

Conflicting counterfactuals: the High Court disagrees with the CAT, ruling that MasterCard's multilateral interchange fees are lawful

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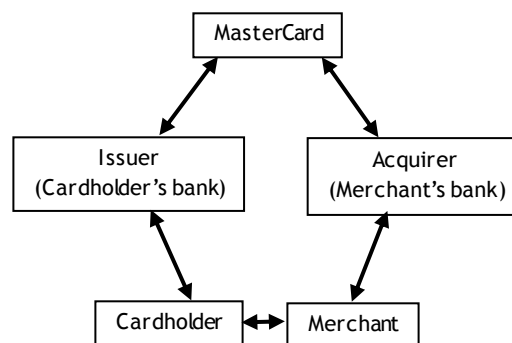
On Monday 30 January 2016 the High Court issued its judgment in *Arcadia & Ors v MasterCard* [2017] EWHC 93 (Comm), finding in favour of MasterCard. This is the latest decision in a series of damages claims against MasterCard and Visa, following findings by the European Commission in 2007 that MasterCard's cross-border European Economic Area (EEA) Multilateral Interchange Fees (MIFs) were in breach of what is now Article 101 of the Treaty on the Functioning of the European Union (TFEU). Similar Commission proceedings against Visa were concluded in 2010 by a decision accepting commitments. The subject matter of the UK claims is, however, wider than the interchange fees that were in issue in the EU cases, and the claims cover a largely distinct time period. Accordingly these are not pure 'follow-on' claims and, except where there is a direct overlap in scope, the High Court is not bound by the Commission's findings.

The case concerned substantially similar issues to those addressed by the Competition Appeal Tribunal (CAT) on 14 July 2016 in *Sainsbury's Supermarkets Ltd v MasterCard Incorporated and Others* [2016] CAT 26. In that decision, the CAT found against MasterCard and awarded damages of £68.5 million to Sainsbury's. The decisions were on the same subject matter and made within a little over six months of each other, yet arrived at diametrically opposing outcomes.

Both cases concerned claims for damages by groups of retailers (Arcadia and others before the High Court, and Sainsbury's and others before the CAT) on the basis that MIFs set by MasterCard were in breach of UK, Irish and EU competition law (in particular Article 101 of the TFEU). MIFs are fees set by MasterCard that are paid between acquirers and issuers in a debit or credit card transaction. The Claimants' case

Key parties involved in MasterCard's payment scheme:

- **Merchant:** supplies goods and services to a consumer (cardholder).
- **Cardholder:** presents card supplied by an issuer to a merchant as payment for goods and services.
- **Acquirer:** provides services to the merchant to allow it to receive card payments. The acquirer obtains payment from the issuer, and passes the payment on to the merchant (less a merchant service charge).
- **Issuer:** pays the acquirer for the goods and services (less an interchange fee) and charges cardholders the full value of the transaction.
- **MasterCard:** charges the issuer and acquirer fees to participate in the scheme. Under the Scheme Rules, MasterCard sets the interchange fees (MIFs) which are to apply in the absence of a bilateral agreement between the acquirer and the issuer.



(consistent with the arguments of the Commission in its investigation) was that the MIF acts as a floor on the price that merchants have to pay for accepting cards and that, by creating such a floor, MasterCard unlawfully restricted competition on the market between acquirers and merchants, with the result that merchants had to pay more than they would otherwise have done to accept MasterCard's credit and debit cards.

In order to determine whether the MIFs were anticompetitive and, if so, the correct approach to quantifying damages, both courts agreed that they had to consider whether the MIFs restricted competition in comparison to a counterfactual scenario where the MIFs did not exist (or existed in some other less restrictive form). The different overall conclusions reached by the High Court and the CAT are a direct consequence of the different conclusions that they reached as to the appropriate counterfactual scenario.

The High Court counterfactual

The High Court considered (and the parties agreed) that the only realistic counterfactual scenarios for the purposes of its analysis were either (a) that MasterCard set a zero MIF or (b) that MasterCard set a positive but lower MIF as the maximum putatively lawful MIF. It then fell to be determined whether, as MasterCard contended, in those scenarios the MasterCard scheme would not be able to continue to exist because issuers would switch away from MasterCard to a higher-paying Visa scheme (this was referred to as the "death spiral" argument). MasterCard argued that this would be the case and that therefore the MasterCard MIF as it actually applied could not be seen as imposing a greater restriction on competition as compared to a situation where MasterCard would be forced to exit the market altogether.

In order to reach a view on these issues the High Court had to decide what competition MasterCard would, in the counterfactual scenario, have faced from its main rival Visa in the inter-system market (i.e. the market in which MasterCard and Visa compete to attract issuers and acquirers). A key question was therefore the level that the Visa MIFs would be set in the counterfactual world: if they were set at 'actual' levels (i.e. the levels at which Visa had actually set its MIFs in the 'real' world), the court accepted that a MasterCard scheme with zero MIFs or materially lower MIFs than Visa would not survive because all of its issuers and acquirers would switch to the Visa scheme, which offered higher fees. If, however, the Visa MIFs in the counterfactual world were set at a level that was identical to MasterCard's MIFs, then this "death spiral" effect would not arise.

The Claimants argued that the court should assume that the Visa MIFs were unlawful to the same extent as MasterCard's, because the schemes were materially identical. Therefore, the court should not assume that the Visa MIFs would have been set at 'actual' levels in the counterfactual world. The court accepted that, if the schemes were materially identical, then the Claimants' approach would be correct. However, it considered that the Claimants had not put forward sufficient evidence to establish on the facts that this was the case. In the words of Popplewell J, "They shied away from asking me to make any findings about the lawfulness of Visa's MIFs... [T]hey could have adduced and relied on the necessary evidence in relation to the Visa scheme and invited me to make findings about the lawful level of Visa MIFs by reference to that evidence, at least so as to establish material identity."¹

¹ *Arcardia & Ors v MasterCard* [2017] EWHC 93 (Comm), [214].

The court therefore set the counterfactual Visa MIFs at their actual level, leading to the conclusion that, absent a MIF, the MasterCard scheme would collapse because MasterCard's issuers and acquirers would switch to Visa. The court therefore found that the MIFs were not a restriction on competition and were necessary for the operation of the MasterCard scheme. This in turn led to an analysis of the maximum level at which MasterCard could set the MIF before it would become more than would be necessary to keep the scheme in operation, such that it would be exempted under an Article 101(3) analysis. The 'exemptible level' for the MIFs was found to be, in almost all scenarios, higher than the MIFs charged by MasterCard in the relevant period and, for this reason, the MIFs were generally found not to constitute an unlawful restriction on competition.

Comparison to the CAT approach

The CAT in the Sainsbury's decision had also considered that in the counterfactual world the Visa MIFs should be set at their actual level, although for different reasons. However it then concluded that the most likely counterfactual was that, faced with a zero MIF, MasterCard issuers would not switch to Visa (despite the availability of higher fees) and would instead negotiate bilateral interchange fees with each acquirer participating in the MasterCard scheme in the UK. In the CAT's view this was (at least in part) because large merchants would be willing to pay a positive MIF to accept MasterCard to avoid the market becoming dominated by a Visa monopoly. With this counterfactual in mind, the CAT then determined, based on the economic evidence before it, that the bilateral interchange fees that would be negotiated would be 0.5% for credit cards and 0.27% for debit cards (significantly below the rates that had been charged by MasterCard in the relevant period). For this reason, it considered the MasterCard MIFs to represent an unlawful restriction on competition.

The High Court judgment considers the CAT approach to the counterfactual but ultimately rejects it. In reaching this conclusion Popplewell J noted that this counterfactual scenario had been developed by the Tribunal itself and had not been put forward by any of the parties in that case. As a result, and in contrast to the High Court hearing, this approach "was not addressed by the factual witnesses, or put to them in evidence, nor had it been addressed in the expert reports... It has been put to the experts by the Tribunal in the course of their evidence, but without it having formed part of the case for which they had prepared. Both experts rejected it."² The High Court provided a number of reasons for rejecting the CAT's counterfactual analysis, but its central argument was that, given the number of parties involved in the MasterCard scheme, it considered that it was unrealistic to think (a) that merchants would individually agree to pay higher fees in order to secure the continued operation of the MasterCard scheme; or (b) that it would be practical to negotiate the large number of bilateral arrangements that would be required.

Analysis

Although the court, as it noted, is not formally bound by the findings of the Commission in relation to the major part of the claims under consideration, it is nonetheless surprising that, against the background of an extensively litigated Commission decision finding that the EEA MIFs did restrict competition, the High Court has reached a conclusion that the UK MIFs did not have the same effect.

² Ibid, para 138.

The court notes that there is only a very small overlap in the time period covered by the damages claim and that of the Commission decision, and that there are a number of factual differences in the market structure and the operation of the MasterCard scheme during the two periods. However, the root of the issue here appears to have been the Claimants inability - or unwillingness - to adduce sufficient evidence of material similarity between Visa and MasterCard to convince Popplewell J to assume a lower Visa MIF in the counterfactual scenario.

Even if the Claimants had been able to establish this point, the approach of the High Court to the counterfactual would have still been different to that adopted by the CAT. This is perhaps less surprising given the lack of support for the CAT approach from any of the parties to the High Court case. However, the CAT was formed as a specialist judicial body to hear and decide cases involving competition or economic regulatory issues; the High Court itself recommended that the Sainsbury's case be transferred to the CAT in early 2016. In the referral decision, Barling J reflected on the often complex and technical nature of competition litigation, and the importance of multidisciplinary panels (including for example, economists and industry experts) when attempting to understand and resolve these difficult issues.³ The Sainsbury's case was considered particularly appropriate for referral due to the inherent complexity of the issues, and the considerable degree of economic evidence and argument that would be required.⁴

It is also not clear that, even if the Claimants had managed to establish that the schemes were materially identical, this would have been determinative of the outcome given that the court concluded on the alternative counterfactual (a positive but lower MIF) that the MIFs in issue were largely set below the level at which they could be exempted under Article 101(3). Given its conclusions the court did not ultimately have to reach a view on which of the two counterfactual analyses it preferred.

The courts are clearly facing difficulty in determining the issues in relation to MasterCard in isolation of those in relation to Visa. The issues in this regard are explored to some extent in the High Court decision although Popplewell J ultimately concludes that, whilst the court is reluctant to reach a conclusion that may "give rise to a risk" of inconsistent findings, this is sometimes unavoidable and reflects the fact that sometimes the evidence and/or the parties are not the same. He also notes that this outcome in this case is not an accident of case management; none of the parties wished for the Visa and MasterCard cases to be heard together.⁵

The case appears to have had an impact on the parallel litigation brought by the same retailers against Visa; one week before concluding arguments were due to be heard, Visa has reached an out-of-court settlement with most retailers. However, Sainsbury's has not entered into a settlement with Visa. It therefore remains possible that this case will lead to the development of yet another counterfactual.

³ *Sainsbury's Supermarkets Ltd v MasterCard Incorporated and Others* [2015] EWHC 3472 (Ch), para 15.

⁴ *Ibid*, para 19.

⁵ *Supra* note 1, paras 212 - 214.

Both the Arcadia and Sainsbury's cases are expected to be appealed to the Court of Appeal (the outcome of the appeal application in the Sainsbury's case is currently pending). Given the divergence of outcomes in cases involving the same conduct it seems appropriate for the Court of Appeal to exercise its powers to consolidate the proceedings and hear the appeal cases together.

The outcome of these cases could also impact on the collective proceedings against MasterCard brought by Walter Merricks on behalf of 46,200,000 individuals in July 2016. Those proceedings combine actions for damages arising from the Commission's infringement finding that MasterCard's cross-border EEA MIFs were in breach of Article 101.⁶ This is a 'follow-on' damages action and as such the Commission's finding of infringement will be binding, but in quantifying any award of damages the UK court is likely to need to address similar issues concerning the charges that might have been levied in a counterfactual scenario.



Isabel Taylor
T +44 (0)20 7090 4315
E Isabel.Taylor@slaughterandmay.com



Jonathon Slade
T +44 (0)20 7090 4303
E Jonathon.Slade@slaughterandmay.com



Sophia Haq
T +44 (0)20 7090 3804
E Sophia.Haq@slaughterandmay.com

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⁶ Case COMP/34.579 MasterCard, COMP/36.518 EuroCommerce and COMP/38.580 CommercialCard, Commission Decision of 19 December 2007.