied by the scheme to merchants, enabling the merchant to be paid.

A. Yes.

THE PRESIDENT: It is different, for reasons we are not going to discuss, with cheques and cash and other things. It has the qualities that you were exploring earlier with Mr Kennelly, but we will not go into that. That is the product that is being provided, whatever its terms and however it works.

Secondly, on the left-hand side of the triangle or the pyramid, we have got a situation where the scheme is providing to cardholders an ability to pay.

A. Yes, you could think of the issuer and acquirer as kind of a distributor of services.

THE PRESIDENT: Well, yes, the issuer sits between the scheme and the cardholder. I am looking at the bottom. I am looking at what I would call the ultimate consumer; the person who is actually using the product sold without on-selling or repackaging it.

A. I understand.

THE PRESIDENT: So I quite accept that on the merchant side, we have got above the merchant, the acquirer, and, indeed, below the merchant, the customer to whom the merchant sells, but on that side of the pyramid, the scheme is providing to the merchant an ability to receive payment. On the other side, we have got as the ultimate consumer the cardholder who, intermediated through the issuer, receives an ability to spend their money more easily from the scheme.

A. Yes.

THE PRESIDENT: So when one is assessing the competitive constraints on those in the middle of the chain -- that is to say, those between the ultimate consumer and the scheme, on the left-hand side the issuer and on the right-hand side the acquirer -- would it be right to say that they are going to be responsive to the competitive reactions of the ultimate consumers at the bottom of their particular chain?

A. Yes.

THE PRESIDENT: Because they ultimately are going to be wanting to provide something that the final consumer wants to buy?

A. If by constraint you mean if they should raise their price how many transactions do they lose, how much fee revenue do they lose and the like.

THE PRESIDENT: Exactly so.

A. Yes.

THE PRESIDENT: So moving then to the question of aggregation. Are we going to have to ask ourselves at each stage in the chain how the player at that stage is going to react to a question of an increased cost? Let me give you an example. It will be relevant to know in regard to a particular scheme how many issuers there are.

A. I am sure it needs to know that, yes.

THE PRESIDENT: We will want to understand what those issuers' choices are, where for instance the scheme in which they are presently participating becomes less attractive?

A. That is a fair point.

THE PRESIDENT: So one of the questions, and I am sure there will be many and we have seen it mentioned a number of times today, one of the questions we will want to ask ourselves about the issuer is that they do not really need to multi home, they can single home?

A. Yes, and some of them do and some of them entered into agreements to exclusively source.

THE PRESIDENT: I am quite sure some of them do and you have said that on a number of occasions and we will see how controversial that is when we come to closing, but I entirely accept your evidence that is what you say happens.

So immediately we need to ask ourselves given that you only need to single home, what choices the issuers as a class have and immediately then we see that we need to work out that there are in fact not one scheme but two schemes at the apex?

A. Yes.

THE PRESIDENT: You have got Visa and Mastercard. So we immediately have a choice between two pretty similar products --

A. I agree with that.

THE PRESIDENT: -- at that stage.

We are also, and this is Mr Cook's point, going to have to take into account other forms of payment scheme like Amex because the issuer will have a choice there.

It may be less attractive for other reasons but we are going to have to work out why and what constrains the issuer's choice there.

A. I agree.

THE PRESIDENT: So immediately our very simple static diagram is becoming much more complicated. We have got a number of schemes at the apex, we have a number of issuers choosing between a number of schemes and we can then move down the pyramid and we can ask ourselves what the position is in regard to the cardholder and just to go through the similar questions there, the cardholder will also typically single home?

A. They will either single home or have strong preferences to use a particular card or at least the retailer has to -- the merchant has to assume, act as if that is how the --

THE PRESIDENT: We will certainly come to the merchant --

A. Yes, okay.

THE PRESIDENT: -- in a moment. But let us stick with the cardholder.

A. Cardholder, they are single homes, enough like it that is what we have to assume.

THE PRESIDENT: What they are going to be doing, and again correct me if this is not your view and I will certainly be corrected if it is not the evidence, but the cardholder really wants an efficient way of spending their money?

A. Yes. To be fair to the defendants, they would argue the cardholder also wants rewards and so on.

THE PRESIDENT: I understand and there may be a route by differentiating different cards in that way. But when one talks about the fundamentals this is a payment system and what you want is an efficient means of payment.

A. I have often started a report by saying, "The purpose of a payment system is to move money from buyers to sellers."

THE PRESIDENT: If that is, and it may not be, but if that is the main motivation then provided it works you will only really need to be involved in one scheme not several?

A. I am sorry, can you repeat the last bit?

THE PRESIDENT: Yes. What I am saying is looking at it from the cardholder's point of view and assuming, but it may be wrong, assuming that all the cardholder wants is an ability to spend their money efficiently.

A. Yes.

THE PRESIDENT: Then provided they are in a scheme that has universality or enough universality to work for the cardholder, the cardholder will probably single home.

A. Sure.
THE PRESIDENT: Okay. So looking at the left-hand side of the pyramid, single homing would be the order of the day on your evidence.
A. In reality, cardholders often have multiple cards and the like. But -- but the essence is they do not need, in order just to spend if there is universality they do not need to have multiple cards.
THE PRESIDENT: I quite understand and I absolutely take your point that you will have a likelihood of cardholder having many cards and therefore they are multi-homing and one of the things I am suggesting we will have to be alive to is what is driving that. Is it simply rewards? Is it something else? What I am suggesting though it is not particularly an ability to spend their money more efficiently.
A. I agree with that.
THE PRESIDENT: Because as between Visa and Mastercard we heard the evidence that they have essentially achieved universality.
A. They both have contactless functionality and the like.
THE PRESIDENT: There does not seem to be any functionality difference.
A. Yes.
THE PRESIDENT: Now, it may be different as far as Amex is

concerned, and again that is something where we will have to consider the evidence because universality is perhaps less of a given in that case and I think that is uncontroversial, do say if you disagree, again it will be down to the evidence ultimately what is right or not.

A. It is a matter of degree, but...

THE PRESIDENT: Fair enough.

A. It is closing, but there is still a gap.

THE PRESIDENT: There is a gap, there is a difference which we need to be alive to. I am grateful.

Turning then to the other side and looking at it from the merchant's point of view, merchants have got to multi home not as a matter of choice but as a matter of --

A. Survival.

THE PRESIDENT: Survival.

A. Yes.

THE PRESIDENT: That is because they do not want to say to the Visa cardholder when they do not subscribe to Visa that they cannot take their money.

A. Correct, there are going to be some customers they will not be able to serve.

THE PRESIDENT: So one has a nexus between the universality which will attract the cardholder and the number of cards that the merchant is likely to want to be able to

offer in acceptance for payment.
A. Yes.
THE PRESIDENT: So let us assume that we have a payment card, I am going to hypothesise some card because I do not want to be rude about Amex, let us hypothesise a card that has almost no universality but other attractions that make it desirable to have with a --
PROFESSOR WATERSON: Discover.
THE PRESIDENT: Discover, right. Well, a hypothetical card that does not have much universality but has other reputational reward benefits that attract cardholders to it. In that situation first of all, the cardholder is likely to have Visa plus this hypothetical card.
A. Correct, or Mastercard.
THE PRESIDENT: Unless -- indeed. The merchant is likely to be quite easily disincentivised from offering the acceptance of payments via this hypothetical card because not many cardholders are presenting it at payment and they may be happy to say: Well, no, give me something different.
A. Unless it is part of an Honour All Cards Rule issue but we will not go there.
THE PRESIDENT: I understand. There is a whole network of legal questions that arise as well but I am going to try and steer clear of that.

A. It is an entrant.

THE PRESIDENT: You are absolutely right. We are going to have to factor those in as well and that is a third oversimplification of my diagram, but you will be relieved to hear that I am not going to ask you about that. So the merchant is per force multi-homing and would you say that affects the way in which the acquirer sees the services that it or they provide to merchants?

A. Yes. I mentioned there were, in Canada, there were separate acquirers that merchants had to go to accept Visa and to accept Mastercard and, you know, finally there was regulatory prohibition on one bank being a member of both. But a joint venture was formed to offer both brands of it and the whole market flipped and that became the norm because it is crazy, you have to have two separate relationships or double fixed costs and the like to deal with two separate acquirers.

So acquirers typically boast about how many different kinds of payments including new fangled, you know, digital payments, that is their business. They want to say "We can accept everything" if they can.

THE PRESIDENT: Thank you that has been very helpful. I want to end because we could ask questions about how the scheme works for a long time and you have been asked about that, I want to end really with this point. For our purposes in order to answer the questions that are arising out of this Trial I, we are effectively going to have to conduct a quasi market definition exercise for every link of the chain because the incentives moving away from this particular transaction are going to differ, at least in degree, according as to which player you are looking at?

A. That is a legal issue. My view as an economist may be a little different. I think as I understand the framework step 1 is to figure out is there an overcharge, is there an upward effect on price?

THE PRESIDENT: Stay away from the law.

A. Okay.

THE PRESIDENT: I am trying to stay away from the law now, so I should not have used market definition.

In order to understand what is going on, we are going to have to consider the response of the class of player at every stage to an increase or decrease in price or other change of material circumstance.

A. Yes. I agree I think all the economists agree that these are all interrelated, however you want to use the word market or defined markets, they are all interrelated components of the set of transactions.

They are phenomena that all link to each other directly or indirectly and they all have to be thought about.

THE PRESIDENT: They are linked, absolutely I accept that. But they are also in a sense rather separate. I mean let me put something to you which we have not talked very much about, but let us suppose we have a situation where a per transaction fee of an unreasonable amount is imposed by merchants on customers. It does not matter why it has happened, but let us say for every transaction you have got to pay an extra £5 even if it is a sandwich in Pret A Manger. At that point, assuming it is every card that is affected by this your customer is going to shift to cash.

A. Yes.

THE PRESIDENT: I mean, it is an absurd example.

A. Assuming they only have one card or cash.

THE PRESIDENT: Well, assuming this affects every card.

A. Okay.

THE PRESIDENT: Let us say the government puts a tax on card transactions so that if I use my card whatever the transaction is I pay the value or the price of the product plus £5 but if it is cash, I do not.

A. You will only use the card for high-priced transactions.

THE PRESIDENT: Absolutely. So all of the low priced transactions where the schemes are making real penetration those would shift away to cash.

A. Okay.

THE PRESIDENT: But that is a choice that exists really only in the customer's level. The merchant is simply providing payment services, they will obviously move to accepting cash and changing their practices, the acquirers will find a problem with the business.

A. Yes, they will have to focus on the high airlines or whatever.

THE PRESIDENT: High value transactions. But my point is the choices, as we are articulating them, differ according to who you are looking at. Sure they are interrelated but the economic implications of a change are different because the choices that exist at each stage are in some way different?

A. I agree with that. I have often focused on who has choices and who does not have choices effectively.

THE PRESIDENT: Okay. The last question, and I see the time. Do you see any particular significance in the fact that at the end of the chain, although not the ultimate consumer, the cardholder is also the customer? I mean that is unusual in a two-sided market.

If you take the free newspaper you have got two different buyer bases; you have got the readers on the one side and you have got the advertisers on the other and although it may be that a reader is also an

advertiser and an advertiser also a reader you do not have a complete overlap whereas here --
A. I see.
THE PRESIDENT: -- you do.
A. I see what you are saying. I thought you -- I mean, a reader -- clearly the advertisers are hoping the readers interact with them.
THE PRESIDENT: Oh, sure.
A. They are fishing.
THE PRESIDENT: Yes. No, that is absolutely right. I mean the advertisers want readers and the readers want interesting content.
A. Correct.
THE PRESIDENT: The advertisers will no doubt try and make the advertisements as interesting as possible so clearly there is that interaction, which is what I would suggest makes a two-sided market. But what I am articulating here is that it is not that sort of interaction here. What we have got is literally the same person, I mean it is so obvious that I almost hesitate in saying it, but I think it is important, we have got the same person making the payment to the merchant as is paying out of the account.
A. I am not sure I follow. Even Visa employees carry Visa cards presumably.

THE PRESIDENT: Sure.
A. And bank employees carry their cards issued by their bank presumably. But in -- aside from that, the identity of the merchant is quite distinct from the identity of the cardholder.
THE PRESIDENT: I know, sorry.
A. I am not following.
THE PRESIDENT: I am not being clear enough. I accept that there may be that sort of overlap between the merchant and the cardholder. But if you look right at the base of the triangle in the picture I have coloured light blue the "cardholder plus customer" and that is because the cardholder is the customer.
A. Yes.
THE PRESIDENT: So if you are looking at the bottom of each leg, it is the same person at the base and my question was: is that something which is significant or is it something that I do not need to worry about when I am considering how all this works?
A. I think only to recognise that the cardholder is also the potential user of a different payment method and also I do not think you should forget that there are non-cardholders who are also customers of the merchant.
THE PRESIDENT: Yes, I accept that.
A. Right, we are not going to talk about pass on and all

that.

THE PRESIDENT: No, we will try and avoid that because that just creates problems.

A. But if there is even a little bit of pass on that will affect the non-customers. There is a whole other case going on about that.

THE PRESIDENT: It is perhaps straying into pass on but I will ask this question. To what extent do we need to be considering the payment reaction of the cardholder/customer as a unitary human being?

Let me unpack that. You might be hypothesising a surcharge and then you would have to work out what the reaction of the customer might be to that or you might postulate a charge on the account by the issuer so that costs could be recovered that way and again you would want to gauge cardholder reaction. But one does need to, when gauging cardholder reaction, look at a consistent economic actor who is at one and the same time transacting with the merchant and also transacting with the issuer?

A. Yes.

THE PRESIDENT: Would you say that that is something which is just one of those things or whether it is something which might be significant?

A. I think it is part of this -- this idea of a two-sided platform, whether I use the word "market" or not it really does not matter.

But you have -- sometimes it is one -- I think what makes it distinct here from many examples is you have got two different entities as an issuer and an acquirer. For most transactions you have a separate provider of the service to the downstream instead of, you know, a matchmaking service directly interacting with the two.

THE PRESIDENT: Thank you very much. I have taken up far too much of your time. Is there any further questions by way of cross-examination?

MR KENNELLY: No, sir, nothing from our side.

Further cross-examination by MR COOK

MR COOK: Just one question, Professor Frankel. When we talk about customers or cardholders being interested in spending money efficiently when one thinks about charge cards or credit cards, one of the things that they might well be influenced by is the ability to transact now and pay later whether that is a month, whether that is six months, depending on whether you want interest free or --

A. Or many consumers prefer debit cards precisely because the balance is deducted immediately and they can keep track easier, especially younger people it seems have migrated over time more to debit than some of us older timers who -- who thought of people as preferring credit.

Q. But that is going to be very much part of the dynamic here whether you want to buy on credit for whatever reason or not will be a key factor for some cardholders?

A. Yes. Some people maybe use a credit card to generate rewards even if they have no -- neither intent to borrow and will just as soon use a debit card otherwise.

THE PRESIDENT: Mr Beal.

Re-examination by MR BEAL

MR BEAL: Thank you very much. Just sticking with that picture, if we may, I am going to call it the diagram because it is the diagram. When you are considering the restriction of competition in this case, what have you been focusing on?

A. I have been focusing on the acquiring side, the provision of services from the acquirer to the merchant.

Q. Have you looked at whether or not a restriction on competition could be justified for example?

A. Could be justified? My understanding is that is for a later proceeding.

Q. Have you, or any of the other experts, considered for example all the efficiencies or the reactions between different component parts of what is otherwise clearly an interconnected series of arrangements?

A. I think there have been a lot of discussions of efficiencies maybe that were useful context to understand where this piece of the case fits into a broader context. I leave it to the legal minds as to the relevance of some of that.

Q. Now, Mr Kennelly threw down the other gauntlet that he was wearing on references in the evidence. I hope we have now left him without gauntlets because he has run out of witnesses.

But putting that to one side he said in re-examination no doubt you would be taken to some evidence concerning New Zealand on surcharging and steering some of the questions you were asked if you remember.

Could we look, please, in bundle {RC-J3/111/19} and hopefully bring up paragraph 55. Can you see that there there is a section from, this is from the Ministry of Business in 2020, dealing with steering and surcharging.

Could you just cast an eye over that material.

(Pause)

A. Yes.

Q. Do you have any observations to make on that material in terms of the evidence available in New Zealand?

A. Yes. So one of the interesting things here that kind of caught my eye is a merchant saying they do not accept contactless. So in New Zealand the EFTPOS system does not have contactless. There has been this big migration to contactless especially because of Covid, so the idea that they are freed under the settlement to steer in that way is helpful. They could encourage their customers -- they could just refuse to accept at the point of sale a contactless or they could surcharge contactless transactions is my understanding which can steer customers to use the cheaper EFTPOS.

Q. Could we look, please, at page 25, paragraph 83. There is some evidence there about surcharging. It says to be fair there is a low prevalence of surcharging by merchants' inability easily accurately to surcharge for each product type.

Could we then -- I am putting that to you in the interests of fairness. If we then please look at page 33, paragraph 112 (c), are you able to make any observations about the collective bargaining process that is there described?

A. Yes. So we -- there have been a few times during my -- my time here where this issue of large merchants versus small merchants has come up and large merchants are more able to negotiate through the threat of steering or the actual steering process can induce an issuer to cut them a bilateral deal for a lower -- a lower fee and

collective bargaining especially through associations and the like assuming that is all, you know, okay with competition law, enables them to achieve what the big merchants can do.
Q. Could we then please look at bundle {RC-J3/85/9} and bring up paragraph 22. You will recall that you were asked about strategically important merchants?
A. Yes.
Q. There is a section here dealing with the differential treatment between small merchants and the largest strategic merchants. Do you have any observations to make about that evidence?
A. It has become a very significant issue in the industry where there is lower scheme fees and lower interchange fees for very large merchants, in part to keep them from steering, and enable the maintenance of otherwise higher MIFs throughout the marketplace.
Q. Could we then please go to page 28. That does not seem to be the right page. There was a table of MIFs. Sorry, I am just trying to find it.
PROFESSOR WATERSON: 29, is it?
MR BEAL: Sorry, it is page 38. {RC-J3/85/38}. That problem arose because I cannot read my own writing.
Can you see there some different MIF rates are shown?

A. Yes.
Q. There are some entries for strategic merchants, can you see that?
A. Yes.
Q. Could we then please move on to page 42 in this bundle, paragraph 158. You were asked about surcharging in particular sectors or rather you gave some evidence about surcharging in particular sectors. Can we see there a reference to certain sectors in New Zealand?
A. Yes, hotels, airlines, governments, tax, tax bodies.
Often you could pay your taxes but they are not going to eat the credit card fee so you have to pay a surcharge.
Q. Your evidence to my learned friend was that surcharging is becoming more common in New Zealand and he suggested that was not the case and you thought it was. To give a homely example, could we please bring up {RC-J1/35/1}. This is a newspaper article dealing with a coffee shop in New Zealand.
A. Yes.
Q. Can you see at the top of page 2 there is a reference to: do you pay the small surcharge for your credit card or contactless payment or opt instead to type in your EFTPOS pin or use cash?
A. I see that.

Q. Is that evidence that you saw when preparing your report?
A. I have seen similar documents from Australia and New Zealand. Actually I found a menu the other day in an Australian restaurant posting to the exact basis point different surcharges for Visa, Mastercard and American Express.
Q. It was also put to you that no scheme would have a price that came down to zero. Can I just confirm when that was put to you we were dealing with a price for the scheme. Are MIFs or IFs the only price that are paid by merchants for the use of a scheme?
A. I am sorry?
Q. Are interchange fees the only price that are paid by a merchant?
A. No. There are scheme fees and the acquirer's fee.
Q. You were asked about bilateral negotiations and there was a certain disconnect between what you thought was being put to you and what you thought was Mastercard's position.

Could I ask you please to look at {RC-R/21/4}, and in particular could we look, please -- well, let us just start at page 3 if we may and you can see that the rule that is being suggested would be inserted is that set out at paragraph 16. Have you seen that rule?

A. I have seen this and this is what I was thinking about when I had that conversation.
Q. Then could we look please at paragraph 17. This is the way Mastercard puts its case, it says:
"In relation to clearing [this is four lines down] the rule makes clear that Mastercard will only clear transactions where a bilateral agreement is in place so Mastercard knows what sums are due between the parties."
It then says:
"That does not require issuers and acquirers to enter into bilateral agreements since they are always free to clear and settle directly."
If it is right that two parties agreed to clear, settle and pay without reference to the scheme, would there be any scheme?
A. Well, that sounds like a bilateral agreement so I do not understand the sentence that says does not require to enter into a bilateral agreement since they are free to enter into bilateral agreements, which ...
Q. What about -- so essentially if you want access to the scheme and the clearing in the scheme, what is it that the scheme requires of you?
A. I think that you have to have a bilateral agreement in place at least for that transaction. There is the slight ambiguity about whether you have to have that in

place for all possible transactions in order to proceed to accept transactions from any issuer.

Q. Now, at one point you said that merchants would be willing to pay the interchange fee in certain circumstances. Do you know whether merchants are willing to pay the interchange fee?

A. Merchants who accept credit cards already do pay the interchange fee, so they are all willing to pay it. That does not mean they are paying the competitive price or ...

Q. Are you implying by that that they have freely chosen to pay a particular fee?

A. Well, this concept of must-take cards is important and real. So they freely choose to pay the fee but in a sense it is at the peril of their business if they do not accept those cards and do not pay those fees.

So I was speaking, as an economist, as a matter of general principle, that does not -- I do not want that to appear to subtract from this important concept in this case that it may cost you your business if you do not pay that fee.

Q. You were asked about cross-border acquiring and it was put to you that somehow an efficiency saving was either being obtained or was not being obtained by paying a higher or lower multi-lateral interchange fee. When

dealing with acquirers, what role does the MIF have in the efficiency of an acquirer?
A. No direct role. It is just -- it is part of the pricing that they charge to merchants. But otherwise acceptance so far as it may incentivise more of one kind of transaction over another, it would have that kind of effect but it does not affect them overall because they accept all those transactions.
Q. It was also suggested to you by my learned friend Mr Kennelly that there were no particular requirements imposed by Visa for establishing a cross-border acquiring operation. That was the question he put to you.
I am going to ask you now please to look at some confidential material, so I do not want to bring up the contents, but I just want your observations as a result of seeing this material. The first is at {RC-J4/54.4/8} and by reference to a public document I can say that there was a dispute between Worldpay and Visa which led to a complaint to the CMA and we know that Worldpay subsequently established a wholly-owned subsidiary in the Netherlands which became the acquiring arm which is Worldpay BV. So that is background.
But if we look, please, at page 8, there is a section dealing under subparagraph (d), (ii), can you

just read that to yourself. (Pause)

A. I see that.

Q. Then please at page 13, just in passing, there is a summary of the Commission's objection at the bottom of the page to the previous Visa regime for cross-border acquiring; can you see that?

A. Yes.

Q. Given that this refers to a document that is now in open, I think it is fair for me to say that they were concerned about maintaining the segmentation of national markets, can you see that?

A. Yes.

Q. Page 14, please, paragraph 2.12, again giving a summary of the European Commission's view at this stage bearing in mind this is before the implementation of the commitments with effect from 1 January 2015 and then if we could look please at page 29, paragraph 2.75, could you read through that paragraph on to the next page but then also please footnote 68 in passing.

A. 68?

Q. Footnote 68.

A. Could you go down a little?

Q. If you could just scroll down a little. Perfect. I am going to put this neutrally, but discussions were had as to the arrangements Worldpay was going to have to put in place; is that a suitably neutral way of expressing what has been going on?

A. Yes, I see what you are getting at.

Q. Right. Finally on co-badging. Could I ask you to look at a couple of pieces of evidence first please {RC-M1/10/9}. In paragraph 25.2 of Mr Willaert's third statement, he gives some evidence about Cartes Bancaires. Can you see that?

A. I see that.

Q. When you were talking about two international schemes being able to be offered on the same card and that driving competition, is that the sort of example you had in mind perhaps?

A. Yes.

Q. Could we then please look at {RC-M1/2/15} and bring up paragraph 47.2. There is some evidence here about a card that was offered by Lloyds. Can I invite you to scan that paragraph and say whether or not you are familiar with that card product?

A. I am familiar with this, this strategy, this business strategy. It has happened elsewhere as well.

Q. Can you describe for us, please, what that business strategy is?

A. This is what is sometimes been referred to as a companion card model, where -- when this was done in

Australia for example the cardholder would be issued two cards, an Amex card and a Visa card, and the purpose was if a merchant surcharged many merchants surcharge Amex or surcharged Amex at a higher rate than they surcharged Visa and Mastercard.

So the idea was you might get fewer rewards on the Visa card but you could use it to avoid a surcharge or get a lower surcharge and when the merchant did not surcharge or had parity surcharging, you could use your Amex card and get higher rewards. That was the strategy. They both flow to the same account.

Q. How would that strategy work if you tried to put it on a single card?

A. It depends on the technology and the rules. But if they were both on the same card, a merchant could steer to the cheaper network, the lower fee network if it was permitted to do so.

MR BEAL: Thank you very much.

Those are the only questions I had in re-examination.

PROFESSOR WATERSON: May I just raise a very quick supplementary on one of the points that Mr Beal put.

You have said more than once during the course of your evidence the fact that someone is willing to pay for something means they value it more.

A. Yes.
PROFESSOR WATERSON: Can we infer anything about competition from that general statement?
A. No. This is a point that comes up in a lot of contexts and seems to come up especially in this industry where the argument is merchants get a lot of value for the small fee we ask them to pay. But that tells you nothing about whether they are getting a competitive price.
PROFESSOR WATERSON: Thank you.
THE PRESIDENT: Professor, thank you very much for your time. We are very grateful.
A. Thank you. Like I said before, I am honoured to be here really.
THE PRESIDENT: Well, you are released from the witness box thank you very much.
MR KENNELLY: Sorry. I see the time.
THE PRESIDENT: Well --
MR KENNELLY: Just to offer something straight away since this is our responsibility as well. You mentioned sitting on Friday, sir. I am conscious Mr Beal is rather squeezed now in the time available under the current timetable and I was raising now, as early as possible, whether the Tribunal would be willing to sit on Friday to allow Mr Beal extra time to conduct his

cross-examination.
THE PRESIDENT: Unfortunately we have a problem with ourselves on Friday, but thank you for that.
We will proceed tomorrow at 10 am start.
Mr Beal, you can take it as read that we will find whatever time you need and we will work on that we are thinking about it already.
MR BEAL: My plan, sir, is to see how the witnesses go, see what I can do. If it comes to 5.00 pm on Thursday and I have not finished, I will be left with no choice but to ask for not parity of treatment -- because I do not think I can physically achieve that now -- but at least some additional time.
THE PRESIDENT: Mr Beal, that will happen. The only thing I am saying is let us try not to leave it to the last minute Thursday.
MR BEAL: Of course.
THE PRESIDENT: We will --
MR BEAL: Take stock.
THE PRESIDENT: -- take stock and of course, you have no idea how long things will take because it takes two to tango and one can have perfectly proper long answers as well as perfectly short answers and that is --
MR BEAL: I am not prejudging --
THE PRESIDENT: No, you are not. I am merely putting down

my own marker that these things are not predictable and to hold you to any estimate would be wrong and all I am saying is if you need it, we will find the time.

MR BEAL: Thank you very much.

THE PRESIDENT: Can I express my gratitude. We have all rabbited on far too long. Thank you for bearing with us I am really very grateful. We will resume again then at 10 o'clock tomorrow morning.

(5.34 pm)

(The hearing was adjourned until 10 o'clock,

Wednesday, 13 March 2024)