Moncton Chambers

Landmark Supreme Court Judgment on Interchange Fees

Sainsbury's Supermarkets Ltd v Visa Europe; Sainsbury's Supermarkets Ltd v Mastercard; and Asda, Argos & Morrisons ('AAM') v Mastercard

Khatija Hafesji, Barrister, Monckton Chambers

Mark Brealey QC *appeared for Sainsbury's, instructed by Mishcon de Reya and Morgan, Lewis & Bockius.*

Jon Turner QC, ***Meredith Pickford QC*** *and* ***Laura Elizabeth John*** *appeared for Asda, Argos and Morrisons, instructed by Stewarts.*

Tom Sebastian *appeared for the European Commission.*

On 17 June 2020, the Supreme Court (Lords Reed, Hodge, Lloyd-Jones, Sales and Hamblen) handed down a landmark judgment on whether certain fees which are paid by merchants to banks under the Visa and Mastercard payment card schemes breach competition law. The judgment finally settles years of litigation in the UK courts, and deep divisions in the rulings which had been given in the lower courts and tribunals. It is also the first judgment of the Supreme Court dealing with the Court of Appeal's powers of remittal.

Background

Visa and Mastercard operate payment card schemes which enable consumers to pay retailers for their purchases using credit or debit cards. Under these schemes, there are four parties: card issuers; cardholders; merchants; and merchant acquirers (generally, these are the merchants' banks). The c*ard issuers* issue payment cards to cardholders. *Cardholders* use the cards to purchase items from *merchants*. The merchants rely upon *acquirers* (usually banks) to provide them with a service which allows them to accept the card payment [9].

The acquiring bank provides this service to merchants in exchange for a fee, known as the merchant service charge ("**MSC**"). There is also a fee which the acquiring bank pays to the issuing bank per transaction, and which is deducted from the payment that the issuing bank makes to the acquiring bank to settle the transaction [11]. This inter-bank fee is not justified as a payment for services that the issuing bank provides to the acquiring bank (or, indirectly, to the merchants

who use the acquiring bank), although in the past it has been described in those terms. It is justified as a tool of the payment system, transferring costs from one side of it (the card issuers and their cardholder customers) to the other side (the acquirers and their merchant customers). It is called the interchange fee. Since the arrangements governing it are a rule of the payment scheme, it is called a "multilateral interchange fee" ("**MIF**"). The MIF applies unless individual card issuing banks strike bilateral deals with individual acquirers for payment of interchange fees. The MIF is therefore also called a "default" fee, even though in practice bilateral deals are almost never concluded.

Regulatory and Appelate History

On 19 December 2007, the European Commission issued a decision that cross-border MIFs operated by Mastercard were contrary to EU competition law (see Decision C (2007) 6474 in Cases COMP/34/579 – Mastercard, COMP/36.518 – EuroCommerce, and COMP/38.580 – Commercial Cards) [23]. That public law decision was followed by appeals before the European Courts, which culminated in a ruling by the Court of Justice of the European Union in September 2014 (Case C-382/12P). Meanwhile, in the UK courts, and in the Competition Appeal Tribunal, various retailers began private law claims for damages against Mastercard and Visa claiming breaches of competition law.

Three substantial judgments were given at first instance: a judgment of the Competition Appeal Tribunal, in proceedings between Sainsbury's and Mastercard; a judgment of the Commercial Court (Popplewell J) in proceedings between a group of retailers including Asda, Argos and Morrisons, and Mastercard; and a judgment of the Commercial Court (Phillips J) in proceedings between Sainsbury's and Visa.

All three first instance decisions came to radically different conclusions on the applicable legal principles, including on the relevance of, and whether or not the courts were bound by, the conclusions of the CJEU in Case C-382/12P.

The appeals in all three sets of proceedings were heard together by the Court of Appeal, which broadly agreed with the retailers who were arguing that the MIF rules of Mastercard and Visa were unlawful.

There were five issues before the Supreme Court on appeal.

(1) The Restriction Issue

The Court of Appeal had found that it was bound to follow the judgment of the Court of Justice in the *Mastercard* appeal (Case C-382/12P) which upheld the Commission's decision finding an infringement of Article 101(1) TFEU. The Supreme Court similarly rejected the Appellants' argument that the judgment

was distinguishable on the facts from these appeals: [73-79].

The Supreme Court also held that even were it not bound by the CJEU, it would nevertheless have come to the same conclusion itself [94]-[95].

The merchants had argued that the MIF restricts competition between acquiring banks by inflating the base upon which acquiring banks set charges to merchants. This effectively sets a "floor" beneath the MSC, which does not reflect the individual acquiring bank's cost base and mark-up but takes as its starting point the artificial cost base of the MIF. The common knowledge amongst the acquiring banks of the rate of the MIF nullifies the power of the merchants to bargain below the common price floor. In the absence of the default MIF, the MSC would therefore be lower.

The payment schemes had argued that the MIF is not a restrictive arrangement: it is just a default term of the system for settling transactions, which does not affect the intensity of competition in any way. In the absence of the MIF (i.e. settling at the face value of the payment transaction, equivalent to a "zero-rated MIF"), there would be no process of competition as to that default term of settlement (zero), and therefore no bilateral agreements between banks on interchange fees. They said that this was just the same as the situation with a MIF: it is a common and transparent cost which is also a default term of settlement over which there is no bargaining. It is like an "excise tax", not a price or a charge. There is accordingly no difference in the competitive process and no restriction on competition [54].

The zero-rated MIF argument was rejected by the Supreme Court. The MIF sets a "floor" on the MSC, or a minimum price which is non-negotiable and immune from competitive bargaining. Acquirers have no incentive to compete over that part of the price as it is a known common cost which acquirers know they can pass on in full and which merchants cannot negotiate down. It is not the high prices resulting from the MIFs which are in themselves restricting competition; it is the fact that they arise from a collective agreement and are non-negotiable. Settlement at par also sets a "floor", but this floor reflects the face value of the transaction rather than a floor set by common agreement. In the counterfactual (assuming the MIF does not exist), the entirety of the MSC is open to competitive bargaining rather than – in a world where the MIF does exist – only a portion of it. The effect, therefore, is a restriction on competition [100-104].

Comment: There are two issues of interest here. The first is the Supreme Court's treatment of the earlier House of Lord's authority of *Crehan v Inntrepreneur Pub Co* (CPC) (Office of Fair Trade Intervening) [2006] UKHL 38, which confirmed that Commission decisions are only binding upon those to whom they are addressed and that national courts are therefore only bound where the parties before them are addressees of the decision. The Supreme

Court held that there is a difference between the decisions of the Commission, and judgments of the EU Courts which are legally binding where – as here – the relevant facts are materially identical and so the legal principles articulated by the EU Courts undoubtedly apply.

The second point of interest is that the Court distinguished the CJEU's judgment in *Budapest Bank* (C-228/18 *Versenyhivatal v Budapest Bank Nyrt* Case), which was handed down after the hearing and which the payment schemes strenuously sought to rely on, on the basis that it concerned a restriction by object, a different type of MIF agreement, and a different counterfactual [88].

(2) Standard of Proof Issue

The payment schemes (Appellants) also argued that the Court of Appeal had wrongly decided that there is a specific requirement for "robust and cogent evidence" from a defendant seeking to rely on Article 101(3), which sets a more onerous standard than the ordinary domestic civil standard of proof (on the balance of probabilities), and that there is a legal requirement for facts and empirical data [106].

The Supreme Court dismissed this ground of appeal [138]. It was common ground that the burden of showing that the exemption is engaged sits with the defendant seeking to rely on it [107]. The Appellants' complaints did not concern the standard of proof, but rather the nature of the evidence required to meet the standard of proof [115]. Article 101(3) imposes its own requirements as to the <u>nature of the evidence</u> that can discharge the burden to establish an exemption under that provision, which is imported into domestic competition law by the 1998 Act. Moreover, cogent empirical evidence is needed to carry out the evaluation of the claimed efficiencies and benefits which Article 101(3) requires [116].

Comment: The essential issue here was whether it was properly a matter for national law to determine the standard of proof, or whether it was a question of EU law. The Supreme Court drew a distinction between the standard of proof (which must be set by national law) and the type of evidence which is required to meet that standard (which is determined by EU law and set out in Article 101(3) TFEU).

(3) The Fair Share Issue

The fair share issue concerns the correct interpretation of limb two of Article 101(3), which states that consumers must receive a "fair share" of the benefits resulting from the restriction of competition. The Court of Appeal agreed with Philips J (sitting in the Commercial Court in *Sainsbury's v Visa*) that in a two-sided market, where there are disadvantages to consumers in the market under consideration (merchants in the acquiring market), those disadvantages cannot

be compensated by advantages to consumers in the other side of the market (cardholders in the issuing market), unless those two groups of consumers are substantially the same (which, in this case, they are not) [144].

The Supreme Court dismissed the appeal on the fair share issue, but for reasons which differed from those given by the Court of Appeal. The Court gave the following "*positive guidance*" [171 onwards]:

- The second condition under Article 101(3) arises only where the first condition is satisfied. In this case in order to satisfy the first condition, it was necessary to show that there are appreciable, objective advantages for the consumers in the market where the restrictive effects are felt, and secondly that the objective advantages to the consumers in both markets, taken together, compensate for the disadvantages which the measures entail for competition [172].

- As for the second condition, the word "consumers" means the direct or indirect consumers of the goods or services covered by the measure which in this case are the merchants. The consumers/merchants must be compensated in full for the adverse effects that they bear owing to the restriction of competition resulting from the measure [173]. The Court drew upon and endorsed the guidance given by Advocate General Mengozzi in *Mastercard*. Given that the second condition is designed to protect the merchants, if they are not fully compensated in their own right, it is difficult to see how they can be said to receive a "fair share" of the resulting benefit [174].

Comment: Without considering it necessary to make a reference, the Supreme Court found that where there is a two-sided market, the benefits in the affected market have to be sufficient to outweigh the detriment in the affected market. This reflected the European Commission's guidance on applying Article 101(3), on which (among other things) the Commission intervened in the Supreme Court to make written and oral representations. In view of the less than clear CJEU judgment in *Mastercard* and the different approach of the Court of Appeal, it is perhaps surprising that a reference was not considered necessary. In any event, the Supreme Court's guidance will be a welcome clarification for the purpose of future cases.

(4) The Broad Axe Issue

Perhaps the most eagerly anticipated aspect of the Supreme Court's judgment is its analysis of "pass on", in the context of the issue of whether the Court of Appeal found, and if so whether it erred in law in finding, that a defendant has to prove the exact amount of loss mitigated in order to reduce damages?

The Appellants had submitted to the Court of Appeal, and subsequently to the

Supreme Court, that whilst they accepted that they bore the burden of proving that pass-on had occurred, they were not required to quantify the extent of any pass-on with precision if such precision could not reasonably be achieved; the court could take a “broad axe” approach. As was obvious to those watching the proceedings in the Supreme Court, the Bench clearly took a special interest in this issue and they invited the parties to make further written submissions on the issue of the burden of proof in the context of pass-on after the oral hearing.

The Supreme Court’s consideration of this issue was in four stages:

First, the Court considered the requirements of EU law as set out in the relevant case law. The Court concluded that in approaching the issue of the quantification of loss, the Court must observe the EU principle of effectiveness (which requires that the rules of domestic law do not make it practically impossible or excessively difficult to exercise rights guaranteed by EU law) [188]. The principle applies to both the procedural and evidential rules by which a court determines whether and to what extent a claimant has suffered loss. This is essentially a question of fact in each case which the national court has to decide [189].

Second, the Court considered the nature of the claims. The Court rejected the written submissions of the Appellants, and concluded that the merchants’ losses are measured by the overcharge in the MSC, rather than by their loss of profit [199]. This is partly because there are numerous ways in which a merchant may respond to mitigate against an overcharge, and not all of these responses will necessarily be reflected in the merchant’s profits. Profitability, therefore, is not always a reliable indicator of loss [205]. Although claimants are allowed to claim the overcharge in the MSC as their measure of loss, if they have taken any measures to mitigate their loss (for example by increasing their prices or responsively renegotiating their input costs with their own suppliers), then the court is entitled to consider what the effect of these mitigating measures may have been on the merchant’s losses [206].

Third, the Court considered mitigation and the burden of proof. The Court found that as a matter of law the burden is on the defendant to show that the claimant has mitigated their loss [211]. To find otherwise may place an insurmountable burden on the claimant to establish their claim and so offend the principle of effectiveness [209], and such an approach may result in the claimant being undercompensated where they have mitigated their losses in a way that has not boosted their profits (for example, where the claimant made savings to their business expenditure by reducing their marketing budget) [210].

The Court’s conclusion at paragraph 216 is significant, and is quoted here in full:

> “The legal burden lies on the operators of the schemes to establish

> that the merchants have recovered the costs incurred in the MSC. But once the defendants have raised the issue of mitigation, in the form of pass-on, there is a heavy evidential burden on the merchants to provide evidence as to how they have dealt with the recovery of their costs in their business. Most of the relevant information about what a merchant actually has done to cover its costs, including the cost of the MSC, will be exclusively in the hands of the merchant itself. The merchant must therefore produce that evidence in order to forestall adverse inferences being taken against it by the court which seeks to apply the compensatory principle." (emphasis added)

Fourth, the Court considered the degree of precision required. The Court held that whilst precision is desirable, the overriding objective requires the courts to deal with cases justly and at proportionate cost even if this is at the expense of precision. Estimation can be sufficient even where a greater degree of precision can be provided (but at disproportionate expense) [217]. The Supreme Court therefore rejected the Court of Appeal's finding that when assessing compensatory damages, there should be a greater degree of precision where the defendant bears the burden of proof [219].

Comment: The judgment regarding the "broad axe" and pass-on issue will be of considerable interest to all defendants claiming pass-on as it has clarified their evidential burden and firmly placed the onus of disclosure upon the claimant. The Court's findings on the burden of proof and the degree of precision required appears to have been informed, at least in part, by the appeal in *Merricks*, an indirect purchaser claim against Mastercard, which was heard by the Supreme Court in May 2020 (judgment is currently pending). The Court had in mind that whatever threshold is set for defendants to establish pass-on will be the same as that which must be met indirect purchasers [224], and the threshold set for indirect purchasers must comply with the principle of effectiveness.

Finally, the question of causation and quantum remain live in both the AAM and Sainsbury's claims, therefore the Court's finding that the question of legal causation is "*straightforward in the context of a retail business in which the merchant seeks to recover its costs*" [215] may be expected to feature prominently in any future hearings in these claims. What is of interest is whether there is space under the approach outlined by the Supreme Court for looking at detailed evidence of how a retailer set its prices, and the economic relationship between any price increases/decreases and the fact that the retailer covered their costs.

(5) Remittal

The final issue concerned AAM's cross-appeal. Even though Asda, Argos and Morrisons should have won outright in their trial against Mastercard at first instance, according to the Court of Appeal, the Court of Appeal decided

it was appropriate to remit the question of whether Mastercard's practices were justified under Article 101(3), so that they would be reconsidered by the CAT alongside Sainsbury's cases (there had been no parallel finding that Sainsbury's should have won outright).

The Supreme Court agreed with AAM that the Court of Appeal was wrong to do this, as it allowed Mastercard to re-open an issue which it had lost after a full and fair trial. This offended against the strong principle of public policy and justice that there should be finality in litigation [237]. Therefore AAM's cross appeal was allowed [247].

Comment: This was a radical and important decision concerning the Court of Appeal's power of remittal, and its limits. The parties did not identify any case where a court had previously done what the Court of Appeal did in this case. It is at first difficult to understand the Court of Appeal's thinking. It appears that it may have been swayed by the public policy context of competition litigation, which requires the court to consider a counterfactual and imagine what an entire market would look like but for the breach. In constructing such a counterfactual, there is an obvious advantage to having as many market players providing evidence as possible, and to reach a judgment based on market-wide evidence across numerous sets of proceedings.

However, the Supreme Court's judgment confirms that even in this specialist context, the task which the court is performing remains an adversarial one, not inquisitorial.

Click here and here for the judgment. Click here for Supreme Court summary.

The case attracted much media attention: The Lawyer, The Telegraph, Finextra, Bloomberg Quint, Retail Systems, Law 360, The Times Law Report.

The comments made in this case note are wholly personal and do not reflect the views of any other members of Monckton Chambers, its tenants or clients.

(all references in the form [x] are to paragraphs within the judgment)

Monckton Chambers
1 & 2 Raymond Buildings
Gray's Inn
London, WC1R 5NR

Tel: +44 (0)20 7405 7211
Fax: +44 (0)20 7405 2084
Email: chambers@monckton.com
www.monckton.com