

Sainsbury's claims damages from MasterCard breach of the Competition Act

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Competition analysis: Richard Pike, partner in the Constantine Cannon LLP's antitrust and litigation and counselling practice groups, examines the decision in *Sainsbury's Supermarkets Ltd v MasterCard Incorporated and Others*, and explores whether the multilateral interchange fees (MIFs) were able to restrict or distort competition.

Original News:

Sainsbury's Supermarkets Ltd v MasterCard Incorporated and others - [2016] All ER (D) 126 (Jul)

Competition—Rules on competition. The Competition Appeal Tribunal held that the MasterCard payment scheme, whereby merchants who accepted payments from customers using a MasterCard were charged a fee by licensee banks within the scheme to process those payments, and the rate of those charges were set by MasterCard, amounted to an agreement between undertakings and was a restriction of competition by effect in infringement of Article 101 TFEU.

On what grounds has the Competition Appeal Tribunal (CAT) ruled that MasterCard's actions fell within Article 101(1) TFEU?

The first issue that the CAT had to address was whether there was an agreement between undertakings, concerted practice or a decision of an association of undertakings. It was common ground between the parties that the previous Court of Justice judgment was binding as to the conclusion that MIFs were set as decisions of an association of undertakings until 19 December 2007. As to the period after that, the CAT decided it did not need to reach any conclusion on whether MIFs continued to be set as decisions of an association of undertakings because it was clear that they were, in any event, set by way of an agreement or agreements between MasterCard and its licensees.

The CAT then addressed the question of whether the MIFs were in breach of Article 101(1) TFEU because they had the 'object' of restricting competition. This point had been left open by the European Commission and Court of Justice in the earlier proceedings relating to cross-border MIFs. The CAT concluded that there was no 'by object' infringement for various reasons including that the anti-competitive effects were not necessarily obvious or intended. Since there was no infringement by object, the CAT had to move on to consider whether the MIFs had the effect of restricting or distorting competition.

How has the CAT approached the question of whether the UK MIF has the effect of restricting competition?

The CAT approached the task of assessing the effect of the UK MIF by asking what would have happened if there had been no MIF. One of the important conclusions reached by the CAT was that interchange fees would have been set through bilateral agreements between issuing and acquiring banks. The CAT concluded that the number of banks involved was sufficiently small that it would have been practical and that there were ample incentives for both issuing and acquiring banks to enter into negotiations. The approach taken by the CAT was rather different to that followed by the European Commission in the earlier decision in that it concluded there was no need to hypothesise a new so-called 'prohibition on ex post pricing' because issuing banks would not be allowed to charge anything under the existing MasterCard terms unless they entered into new bilateral agreements. This was enough to drive them to negotiate.

Having concluded that there would be bilateral agreements, the CAT then considered what level of interchange fees would have existed as a result. MasterCard argued that they would have been at least as high as the UK MIF because it would have had to compete with MIFs set by Visa. Sainsbury's argued that if MasterCard's MIF was illegal then the same would be true of Visa's MIF so it should not be assumed that Visa's MIF would stay at the same level. The CAT rejected Sainsbury's position but still concluded that Visa's higher MIF would not prevent the bilateral agreement of much lower MasterCard interchange rates. Its view was that the MasterCard interchange fees bilaterally agreed would be based in large part on the costs incurred by the issuers in providing elements of card services that benefitted the merchants. This focus on the costs of issuers rather than the cost to merchants of accepting alternative forms of payment is different to how the EU authorities have approached interchange in the context of the new Interchange Fee Regulation (EU) 2015/751. Having concluded that there would have been much lower interchange fees without the UK MIF, and probably also novel fee structures, it followed almost automatically that the UK MIF restricted competition.

Why doesn't Article 101(3) TFEU apply?

The CAT dealt with the Article 101(3) TFEU arguments very briefly because they are only relevant if the conduct infringing Article 101(1) TFEU can be said to provide some benefits to balance out the restriction of competition. Here, however, the CAT concluded that the MIFs actually set were not exemptible because they offered no benefit over its counterfactual of bilaterally agreed interchange fees at a lower level. Further, it concluded that a level of MIF based on the issuer costs it had calculated could only be potentially exemptible if bilateral agreements were unlikely, because it would otherwise preclude or substantially inhibit the conclusion of bilateral agreements that would otherwise have occurred.

Why did MasterCard's illegality defence in relation to Sainsbury's bank fail?

MasterCard argued that Sainsbury's should not be able to recover anything because Sainsbury's bank had participated in and gained from the illegality itself in that it issued credit cards using the MIFs and received MIFs as a result. The judgment considers the case law at length but, in summary, it concluded (on the facts) that:

- there was no, or insufficient, 'turpitude' on the part of Sainsbury's bank
- Sainsbury's bank and Sainsbury's could not be treated as being part of the same undertaking but even if they were, any infringing conduct on the part of Sainsbury's bank could not be attributed to Sainsbury's
- it could not be said that Sainsbury's bore significant responsibility for the infringement (an additional requirement that had to be met under EU law)

What has the CAT held in relation to passing-on and mitigation of loss by Sainsbury's?

This is the single most controversial part of the judgment. MasterCard argued that Sainsbury's should not be able to recover anything to the extent it had either increased its retail prices or reduced its costs to mitigate the effect of the MIF. On mitigation, the CAT concluded that no account could be taken of anything that Sainsbury's could be expected to have done anyway and that it would be necessary to show a clear causal connection between the MIFs and the alleged mitigation, which MasterCard could not do.

On passing-on, the CAT accepted that passing-on must be taken into account in the assessment of damages so as to avoid over-compensation of the claimants or over-payment by the defendants. It, however, set the legal bar for proving it at a very high level, by only including 'identifiable increases in prices by a firm to its customers' that are 'causally connected with the overcharge, and demonstrably so'. Further, the CAT considered that there should be no deduction

unless the defendant has shown that there exists another class of claimant downstream to whom the overcharge has been passed on and who would be in a position to claim damages.

Applying this test, the CAT concluded there should be no reduction for passing-on. It considered that MasterCard had not established any identifiable increase in retail prices and still less one that is causally connected to the UK MIFs. It also considered that MasterCard had not identified any downstream group that would be in a position to claim damages. This conclusion on passing-on is likely to have significant consequences for all competition damages claims in the UK courts and not only claims in relation to interchange.

How has the CAT determined the quantum (including the discounts in relation to Sainsbury's bank)?

The starting point was to compare the interchange actually charged with what the CAT concluded would have been charged under bilateral agreements (as assessed in considering whether there was an effect on competition). Although the CAT considered it likely that novel structures of charging would have developed in bilateral agreements, it decided to use the same average figure that it had assessed at the earlier point of the judgment, which was 0.5% for MasterCard credit card interchange fees. It also calculated a counterfactual interchange fee for debit cards but this involved much less reasoning since it was a small part of the claim by Sainsbury's against MasterCard.

Having calculated the overcharge by comparing the actual and counterfactual interchange fees, the CAT then considered whether Sainsbury's had received any benefits as a result of the MIF that it would not have received in the scenario of bilaterally agreed interchange fees. The CAT rejected the argument that the benefits provided to merchants generally would have been different, or that card usage would have been less because of worse terms being offered to cardholders, but concluded that Sainsbury's had received benefits from Sainsbury's bank that it would not have received absent the MIFs. The CAT decided to value these benefits by reference to the value of the unlawful MIFs received by Sainsbury's bank. The CAT also identified a further possible source of benefit in that Sainsbury's may have had to pay higher taxes if its profits had been higher as a result of paying lower interchange fees. Argument on this point was left for a later date.

After calculating the overcharge and deducting the benefits received from Sainsbury's bank, the CAT then considered the question of interest. The CAT took a rather unusual approach to interest. Despite not allowing any deduction for passing-on earlier in the judgment, it concluded that it would only allow interest on half the damages because it was likely that half of the loss was actually passed on in a general (rather than legal) sense through higher prices to consumers. Sainsbury's argued that the rate of interest should be based on its actual cost of capital and had asked the CAT to use the so-called weighted average cost of capital (WACC) approach that is used in corporate finance theory and in setting price controls in regulated industries.

The CAT refused to use the WACC approach as it considered it to be a theoretical construct that did not reflect the real world situation of Sainsbury's. The CAT sought instead to estimate approximately how Sainsbury's cash reserves and debt would have been affected if it had not paid the UK MIFs. For the remaining half of the damages, the CAT ordered that interest be payable for 20% of it at the rate Sainsbury's earned on its cash balances and 30% at the rate it paid on its debts. This again, is a totally novel approach. It ordered the interest to be compounded quarterly.

Is it likely that MasterCard will appeal this judgment and on what basis?

On the face of it, an award of more than £68m in damages would normally make a defendant think seriously about bringing an appeal. The fact that the judgment is also relevant to many other ongoing proceedings might also seem to increase the attractiveness of an appeal. At the same time, though, the judgment is not all bad for MasterCard and, to the

extent it is unfavourable, MasterCard may prefer that the points remain only in a non-binding first instance decision rather than being confirmed by an appeal court in a binding judgment. If MasterCard is seriously concerned about the consumer collective action that has been filed, it may also consider that the damages paid to Sainsbury's are a small price to pay to gain a judgment that appears to be so damaging to the collective action.

On balance, though, it is still quite likely that MasterCard will seek permission to appeal. The conclusions on passing-on, if followed in other proceedings, could substantially increase MasterCard's exposure in claims by merchants. If, as I suspect is likely, MasterCard is more concerned about those claims than the consumer collective action, it may put more weight on the possibility of reducing those claims than on any possible impact on the consumer action. There are also a number of respects in which the CAT has differed from the approach taken by the European Commission and Court of Justice, such as on the counterfactual, where MasterCard might consider it had reasonable prospects of bringing a successful appeal, but to do so would be risky given that the ultimate result could be worse if following the EU approach.

Of course, it is also possible that Sainsbury's might appeal. Sainsbury's might fancy its chances in relation to interest given the novelty of the approach taken by the tribunal and the arguable inconsistency with the earlier conclusions on passing-on. Sainsbury's might also think that it could establish a lower counterfactual interchange rate for credit cards by trying to persuade an appeal court to follow the EU approach rather than basing the counterfactual primarily on issuer costs—though that may be challenging given that an appeal is only possible on points of law.

What does this judgment mean in relation to other claims lodged (both before the High Court and the CAT) against both MasterCard and Visa?

This judgment is not strictly binding on any other court hearing claims against MasterCard and Visa but is sure to be taken into account. Other judges would normally be reluctant to take a different approach on substantially identical facts. If the same approach is followed, it is likely to be positive for claims in relation to credit card interchange fees against both MasterCard and Visa. The counterfactual interchange fee level is higher than sought by claimants (at 0.5% compared to the 0% to 0.3% sought by claimants) but the high threshold established for passing on is likely to more than balance that in the assessment of most claimants (even though the actual extent of passing on will remain a question of fact in each case). More generally, the approach of the CAT to liability will give claimants added confidence that their claims are likely to succeed. In that respect, it is difficult to see any sensible basis for distinguishing between Visa and MasterCard.

The position in relation to debit card interchange fees is different. As debit card interchange fees were not really the focus of the Sainsbury's litigation against MasterCard, it is unlikely that other courts will put much weight on the conclusions reached by the CAT in that regard. Debit card issues are likely to be dealt with afresh in the litigation against Visa (Visa having a very high market share in debit cards in the UK).

Will this judgment have any impact on the pending collective action that is expected to be lodged against MasterCard (especially in relation to passing-on)?

As already noted, the Sainsbury's judgment is not strictly binding on any other court but, to the extent it is given weight, it is certainly problematic for the proposed collective action. The finding that, in legal terms at least, there was no passing on would appear to leave consumers with no claim for damages at all. If I were acting for them, though, I would put more weight on the comments in relation to interest where it was said that there probably was, in fact, something like 50% pass-through of the overcharge in economic if not legal terms.

Interviewed by Diana Bentley.

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