

COMPETITIVE EDGE

A £68m question: The CAT's judgment in the *Sainsbury's vs. MasterCard* interchange litigation

Why is this case so important?

In a judgment handed down yesterday, the Competition Appeal Tribunal (**CAT**) required MasterCard to pay £68.6m in damages to Sainsbury's. This was the first cartel damages action to be litigated through to judgment in the UK and, as such, provides the first fully reasoned example of how the CAT will analyse such claims. From a precedent perspective, its treatment of concepts like the "counterfactual", "overcharge" and "passing-on" are of particular interest.

The damages award is in respect of charges, known as multilateral interchange fees (**MIFs**), which MasterCard set for the period of December 2006 – December 2015. The term "interchange fee" is used in the payment card industry to describe the fee paid between payments institutions for the acceptance of card based transactions. Usually it is a fee that the merchant's "acquirer" pays to the issuer of the card being used, the cost of which is ultimately passed through to the merchant, such as a retailer like Sainsbury's.

The MIF represents the default level of interchange payable in the absence of a bilaterally agreed rate. It constitutes approximately 90% of the charge which merchants pay under the MasterCard scheme.

As the first of its kind, yesterday's judgment will be scrutinised carefully by a number of third parties, including:

- ▶ Twelve other retailers which are in the middle of a High Court trial, bringing a similar action against MasterCard. Proceedings were suspended on 7 July, in expectation of yesterday's outcome;
- ▶ A large group of merchants bringing similar claims against Visa; and
- ▶ Those leading a "collective action" against MasterCard on behalf of consumers, to be filed in the CAT under new rules (and expecting a trial in mid-2018). The reported claim value is £19 billion.

In this article, we consider what, in particular, is going to catch their eye as they pore over the 309 page judgment, as well as the wider implications for the card schemes.

The relevance of the European Commission decision

In support of its claim, Sainsbury's relied on a European Commission (**EC**) decision, addressed to MasterCard in December 2007. That decision found that cross border interchange rates set by MasterCard within the European Economic Area (**EEA**) infringed Article 101 of the Treaty on the Functioning of the European Union (**TFEU**). MasterCard brought appeals to the General Court and then the Court of Justice (**CoJ**), each of which was dismissed.

The parties agreed this was not a "follow-on" action. In such an action, the EC's findings of infringement would have been binding on the CAT and Sainsbury's would only have needed to prove loss as a result of that infringement. Nevertheless, Sainsbury's argued initially that the EC decision could be "read across" to the present case. In other words, it was somehow binding or influential on the CAT.

MasterCard contested that the decision did not relate to, or even consider, domestic UK MIFs and only related to the EEA MIF that was in force between 1992 and 2007. Sainsbury's claim, MasterCard argued, was therefore effectively a "stand-alone" action, such as required it to prove each element of its claim. On this point, the CAT effectively sided with MasterCard, concluding it was *"difficult to see how the Commission's findings of fact, although no doubt of interest, could be in any way binding."* By contrast, CoJ conclusions on matters of law were binding – in particular the characterisation of MasterCard's MIF-setting as a decision by an association of undertakings.

The importance of finding an "effect" on the relevant markets

The original EC decision had found no need to reach a definite conclusion on whether the infringement was "*by object*", given its view that a restriction by effect could be clearly established. Although Sainsbury's argued that the UK MIF constituted an "object" infringement (for which there is no requirement to establish an anticompetitive effect), it did so almost reluctantly, with Mr Brealey QC for Sainsbury's noting at one stage "*if you are pushing me, then I would say it was an object infringement*".

Indeed, in the event, the CAT did not find the UK MIF was a restriction of competition "by object". This has wider implications for antitrust enforcement, where the authorities have traditionally sought to show object infringements, in order to avoid the need to prove effects. Indeed, when read with the CoJ's judgment in *Cartes Bancaires* (C-67/13 P), it seems clear we are now past the high water mark for the "object shortcut".

The present case therefore focused on whether the infringement did, in fact, give rise to an appreciable economic effect. In concluding that it did, the CAT considered detailed evidence on the following questions:

- ▶ *What was the relevant market?* Whilst Sainsbury's contended the analysis could be confined to the merchant acquiring market, the CAT agreed with MasterCard that any assessment of effects should consider each of the three inter-related markets for payment systems, card issuing and merchant acquiring.
- ▶ *What would have happened in the absence of the MIF?* The CAT concluded that issuers and acquirers would probably agree bilateral interchange fees, at a level that would result in merchants paying less than the present UK MIF, but still encourage issuers to remain in the MasterCard scheme.
- ▶ *What level would those bilateral fees be agreed in the absence of the MIF?* This involved a detailed consideration of what was actually paid, as well as the costs of issuing cards. The CAT concluded that the likely bilaterally agreed interchange fee would have been 0.5% for credit cards and 0.27% for debit cards. As we discuss below, this may in fact be good news for card schemes, in a different context.

How did the CAT arrive at £68.6m?

As the first action of its kind, the CAT's analysis of the twin concepts of overcharge and pass-on is critical.

The CAT determined the overcharge by assessing the difference between (i) what Sainsbury's actually paid by way of UK MIFs during the claim period and (ii) what Sainsbury's would have paid by way of interchange fees, had MasterCard not committed the wrong. The latter question was directly informed by the level of bilateral fees which the CAT determined would have been agreed, in the absence of the MIF (discussed above). This is known as the "counterfactual".

Next, the CAT had to consider the extent to which Sainsbury's had passed on any overcharge to its customers. It concluded that a pass-on "defence" should only succeed where "*on the balance of the probabilities, the defendant has shown that there exists another class of claimant, downstream of the claimant(s) in the action, to whom the overcharge has been passed on.*" It continued that: "*Unless the defendant (and we stress that the burden is on the defendant) demonstrates the existence of such a class ... a claimant's recovery of the overcharge incurred by it should not be reduced or defeated on this ground.*"

In the CAT's view, MasterCard failed to identify an increase in retail price, let alone one that was causally connected with the UK MIF. Nor was MasterCard able to identify any Sainsbury's customer (or class of customer) to whom the overcharge has been passed, who would be in a position to claim damages. Interestingly, though when considering the amount of interest to award to Sainsbury's, the CAT "*considered that*

a substantial amount of the UK MIF - 50% - would have been passed-on (albeit not in a manner which would have amounted to a "defence" of pass-on...)". More on this later.

That interest calculation was important. Unusually, the CAT considered that, to compensate Sainsbury's fully in respect of the losses it had suffered, interest should be awarded on a compound basis, on the remaining 50% of Sainsbury's assessed damages (on the basis that 20% would have resulted in interest foregone from higher cash balances and 30% in higher borrowing costs). This made a significant difference to the overall damages sum and may be an important precedent for future cartel damages actions.

Where does Sainsbury's Bank fit in?

The CAT did, however, see fit to reduce Sainsbury's damages by 80% of the unlawful amount that Sainsbury's Bank had received in interchange fees, on the assumption this money would ultimately have benefitted the retailer. This was particularly high because Sainsbury's Bank offered MasterCard credit cards with generous rewards in the form of, in particular, Nectar points. These were designed to encourage credit card customers of Sainsbury's Bank to maximise their spending at Sainsbury's.

More generally, the CAT rejected MasterCard's argument that, as a card issuer which benefitted from UK MIFs, Sainsbury's Bank should not benefit from a legal remedy arising out of its own illegal act. The CAT concluded there was no, or insufficient, turpitude on the part of Sainsbury's Bank and it did not form part of a "single economic unit" or "undertaking" with Sainsbury's, within the meaning of Article 101(1) TFEU.

Some good news for the card schemes

In concluding on the likely bilaterally agreed interchange fees, the CAT rejected the EC's reasoning on the "merchant indifference test" (**MIT**), declaring it (amongst other things) "*wholly unfit for purpose*". The MIT was the EC's attempt at determining the extent to which, in a one-off transaction, a merchant would prefer payment by card rather than cash.

The CAT found that the MIT does not capture the advantages gained by merchants through the use of cards, even though this will be the driver for merchants accepting payment by card. Further, it ignores the costs of card schemes in the issuing market and considers only the acquiring market, ignoring the fact that MIF pricing also affects the markets for payment systems and card issuing.

Many in the payments industry found it convenient that an independent report, commissioned by the EC on the MIT, retrospectively supported the fee caps the EC had previously proposed for the Interchange Fee Regulation (**IFR**). That IFR is now in full effect, with uniform interchange caps applying in all Member States, as well as for cross-border transactions. Indirectly, the CAT raises some serious concerns about this.

There are two ways this could benefit the schemes:

- ▶ Firstly, instead of the MIT, damages in further actions are likely to follow the CAT's approach. Higher rates in the absence of the MIF mean there has been less overcharge, which in turn means lower damages.
- ▶ Secondly, if the UK's new Prime Minister Theresa May delivers on her pledge that "*Brexit means Brexit*", HM Treasury may find itself having to decide whether the UK should depart from the IFR when it comes to domestic fee caps. If that does happen, the CAT's judgment will certainly be persuasive for those arguing for higher caps.

Unsurprisingly, therefore, MasterCard's short press release after the judgment notes simply that *"the court concluded that a lawful level of credit interchange for the UK market would be over 65% higher than the 30bps rate cap imposed in the 2015 [IFR]."*

And some more good news for the card schemes

Remember the other pending actions? The CAT's finding that there has been no pass through, although helpful to other merchants like Morrisons, makes the £19 billion collective action look more difficult. If MasterCard was unable to show that Sainsbury's passed on the charges to its customers, those bringing the collective action will certainly find it challenging to show that the overall customer group suffered an overcharge.

Lawyers bringing that action will no doubt argue their claim covers the whole market, as opposed to Sainsbury's alone. The judgment does offer another ray of light, however. As noted above, when ruling on compound interest, the CAT assumed that 50% of the MIF would have been passed on to consumers. Whilst not entirely clear, it seems to be suggesting such an assumption was appropriate when calculating interest, even though the legal pass-on test had not, itself, been met in this case.

And finally ... some implications for the use of economic experts

The CAT's judgment seeks to make clear that neither of the economists being used as expert witnesses were experts in the field of payments systems. Further *"there was a strong interplay between the legal principles, and the questions the economists were being asked to answer. Because these points were insufficiently clearly articulated and agreed early, both economists found themselves in difficulties that were not of their making."*

The CAT goes on to direct that *"in cases where significant economic evidence is being adduced by economic experts who lack specific expertise in the particular factual field ...the parties need to be especially assiduous in ensuring that the economic experts are: (1) clearly instructed on the legal principles they are to apply, and in particular any assumptions they are being required to make; and (2) Absolutely clear as to the factual material on which their reports are to be based."*

So what next?

Yesterday's judgment, although critical, was just the tip of the iceberg:

- ▶ Expect the action by the other merchants against MasterCard to start again soon, watched closely by those bringing the collective action;
- ▶ We wait to hear whether MasterCard will appeal;
- ▶ The actions against Visa will continue, buoyed by a good result for Sainsbury's;
- ▶ Competition litigation more generally will be spurred on by the first successful judgment; and
- ▶ Not content with the level of litigation it has already generated, the EC has an open investigation into Visa's international inter-bank fees that apply when a card holder from outside the Visa Europe territory (e.g. the US) uses their Visa credit card to make a purchase at a merchant in the EEA. Further, last year it announced the opening of a new MasterCard investigation in relation to, amongst other things, inter-bank fees for payments by cardholders from non-EEA countries.

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