

1 European Commission that a representative sample for
2 undertaking a cost study in a given market would be
3 achieved if the participating banks would account for at
4 least 70% of the transaction volume in the market.
5 Edgar Dunn & Company has applied the same rationale for
6 the selection of participants in the UK market."

7 Now, just pausing there. I understand that those
8 names in table 1 are confidential. If you then go to
9 what Mr Sidenius said about this when I asked him. So
10 if you go back -- this is now page 24 of the transcript,
11 page 1395. If we pick this up at line 12. This is the
12 sample size. Then I read it out. Then over the page at
13 1396, line 6.

14 "Question: So there you are concentrating on the
15 largest issuers and transactional volume, correct?"

16 "Answer: As part of the selection for the study,
17 yes.

18 "Question: Then you go on, I will ask you about
19 this ..."

20 Then I read out what I have just read out in court
21 and you can see what he says at the bottom:

22 "Answer: That goes back many years ago. That was
23 when we started ..."

24 He goes on, if you want to read that. Then picking
25 this up at 1398, page 27:

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1 "Answer: So in reference to this, the 70% was
2 a minimum requirement. We have tried always where we
3 could to go higher than that --

4 "Question: Pausing there. 70% was sufficient for
5 a robust study?

6 "Answer: Well, for the purposes of the Commission.
7 But you should compare that to markets such as ..."

8 And he goes to Norway, and then down at line 17,
9 I ask him to look at table 1, which is the confidential
10 table which I have just referred to:

11 "Question: There is seven is there? There is
12 seven. They are the issuing banks. I mean, they seem
13 quite large to me."

14 I'm saying:

15 "Question: Clearly in the UK, even at that time,
16 you had other banks."

17 Then I set out the various other banks:

18 "Question: Why pick those big seven and exclude the
19 smaller ones?"

20 "Answer: We are seeking representative samples of
21 transactional activity. That's what the Commission
22 asked us to do and that's how we chose the sample.

23 "So as you can see, this was over 90% of all the
24 domestic transactions in the UK. That would be, in all
25 instances I have come across, deemed to be a very

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1 representative sample."

2 So again I'm emphasising here the large people:

3 "Question: So picking the largest you thought was
4 a representative sample?"

5 "Answer: Yes."

6 Again, you are relying in your report on this report
7 which has taken large issuers as a representative
8 sample. So why do you exclude it when you rely on the
9 Deloitte's survey?

10 A. I think again there is not really -- it is not really
11 the right comparison. In the issuer cost study I think
12 again it is an established method etc and the idea is to
13 get a good picture of what the issuer costs are. In
14 terms of 'are there biases therefore'; well, possibly.
15 If there is a significant bias from looking at the
16 largest merchant, then probably it is that -- sorry, at
17 the largest issuers, then probably it is that the
18 smaller issuers have higher costs, if anything, I think
19 Mr Sidenius has also said that in his evidence.

20 So if anything the result of the EDC, if there is
21 such a bias indeed -- although he also I think says
22 there isn't such a difference, but if there is, then if
23 anything the costs that come out of the EDC cost study
24 are too low because if you include all the smaller
25 issuers of higher costs you would get a higher number.

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1 So there is no risk also from my perspective and I rely
2 on these numbers that we somehow produce a MIF that is
3 too high.

4 For the -- coming back to the MIT, to the EC
5 merchant cost study, it is a different -- it is a whole
6 different -- it is a very different situation. What you
7 are after there is the average merchant. We are not
8 after some representative or typical transaction value.
9 So in that context saying "Oh we just take the largest
10 80% of merchants", which is sort of what they got, or
11 merchants, the very large merchants representing 80% of
12 all transactions is not good enough for MIT purposes
13 because it doesn't give you a good feel for what's then
14 the MIF. So if you rely on that entire sample, which is
15 biased towards the large merchants, you are going to
16 clearly underestimate the MIT because you are -- because
17 those larger merchants have much lower cost of cash
18 handling than smaller merchants.

19 Even within the sample, as we have seen in the
20 evidence of the merchant cost study, you could also see
21 that the very, very large merchant had a much lower cost
22 of cash handling than even the still large but somewhat
23 smaller merchants.

24 So that was for me enough basis to say well, if you
25 had included the even smaller merchants, your cost of

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1 cash handling would be much higher and therefore your
 2 MIT would be much higher. Therefore I felt that it was
 3 correct to make an adjustment for size, taking the EC
 4 merchant cost data, but making adjustment for size to
 5 incorporate -- to take account of the fact that smaller
 6 merchants who were not included in the survey would have
 7 on average substantially higher cost of cash.
 8 Q. We will come onto the average transaction in a moment,
 9 but I will ask you this question: if you are wrong on
 10 that and it is correct to take the average transaction,
 11 do you accept that you are then wrong to exclude large
 12 merchants?
 13 A. The average transaction. So, yes I think that is
 14 incorrect for MIT, but let's say, let's take the
 15 proposition --
 16 Q. It is a simple question Dr Niels.
 17 A. So I have -- so my adjustment is still based on the full
 18 sample, but it excludes the cost of cash of the very,
 19 very large merchant. So I still have in there, in my
 20 MIT, the other -- so the size 6 and size 7 category
 21 merchants, between 20 and 200 million revenue. So it is
 22 basically my MIT, my adjustment there is their MIT based
 23 on their cost of cash handling as mentioned in the
 24 survey.
 25 Now, if they in the survey represented the typical

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1 transaction, as was ours, then that is still captured in
 2 my MIT. So what I'm getting at is I have excluded the
 3 very largest merchant. If the average or typical
 4 transaction takes place at those, then, yes, I accept
 5 that I have excluded it. But if the average transaction
 6 takes place among merchants in size 7, 6 and 7 category,
 7 then I still capture the average transaction.
 8 PROFESSOR JOHN BEATH: Could I just ask for a clarification.
 9 In making your adjustment for large merchants, did you
 10 exclude all the very large merchants?
 11 A. Yes.
 12 PROFESSOR JOHN BEATH: So in a sense what you have done is
 13 to truncate the distribution of costs, haven't you, by
 14 getting rid of the very largest ones?
 15 A. Yes.
 16 PROFESSOR JOHN BEATH: Why didn't you leave some of them?
 17 Because after all what you are after is the average
 18 merchant. Could you explain to me why you did what you
 19 did?
 20 A. Yes. In essence, you have to make some -- you have to
 21 draw the cut somewhere, so I thought it was cleanest to
 22 just --
 23 PROFESSOR JOHN BEATH: You chopped off the top end of the
 24 distribution.
 25 A. Yes, because what we are missing is the other very large

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1 tail end of the distribution of the very small
 2 merchants, which isn't in there at all. I thought
 3 therefore the middle bit, indeed the truncated middle
 4 bit, so merchants of categories 6 and 7, I have taken
 5 those as more likely to be representative of the overall
 6 average than even with some of the very large merchants
 7 included.
 8 PROFESSOR JOHN BEATH: I understand your argument now.
 9 MR BREALEY: If you can put that bundle away, E3.6, and take
 10 out E2. Have a look at another survey that MasterCard
 11 has undertaken. E2, tab 3. Now this is an annex. I do
 12 not think this is confidential. This is DotEcon
 13 economic evidence. This was submitted to the OFT. Do
 14 you recognise this document?
 15 A. Yes.
 16 Q. December 2003. Referred to this at 115 is a merchant
 17 survey. We haven't -- we were refused disclosure of the
 18 whole survey, but we can pick it up on this description
 19 of annex 1. But I note yesterday you said that Oxera or
 20 you were involved in some sort of merchant survey. Is
 21 this the merchant survey you were involved in?
 22 A. No, we did a separate merchant survey at the time in
 23 probably just even before 2003, but this was done
 24 by DotEcon but not by us. DotEcon were advising
 25 Mastercard International in the OFT proceedings.

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1 Q. But you were aware of the survey at the time? Your
 2 client was MMF.
 3 A. Yes.
 4 Q. So if we look at 115. This is a survey. We don't --
 5 unless you want to explain we don't have to go to the
 6 nature of the survey, the purpose of the survey. It was
 7 rejected by the OFT and the European Commission, but I'm
 8 interested in how it was conducted. So this is
 9 a merchant survey undertaken by MasterCard. Page 115,
 10 paragraph 93:
 11 "The sample was drawn randomly from the set of UK
 12 merchants sold directly to consumers turnover 55,000 or
 13 more."
 14 So probably the small corner shops are excluded:
 15 "The sample was drawn ... sampling from 100 plus...
 16 The survey was designed by PwC executed by MORI [and]
 17 a total of 502 merchants completed..."
 18 So that is how it starts. If one goes to
 19 paragraph 100 on 117:
 20 "In order to provide data from organisations of
 21 different sizes as defined by turnover, interview quotas
 22 were set. These quotas were not pro rata."
 23 There you get small, medium and large.
 24 "The sampling, 101, was designed to oversample
 25 merchants with high turnover. If a purely random sample

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1 had been selected without quotas being set for size of
2 business only a small number of organisations, with
3 an annual turnover of 10 million or more, would have
4 been interviewed. While such organisations account for
5 a large proportion of all UK sales they represent only
6 a small fraction of individual businesses. Within each
7 of the three turnover categories companies were
8 conducted randomly with the exception that for large
9 companies a small number of key companies, eg the large
10 supermarket chains, were added to the sample. Such
11 companies account for many billions of sales and it was
12 therefore considered important that each had the
13 opportunity to participate in the study."

14 If you continue with this theme, at paragraph 111,
15 at page 125:

16 "As noted above, the sampling method was designed to
17 ensure that larger merchants who account for a greater
18 proportion of all transactions are well represented in
19 the survey. This inevitably leads to some over and
20 under sampling, not only in terms of turnover balance
21 but also in terms of the representation of different
22 sectors."

23 But again Dr Niels this is an example of MasterCard
24 doing a survey and emphasising the importance of large
25 merchants, do you accept that?

25

1 A. Yes. This is -- again one has to look at the objectives
2 of the survey. So this survey -- and I can't recall the
3 details, but my understanding is this DotEcon exercise
4 was done with I think two main objectives in mind: one
5 was to assess the competitive constraints that merchants
6 imposed on the scheme, so it was that whole question of
7 restriction of competition, is there competitive
8 constraint, because that was a relevant question at the
9 time in the OFT proceedings; and the survey is designed
10 to get a good picture of merchant benefits in general.
11 So from those object -- with those objectives in mind
12 I think it is reasonable at least to get a good
13 representative sample and also to get the larger
14 merchants representing more transactions in the survey,
15 because then you can get a good feel for okay how big is
16 really the total merchant constraint on schemes, or, you
17 know, what are the merchant benefits overall. But for
18 the MIT exercise, the objective is different. It is
19 much more important, because we are after the average
20 merchant, at least in my opinion, and then it is -- then
21 having representation for the whole merchant sample is
22 very important.

23 So that is a different objective. I don't think --
24 I think that's where the comparison between the two
25 stops.

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1 Q. You can put that bundle away. We will have a look at
2 the objectives in a moment. Go back to your first
3 report at D3, tab 3. Page 319, paragraph 6.39.

4 You are looking after, as I understand it, the small
5 merchants, are you, at 6.39? You say:

6 "A further reason why setting individual or very
7 specific MIFs is inappropriate is it would disadvantage
8 smaller merchants who have higher costs of cash and
9 would have correspondingly higher MIFs as well. In
10 practice smaller merchants already tend to pay higher
11 MSCs but the MIF is generally the same."

12 As I understand it, you don't want small merchants
13 to be disadvantaged by higher MIFs, is that correct?

14 A. Well, I think this is one of the reasons why it is
15 preferable that one looks at an average -- that one sets
16 a MIT-MIF for the -- that applies to all merchants on
17 average. It is not that I particularly want to protect
18 small merchants but this is a good policy or economic
19 reason for not distorting competition by having let's
20 say Sainsbury's -- let Sainsbury's have a very low
21 MIT-MIF because their cost of cash handling is lower and
22 let the corner shop or the Tottenham restaurant have
23 a very high MIT-MIF because its costs of cash handling
24 are much higher. So I think there is a reasonably
25 commonly accepted principle that what we are after and

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1 also what the Commission and also the interchange fee
2 regulation is after, that we have one MIT -- one MIF for
3 the whole market.

4 Q. By excluding large merchants you are ensuring that the
5 small merchants now pay a higher MIF. In other words,
6 if you include the large merchants, the corner shop, the
7 small restaurant in Tottenham pays a lower MIF; that is
8 correct isn't it? If you include the large merchants,
9 the small restaurant in Tottenham will pay a lower MIF?

10 A. If you --

11 Q. Include the large merchants, as Mr von Hinten-Reed has
12 done, the small restaurant in Tottenham will pay a lower
13 MIF?

14 A. So, yes, if you include the large merchants and get
15 a very -- so get a much lower MIT-MIF then the average
16 is lower, that is correct, I agree with the proposition.
17 And therefore -- but still the very large merchants
18 still pay -- are paying a MIT-MIF that actually covers
19 their cost of cash, but the smaller merchants are still
20 paying -- are still -- still have a higher cost of cash
21 handling for it.

22 But yes, maybe so as not to complicate matters
23 further I agree with that proposition, yes.

24 Q. Let's just have a look to see how the Commission has
25 treated this. Could you go, I don't know -- what

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1 bundles have you got there? Have you still got E2
 2 there?
 3 A. I have my own report, the transcripts and E2.
 4 Q. You can put E2 away. You will need E3.10.
 5 So this question of large merchants was something
 6 that the Commission was aware of; you accept that do
 7 you?
 8 A. Yes.
 9 Q. So at E3.10 we have at tab 202 our trusted survey, the
 10 Deloitte's European Commission survey.
 11 A. Yes.
 12 Q. If you go to page 4324, the relevant paragraphs are 120
 13 onwards. You have obviously read these before, have
 14 you?
 15 A. Yes.
 16 Q. So at 120 the merchant population is heterogeneous, the
 17 merchants differ in respect to several characteristics,
 18 we know that. At 121:
 19 "For this reason it was decided to limit the number
 20 of characteristics that were going to be reflected in
 21 the sample. DG Competition decided to focus on
 22 surveying large merchants. Two main reasons supported
 23 this choice, first, large merchants are most likely to
 24 be able to provide the necessary data. Second, focusing
 25 on large merchants would maximise the coverage of the

1 samples in terms of transactions and in this way to
 2 enhance the liability of the outcome."
 3 So they are aware of it. Then you will see at 122
 4 that:
 5 "An argument often made with respect to merchant's
 6 cost of payment is that they exhibit economies of scale
 7 and thus large merchants have considerably lower costs
 8 of payment than smaller merchants."
 9 And that you would agree with.
 10 "Several stakeholders ..."
 11 Is that including you, MasterCard? Do you know who
 12 he pointed out?
 13 A. I don't know.
 14 Q. Anyway:
 15 "Several stakeholders pointed out that surveying
 16 large merchants only will provide an incomplete picture
 17 of costs and possibly a biased estimation of MIT-MIF.
 18 It should be noted that this potential bias would not
 19 necessarily result in lower MIT-MIFs since such
 20 economies of scale might concern both cash and cards.
 21 In particular, as the Commission also concluded in its
 22 decision, the acquirer margin under card payments was
 23 higher for small merchants than for large merchants,
 24 which implies the existence of scale effects for
 25 merchants on credit card transactions."

1 You see there at footnote 55 that DG Competition
 2 carried out a stakeholder consultation on the
 3 methodology which proposed surveying large merchants.
 4 So the Commission was well aware of this issue and
 5 it decided that it was preferable or desirable to select
 6 the data from the large merchants and do you disagree
 7 with paragraph 122, where the Commission says it is not
 8 necessarily the case that MIFs would be lower and that
 9 small merchants would affect the overall outcome?
 10 A. I disagree. In theory it could be right but actually
 11 the actual data that has come out of the survey, and we
 12 have seen that in the evidence actually, confirms that
 13 there is significant economies of scale, significant
 14 differences in cost of cash handling, even taking into
 15 account the card costs, because even when you look at
 16 the MIT, the implied MIT-MIF level between very large
 17 merchants and then the smaller merchants in the sample,
 18 there are significant differences. While in theory this
 19 statement here might hold, the actual data that has come
 20 out of the survey confirms that there are significant
 21 differences even in the survey sample.
 22 Q. Remembering, Dr Niels, that the burden of proof of this
 23 is on MasterCard, have you undertaken a study taking the
 24 large merchants as identified in the Deloitte's survey
 25 and placed on top detailed data relating to small

1 merchants?
 2 A. No, that was the big unknown, the big absence of data on
 3 any data on small merchants. I think that data is just
 4 isn't out there. Everyone is struggling with it. With
 5 that fact. The Commission is aware of it, as is clear.
 6 We are aware of it. Still, I found it unsatisfactory to
 7 just therefore rely on the sample because while
 8 the Commission is aware of it, they then don't make any
 9 further adjustments and I found that bit unsatisfactory.
 10 So I did make the further adjustment.
 11 The burden of proof on the defendants I think there
 12 is the beautiful symmetry with the damages overcharge.
 13 I also very much did this analysis as part of my
 14 assessment of damages. So the beautiful symmetry where
 15 calculating the exemptable level of MIF also gives you
 16 the calculation of the overcharge.
 17 Q. If you go to bundle D2.1, which is where you will find
 18 Mr von Hinten-Reed's second report. Tab 3, page 526,
 19 paragraph 506. He, unlike you, has at least tried to
 20 factor in smaller merchants. So 526, at the bottom. He
 21 has taken the large merchants as the Commission has done
 22 and he says at paragraph 506:
 23 "As a sensitivity check I consider how the MIT-MIF
 24 for credit cards would be affected by the inclusion of
 25 small merchants, assuming that they account for 25% of

1 retail sales based on the Eurostat data. As I mentioned
2 earlier no data is available for the cost of payments to
3 small merchants. In my sensitivity analysis I consider
4 two scenarios, the MIT-MIF for small merchants being
5 twice as high and three times as high. I apply this
6 sensitivity test to three MIT-MIF estimates."

7 Then he says at 507:

8 "The results are shown in table 7.7. As can be
9 seen, including small merchants and assuming for them
10 an extremely high MIT-MIF does not change the results
11 dramatically."

12 Now, have you any basis to challenge that? Have you
13 attempted to challenge that in your reports?

14 A. Well this was Mr von Hinten-Reed's second report and
15 I haven't had a reply on that since, but I clearly
16 disagree with this adjustment. I think it is
17 an inappropriate adjustment. So both Mr von Hinten-Reed
18 and I -- well I tried it in my first report,
19 Mr von Hinten-Reed in his second report, we tried to
20 adjust for this size issue or to do a sensitivity check.
21 I have done it my way as explained. This sensitivity
22 check, the reason why I fundamentally disagree with it
23 actually is in the assumption that the MIT-MIF for small
24 merchants being twice or three times as high, when we
25 saw clearly from the data, and maybe we can have a look

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1 at it again, but even in the full sample in the EC
2 merchant cost study, there were already significant
3 differences, much more than 2 or 3 times, there were
4 differences, 5, 10, even 20 times. So to say that the
5 even smaller merchants have 2 or 3 times higher costs of
6 cash I think is inappropriate. It should be a lot
7 higher and I have given actually an example in my second
8 report why this adjustment actually significantly
9 understates the resulting MIT-MIF.

10 Q. Don't you, as an expert economist, recognise that the
11 approach of taking large merchants and then sense
12 checking it by reference to small merchants is
13 preferable to just ignoring all the large merchants?

14 A. I don't agree that that is the right characterisation of
15 what I have done. What I have done is to say we have
16 a sample which is biased towards the very large
17 merchants, let's truncate that and that's a better
18 indication of the overall size, including the small
19 merchants, the big chunk that we don't have. I think
20 this adjustment here requires some guesswork, some
21 assumption as to: okay, if you include the small
22 merchant, well what is their cost of cash? No one
23 knows, that's the unsatisfactory part. But what I do
24 know for certain is that it will be -- the cost of cash
25 of smaller merchants will be more than 2 or 3 times

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1 higher than that of the larger merchants.

2 I have included, I believe, a numerical example
3 showing that in my second report, that very rapidly --
4 if you assume something higher than 2 or 3 times as
5 high, then you rapidly get a much higher MIT-MIF.

6 Q. Let's see what the effect on the data is excluding your
7 larger merchants. If one goes back in
8 Mr von Hinten-Reed's second report to page 523,
9 paragraph 489. Let's just see what effect your approach
10 has to the robustness of the data. He says:

11 "I note that excluding the largest merchant
12 seriously limits the reliability of results and their
13 applicability to the UK. 130 merchants out of 256
14 included in the sample observation belong to the largest
15 group, excluded by Dr Niels. Excluding the largest
16 merchants reduces the sample size by more than half.
17 Given that the sample is already small such an operation
18 seriously reduces the reliability of the results as also
19 shown by our lower R2 values. In the total sample UK
20 merchants account for 10% of merchants but for 40% of
21 total sample turnover. Out of 27 UK retailers in the
22 sample 19 belong to the largest size group. Thus the
23 MIT-MIFs obtained for the whole sample are largely
24 influenced by UK retailers and can therefore be expected
25 to be relatively close to the UK MIT-MIFs. By excluding

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1 the largest retailers Dr Niels also removes most of the
2 UK sales from the sample. Therefore, the MIT-MIFs
3 obtained by the smaller group are likely to bear little
4 relationship to the MIT-MIFs for even small UK
5 retailers. According to Eurostat data, in 2013 69% of
6 retail turnover in the UK was generated by retailers
7 above 200 million turnover, while retailers with
8 turnover between 20 million and 200 million accounted
9 for 9%. Even if the MIT-MIF estimated for those smaller
10 merchants is representative of the UK, which is unlikely
11 as argued above, it is difficult to justify ignoring the
12 MIT-MIF for merchants representing almost 70% of
13 transactions."

14 Do you not agree that it is undesirable to ignore
15 for the purposes of the UK MIT-MIF merchants
16 representing almost 70% of transactions?

17 A. I disagree with these conclusions here. I think there
18 is agreement that an adjustment is needed for size
19 because not making any adjustment, in my opinion,
20 certainly would be incorrect for the reasons we have
21 discussed.

22 There is not a lot of information to decide which
23 adjustment is the most appropriate one -- that is
24 unfortunate but it is a fact. I think my adjustment, it
25 is quite clear, yes, it then throws out the very largest

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1 merchants, I'm clear on that, and yes, a lot of those
 2 were from the UK, I'm clear on that. I still think that
 3 my truncated average is more likely to reflect the
 4 average MIT in the market overall.
 5 Q. Just to conclude on this point and then maybe we can
 6 have the short break. Just picking up on the average
 7 transaction, you have majored on you have got to look at
 8 the average merchant not the average transaction. Do
 9 you still have E3.10 in front of you?
 10 A. Yes.
 11 Q. Tab 202.
 12 A. Yes.
 13 Q. Page 4315, paragraph 82:
 14 "Merchants in this population are likely to be
 15 heterogeneous ...(Reading to the words)... process and
 16 payments need to be taken into account."
 17 The simple question is, are you disagreeing with the
 18 European Commission here that it is the average
 19 transactional benefit that is relevant not the average
 20 merchant?
 21 A. I think the principle of MIT is that you are looking for
 22 the average merchant in the market. I'm not sure
 23 whether the distinction here is drawn very precisely
 24 between average transactional benefit or average
 25 merchant. I think what we are after with the MIT-MIF

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1 approach is the MIT-MIF for the average merchant.
 2 Q. If you still have Mr von Hinten-Reed's second report, at
 3 525, he deals with this point in some detail. Again he
 4 interprets Rochet and Tirole completely differently to
 5 you. 496:
 6 "The rationale for the MIT-MIF methodology is to
 7 measure the transaction efficiencies. Efficiencies are
 8 measured in terms of reduced costs of transactions.
 9 Efficiencies are about incremental costs."
 10 497:
 11 "In their original paper Rochet and Tirole conclude
 12 that when merchants are heterogeneous in the sense they
 13 derive different benefits from replacing cash by cards,
 14 the MIT-MIF should be based on the average transactional
 15 benefit amongst the merchants."
 16 So he and the Commission are at one, not only in
 17 applying the average transaction, but also in
 18 interpreting Rochet and Tirole. Again I put it to you,
 19 are you disagreeing with the approach of
 20 Mr von Hinten-Reed and the European Commission?
 21 A. I think Rochet and Tirole elsewhere also talk about
 22 "average merchants" and generally I think they talk --
 23 or the literature talks more about average merchants
 24 rather than the average transaction value. The concept
 25 of average transaction benefits I think is again --

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1 again it is generally worded, that could still apply --
 2 or that still leaves open the question, are you talking
 3 about the average merchant or the merchant where the
 4 average transaction takes place.
 5 MR BREALEY: If that's a convenient moment?
 6 MR JUSTICE BARLING: We will have a short break.
 7 A. I said I would clarify something, can you just remind me
 8 of the reference in Mr von Hinten-Reed's report, because
 9 I think --
 10 MR BREALEY: Sorry, the reference of what?
 11 A. There was a question about whether the impact of the
 12 adjustment from fixed and variable costs, 0.15 to 0.2,
 13 you pointed me to your opening statement with a footnote
 14 to Mr von Hinten-Reed's --
 15 (Pause).
 16 MR BREALEY: I'm told by Mr Cook it is footnote 266.
 17 MR JUSTICE BARLING: If you want to try to find that
 18 reference for Dr Niels and then he can look it up in the
 19 break. We will have a short break.
 20 (11.40 am)
 21 (A short break)
 22 (11.50 am)
 23 MR JUSTICE BARLING: You found the bit you were looking for?
 24 A. Yes, I have. If I may briefly. So the question was
 25 what is the impact of that first adjustment, so looking

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1 at fixed or variable costs rather than just variable.
 2 I think the best indication for that is table 6.4 in my
 3 first report.
 4 MR JUSTICE BARLING: Yes. Table 6.4. Do you have a page
 5 reference? Here we are, page 339.
 6 A. Yes. I think the best way to look at it is there
 7 between the medium estimate and the high estimate, so
 8 the second and third columns. The MIT-MIF that results
 9 is 0.45, versus the 0.73. The difference between those
 10 scenarios is whether you take the Commission's medium
 11 term middle scenario approach or you take
 12 the Commission's long-term econometric approach. So
 13 that is in essence the difference. So in my analysis
 14 it produces -- the makes the difference from 0.45 to
 15 0.73 basically.
 16 MR JUSTICE BARLING: More costs become fixed in the
 17 long-term?
 18 A. Yes, so more fixed costs become variable in the
 19 long-term, so you --
 20 MR JUSTICE BARLING: Yes, exactly.
 21 A. Yes, so you account for them. But this is still what
 22 the Commission itself did. It is just that I prefer the
 23 third approach from the Commission over the second.
 24 If I compare that then with what was put to me,
 25 table 7 in Mr von Hinten-Reed's report -- that's

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1 table 7.6.
 2 PROFESSOR JOHN BEATH: Which is?
 3 A. In his second report on page 520. In that table you can
 4 see -- I think there the point was if you make the
 5 adjustments, you go from 0.15 for credit card, so the
 6 far right number in the bottom, to 0.20.
 7 Now, so that is one adjustment but that is not the
 8 full adjustment. I think this is still in
 9 Mr von Hinten-Reed's own analysis which is based on
 10 Sainsbury's and what he does here is test for the
 11 sensitivity to a different cost allocation by
 12 Sainsbury's itself. That gives you one difference. But
 13 it is still in the context of the medium-term approach
 14 that the Commission -- which he relies on.
 15 PROFESSOR JOHN BEATH: That's scenario 2?
 16 A. Yes, scenario 2. I prefer scenario 3. So the effect of
 17 that first adjustment is the difference mainly between
 18 scenarios 2 and 3 as per my table. So it is a bit
 19 bigger than just going from 0.15 to 0.2.
 20 MR BREALEY: So what was the difference in the end?
 21 I missed that sorry.
 22 A. It is in essence the jump in my numbers from 0.45 in
 23 table 6.4 at the bottom, to 0.73.
 24 Q. So if you take Mr von Hinten-Reed's approach and all you
 25 do is -- so you take the cost of cash, you take the

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1 large merchants, but all you do is take scenario 3,
 2 rather than scenario 2 -- I'm sorry. If you leave all
 3 the large merchants in and the only -- I tried to
 4 establish at the beginning there are three main
 5 adjustments, yes?
 6 A. Yes.
 7 Q. Scenario 2 versus scenario 3?
 8 A. Yes.
 9 Q. Large merchants, what I have called the Amex point --
 10 A. Yes.
 11 Q. So let's assume that you are wrong on Amex, let's assume
 12 that you are wrong on the merchants and you adopt
 13 everything that Mr von Hinten-Reed has done, all you are
 14 doing is taking scenario 3 rather than scenario 2; what
 15 difference does that make to his calculation?
 16 A. So yes, for that first adjustment it is in essence going
 17 from the Commission's scenario 3 to the Commission's
 18 scenario 2. I have shown the effect. You can also look
 19 actually at the Commission's own results which are
 20 probably sort of -- they also show the difference. So
 21 in paragraph 19 of the Commission's study you can also
 22 see that the Commission itself gets higher results for
 23 scenario 3 when they do the econometrics. So those
 24 results go up to 0.47. If the question is what
 25 difference does it make to Mr von Hinten-Reed's

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1 assessment, I can't answer that question right now.
 2 I think the adjustment that I was shown here is just
 3 an adjustment to Sainsbury's allocation of fixed and
 4 variable costs. So that is part of it. But it is still
 5 within the scenario 2 scenario.
 6 Q. Maybe we will try and get some common ground between
 7 you. Quickly on the third adjustment, just to sort that
 8 out, the third adjustment, what I have called the Amex
 9 point, you put forward a third adjustment to the MIT-MIF
 10 whereby Amex is the comparator and not cash -- I know
 11 there is a mix but Amex is through there the whole
 12 piece -- and this applies to online and face to face
 13 credit; correct?
 14 A. Yes, so it captures two elements, online and the credit
 15 functionality of credit cards, yes.
 16 Q. You are aware that the MIT-MIF as calculated in the
 17 Deloitte report and as calculated by Mr von Hinten-Reed
 18 and as calculated in the interchange fee regulation, so
 19 the MIT-MIF that they arrive at applies to online sales.
 20 So they apply the MIT to online sales?
 21 A. I believe that is right. I believe that they measure it
 22 on the basis of the cash versus card comparison.
 23 I think they -- the Commission explicitly says "Well we
 24 couldn't do a merchant cost study for online", so it is
 25 a card cash comparison based MIF, but my understanding

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1 is also that the MIF in the regulation 0.3/0.2 applied
 2 to all transactions, so again we have one MIT-MIF,
 3 including online.
 4 Q. So it is not as if online are excluded from interchange
 5 fees, it is just that online is a slightly different
 6 calculation and the regulators have taken the cash
 7 comparator and applied it to online sales, correct?
 8 A. Correct. I found it possible to actually make a more
 9 explicit adjustment or measurement of payment methods as
 10 compared to other than cash for online payments and
 11 that's what I have done. That is part of my third
 12 adjustment.
 13 Q. You are aware that Mr von Hinten-Reed regards this as
 14 something of a windfall to the card schemes, because he
 15 says that a MIF is not necessary to achieve any
 16 efficiency gain within the meaning of article 101(3).
 17 He says you don't actually need a MIF for online sales,
 18 they would happen anyway. So there's no efficiency
 19 gain, but for reasons of practicality, it will be
 20 applied. That effect is, according to him, schemes
 21 obtain a windfall.
 22 A. From an economic perspective, I see that differently.
 23 I think the principle of the MIT-MIF is that you set
 24 a regulatory price or fair price or exemptible price.
 25 With reference to the cost of -- or the price of

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1 comparator payment systems, so alternative payment
 2 systems, the next best alternative, this idea of online
 3 would happen anyway, I think that's then -- that's not
 4 right because clearly there are still costs to that. So
 5 I think it is right that if we are talking about online
 6 payments, you have to apply the same principle of
 7 benchmark pricing regulation, so you look at the next
 8 best alternatives, and for online payments they are Amex
 9 and PayPal we have taken. Now the fact that that
 10 actually makes the MIF higher, so because the cost of
 11 those alternatives, PayPal is more expensive to
 12 merchants than credit cards, generally, you may call it
 13 a windfall or it has been compared with Kafka,
 14 Kafkaesque, but I think it is only Kafkaesque if the
 15 cost of the next best alternative, say PayPal or Amex
 16 online, is higher then it is perfectly efficient that
 17 you are allowed under this price cap approach to price
 18 all the way up to that level. So I do not think it is
 19 wrong that including online payments where alternatives
 20 are more expensive leads to a higher MIF.
 21 Q. At paragraph 6.82 of your first report you say that
 22 online merchants gain a large benefit from accepting
 23 cards. As we established yesterday, it is not the right
 24 question. It is not the question whether cards are of
 25 benefit, the question is whether the MIF leads to

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1 an efficiency gain. That is the question isn't it,
 2 whether the restriction of competition, the MIF, is
 3 necessary to achieve an efficiency gain?
 4 A. I understand that that is the question for the legal
 5 assessment under article 101(1), but when we are talking
 6 here about what's the right economic approach to
 7 MIT-MIF, and following the same principles why someone
 8 may like the MIT-MIF and cash as a comparator, following
 9 those very same principles, I think it is consistent
 10 then to also look at online because it does benefit
 11 merchants at the end of the day and there is a cost
 12 involved in providing credit card services also for
 13 online payment. So it is only fair that the MIT-MIF in
 14 that same logic should cover also the relative costs to
 15 merchants for online payments and not just cash as
 16 a comparator.
 17 Q. Have you included in any calculation the cost to the
 18 merchants of accepting online payments?
 19 A. Yes, I tried as an approximation to look at the costs to
 20 merchants of the alternative methods for online
 21 payments, so Amex and PayPal. I have described that in
 22 my report.
 23 Q. The actual cost that merchants incur for online
 24 payments, that Mr Rogers refers to in his witness
 25 statement?

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1 A. I don't think I had much more basis than -- much more
 2 specific information for merchants for these purposes
 3 than looking at what my understanding was of PayPal and
 4 Amex.
 5 Q. On face to face, as I understand it, your evidence is
 6 that the Amex based MIF is based on a notion that for
 7 some transactions the customers may not have enough
 8 cash, is that correct?
 9 A. Yes, that's in line with the --
 10 Q. The academic articles?
 11 A. The Rochet and Wright thinking, which recognises that
 12 credit functionality has a benefit to merchant and there
 13 the next best alternative is actually not cash but for
 14 that type of payment it is other credit that would have
 15 been extended to the consumer at that point.
 16 Q. So you and the academics are basically saying, as
 17 I understand it, that every merchant that accepts
 18 a MasterCard is effectively operating a store card?
 19 A. Yes. In that approach of Rochet and Wright, the
 20 effective comparator is a store card. Now, clearly not
 21 all merchants operate store cards but nonetheless the
 22 concept of store card, and within that I have then taken
 23 Amex as a proxy -- as a conservative proxy because
 24 I think the real cost of providing a store card would
 25 probably be a bit higher than just Amex. But, yes, the

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1 comparator is that the retailer somehow would have to
 2 provide credit, otherwise that transaction would not
 3 take place. So whether the retailer actually provides
 4 store credit or would have to do something else, the
 5 premise of the theory, which I agree with, is that the
 6 comparator there is not cash for those transactions but
 7 credit provided by the stores themselves.
 8 Q. This is a store card that the small restaurant in
 9 Tottenham is operating without any opportunity of
 10 obtaining interest payments. You don't take interest
 11 into account yet again in this analysis.
 12 A. That is correct. So you look -- for this approach, the
 13 Rochet and Wright approach, you look at the costs that
 14 the merchant would have to incur to provide the credit.
 15 Now, yes, of course, merchants also can earn credit --
 16 interest revenue on it and somehow one would -- one
 17 might have to take that into account perhaps, although
 18 I would also think that the logic in Rochet and Wright
 19 most of the time is that when merchants provide credit
 20 it is not that they are a bank, they are in the business
 21 of lending, they do that to promote spending in their
 22 store, so I think even most store cards are probably
 23 more charge cards or transactional benefits orientated
 24 then actually being a source of profit. But that I have
 25 no further information on.

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1 Q. You have no information, as we established yesterday, on
 2 the magnitude of the benefits that you say accrue to
 3 merchants, you haven't done any calculations that would
 4 give us an indication of the magnitude.
 5 A. Correct. In this context we are talking about the costs
 6 to merchants of the alternative payment system. So in
 7 this context it wouldn't be relevant to quantify the
 8 benefits to merchants.
 9 Q. You have calculated the costs to merchants, but the
 10 whole point of article 101(3) is to measure the
 11 benefits.
 12 So what are the benefits you say that accrue to
 13 merchants?
 14 A. Merchants obtain benefit from extending credit, both
 15 merchants individually --
 16 Q. Sorry Dr Niels, we are talking about increased sales
 17 again are we?
 18 A. Yes, increased sales. Both individually and in
 19 aggregate merchants benefit.
 20 Q. And you haven't calculated at all the nature of the
 21 increased sales?
 22 A. I have analysed the nature and I have explained the
 23 theory on extended -- so the effect on aggregate sales
 24 and I conclude that there is a positive effect. What
 25 I haven't been able to do and I think no one would ever

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1 be able to do is quantify the exact benefits to
 2 merchants.
 3 Q. Can I just ask one last question on exemption Dr Niels.
 4 It is quite an important question. Not that any of the
 5 others haven't been important, but this is an important
 6 question. Mr von Hinten-Reed has put forward
 7 an exemption methodology, which broadly follows
 8 Commission, correct?
 9 A. He has put forward a methodology which broadly follows
 10 the Commission, correct.
 11 Q. And you have put forward two methodologies, one is
 12 an issuer's based methodology, and the other is this
 13 adjusted MIT-MIF?
 14 A. Yes.
 15 Q. And you know that in the last hour or so of
 16 cross-examination that we have issues with your
 17 methodology, correct?
 18 A. Yes.
 19 Q. You know that the burden of proof is on MasterCard to
 20 prove an exemption, correct?
 21 A. Yes.
 22 Q. So my question is this: is the calculation that
 23 Mr von Hinten-Reed has undertaken one that is within
 24 a range in your view that the Tribunal could adopt
 25 sufficient to give MasterCard an exemption? If you want

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1 me to repeat that I will, but essentially what I'm
 2 asking you is, I know you have your two methodologies,
 3 but is Mr von Hinten-Reed's methodology within a range
 4 in your view that the Tribunal could adopt sufficient to
 5 give MasterCard an exemption?
 6 A. My answer to that is no. My adjusted MIT methodology is
 7 in essence the same as Mr von Hinten-Reed's MIT
 8 methodology, so if Mr von Hinten-Reed's methodology is
 9 accepted as a good approach for exemptible level, then
 10 in my opinion so should my adjusted MIT, it is just the
 11 adjustments that I make to my MIT approach are better
 12 founded in economic theory and economic principles. So
 13 it is still a MIT, I agree that it is still a MIT
 14 approach, but it has better foundations in economic
 15 theory, it is based -- so Mr von Hinten-Reed's approach
 16 is based on the very narrow interpretation of Rochet and
 17 Tirole. I think we have seen evidence already that even
 18 in Rochet and Tirole there are some doubts expressed
 19 about is that the right MIF or should you get a higher
 20 one, but there are five adjustments in later theoretical
 21 papers that express some doubts about that very narrow
 22 interpretation. The first one is that when assessing
 23 welfare do you also look at issuer profits or not?
 24 Rochet and Tirole themselves said it. Whether that
 25 applies to article 101(3), I don't know.

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1 But the other four adjustments are -- and they all
 2 mean that if the narrow interpretation of MIT-MIF is too
 3 low, so all these adjustments would raise it, one is the
 4 fact that if, as Tirole in a later paper recognised,
 5 other payment systems, like cash, are also subsidised
 6 from a social perspective, so the consumer doesn't face
 7 the cost of -- the real cost of cash, then the MIT-MIF
 8 is too low.
 9 Thirdly, if -- so the MIT-MIF in the narrow
 10 interpretation doesn't recognise the credit
 11 functionality, so that is the Rochet and Wright
 12 adjustment that I have also adopted.
 13 Fourthly, in the Rysman and Wright paper we saw that
 14 there is concern that the MIT-MIF should -- so the
 15 interpretation of Rochet and Tirole of cost should be
 16 longer marginal costs so including fixed costs, so that
 17 you get the right long-term incentives between payment
 18 systems.
 19 And the last adjustment, also in Rysman and Wright's
 20 paper, is that it is not just cash that is the
 21 comparator, you should also look at other comparators,
 22 in particular for online and that's also an adjustment
 23 I have made.
 24 So in sum I would say we have tried to follow --
 25 both the experts have tried to follow the MIT-MIF

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1 approach, but I have said why I prefer my adjustment to
 2 it.
 3 MR BREALEY: I'm moving on to a different subject, which
 4 relates to Amex and internal documents relating to
 5 Sainsbury's.
 6 MR JUSTICE BARLING: How do you feel about the possibility
 7 of framing questions and answers sensibly -- I mean can
 8 it be sensibly done or is it really too difficult in
 9 view of the material to do it in public, without
 10 revealing the material?
 11 MR BREALEY: I will try. Can I just ask Mr Hoskins: E13,
 12 tab 249, is that confidential? That's one of
 13 Mr Hoskins'. E13, tab 249?
 14 MR HOSKINS: It is currently marked confidential.
 15 MR BREALEY: I'm going to go to essentially page 531 ...
 16 MR JUSTICE BARLING: If you think there is a significant
 17 risk that it is just going to be too difficult for the
 18 witness --
 19 MR BREALEY: Actually it is the negotiation between
 20 Sainsbury's and Amex.
 21 MR JUSTICE BARLING: So it is sensitive material.
 22 MR BREALEY: It is really.
 23 MR JUSTICE BARLING: The sort of questions you want to raise
 24 probably require --
 25 MR BREALEY: I could just let Dr Niels look at them but --

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1 MR JUSTICE BARLING: It sounds as though it is going to be
 2 too difficult. I think rather than waste time.
 3 MR BREALEY: I will tell you what I could do, I could take
 4 the cross-examination a bit out of order.
 5 MR JUSTICE BARLING: Well I'm a bit reluctant for you to do
 6 that ...
 7 MR BREALEY: Why don't I do that and then it may be the
 8 afternoon will be in private because then I have to deal
 9 with Maestro, which is confidential. So if I was to do
 10 the Amex/Sainsbury's and the Maestro this afternoon
 11 and --
 12 MR JUSTICE BARLING: If you think you can do it like that
 13 without, as it were, totally dislocating your --
 14 MR BREALEY: It is a bit better than yesterday when I got to
 15 page 7 and I realised I didn't have about five pages of
 16 my cross-examination notes. But I found them.
 17 MR JUSTICE BARLING: All right.
 18 MR BREALEY: Okay, Dr Niels. Do you want to put everything
 19 away and then we will go on to something new.
 20 Do you want to take bundle E1 out. Before we get to
 21 the documents, I know you are experienced in these
 22 matters, can you explain to the Tribunal what you
 23 understand by the concept of ancillary restraints?
 24 A. I'm afraid I haven't got that really clear in my mind,
 25 it is a legal concept.

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1 Q. I ask that because that is the basis upon which you give
 2 your economic evidence on the Visa counterfactual?
 3 A. I can't say much more on that.
 4 Q. Well let me show you some documents to assist you.
 5 So when you have given your evidence on the Visa
 6 counterfactual and how there would be a migration from
 7 MasterCard to Visa, you haven't had regard to the
 8 concept of ancillary restraints?
 9 A. Not as such, I have done my analysis in the context of
 10 knowing that counterfactual analysis is relevant for
 11 article 101(1) and 101(3) so I looked at various
 12 counterfactuals from an economic perspective. Where
 13 exactly it fits in the legal framework, in terms of
 14 ancillary restraint versus just generally agreements,
 15 I don't know. I didn't look at that specifically.
 16 Q. But normally economists deal with ancillary restraints
 17 in mergers, don't they? They look at whether the
 18 overall transaction is pro-competitive and they look at
 19 whether the restriction is necessary for it; that's
 20 essentially what it is, isn't it?
 21 A. Yes, I'm just confused by the term "ancillary". We look
 22 at restraints and we look at their effects on
 23 competition, but whether something is ancillary or not,
 24 that's the bit I'm saying that I don't have so clear in
 25 my head.

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1 Q. Okay. Let's just try and put your economic evidence in
 2 some proper context then. If we can go to E1, tab 2A.
 3 I won't labour this point but I will go to the
 4 guidelines and the Court of Justice.
 5 At tab 2A you have the Commission's guidelines on
 6 101(3), which you say that you have read, yes?
 7 A. Yes.
 8 Q. Then if you go to page 38A.5, paragraph 28, it is headed
 9 "Ancillary restraints".
 10 A. Yes.
 11 Q. So, this is the concept of ancillary restraints.
 12 Paragraph 18 sets out a framework analysing the impact
 13 of agreement and its individual restrictions on
 14 inter-brand competition and intra-brand competition:
 15 "If on the basis of those principles it is concluded
 16 that the main transaction covered by the agreement is
 17 not restrictive of competition, it becomes relevant to
 18 examine whether individual restraints contained in the
 19 agreement are also compatible with article 81(1) because
 20 they are ancillary to the main non-restrictive
 21 transaction."
 22 29:
 23 "In community competition law the concept of
 24 ancillary restraints covers any alleged restriction of
 25 competition, which is directly related and necessary to

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1 the implementation of a main non-restrictive transaction
2 proportionate to it."

3 Just pausing there. The question we are looking at,
4 so you know that our submission is that there are three
5 anti-competitive vices. There is a restriction between
6 the issuers, there is a floor, there is a high floor.
7 So what we are having to do is work out whether those
8 three restrictions of competition are necessary for the
9 implementation of the main agreement, which is the
10 payment card scheme.

11 It goes on:

12 "If an agreement in its main part, for instance
13 a distribution agreement or a joint venture, does not
14 have as its object or effect the restriction of
15 competition, then restrictions which are directly
16 related to and necessary for the implementation of that
17 transaction also fall outside article 101(1). Those
18 related restrictions are called ancillary restrictions.
19 A restriction is directly related to the main
20 transaction if it is subordinate to the implementation
21 of that transaction and is inseparably linked to it.

22 The test of necessity implies the restriction must be
23 objectively ..."

24 And we will pick up on this word again when we see
25 the court:

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1 "The test for implementation must be objectively
2 necessary for the implementation of the main transaction
3 and be proportionate to it."

4 Then 30:

5 "The application of the ancillary restraints concept
6 must be distinguished from the application of the
7 defence under article 101(3) which relates to certain
8 economic benefits produced by the restrictive agreements
9 and which are balanced against the restrictive effects
10 of the agreement. The application of the ancillary
11 restraints concept does not involve any weighing of
12 pro-competitive or anti-competitive effects. Such
13 balancing is reserved for article 101(3)."

14 Now, I take it from your answer a moment ago that
15 when you are dealing with the Visa counterfactual you
16 have not had this in mind?

17 A. Well, my analysis is about MIF and the competitive
18 effects on MIF in various counterfactuals and I think my
19 analysis fits very well into the overall framework.
20 What I haven't done explicitly is to say the overall
21 agreement is the scheme and the MIF is the ancillary
22 restriction. I think for my economic analysis, making
23 that explicit wasn't necessary, I think my analysis
24 would in any event be informative for the legal
25 assessment.

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1 Q. Okay. If you move on to what the Court of Justice said
2 about this at tab 19, page 419. It is not just
3 an exercise in law, Dr Niels, I promise you, but it is
4 extremely important when it comes to the context of your
5 economic evidence.

6 So, page 419, MasterCard and I imagine your clients,
7 which were RBS, were appealing this concept of ancillary
8 restraints to the General Court and ultimately to the
9 main court, the CJEU, and the findings of the main court
10 are at page 419, paragraph 89:

11 "It is apparent from the case law of the Court of
12 Justice that if a given operation or activity is not
13 covered by the prohibition laid down in article 101,
14 owing to its neutrality or positive effect in terms of
15 competition, a restriction of the commercial autonomy of
16 one or more of the participants in the operation is not
17 covered by that prohibition rule either if that
18 restriction is objectively necessary to the
19 implementation of the operation."

20 Now I ask you to remember the word "objectively"
21 because it is quite important.

22 "Where it is not possible to dissociate such
23 a restriction from the main operation or activity
24 without jeopardising its existence and aims, it is
25 necessary to examine the compatibility of that

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1 restriction with article 81... 101... in conjunction
2 with the compatibility of the main operation or
3 activity, even though taken in isolation such a
4 restriction may appear on the face of it to be covered
5 by the prohibition."

6 91:

7 "Where it is a matter of determining whether
8 an anti-competitive restriction ...

9 So again the three vices:

10 "... can escape the prohibition laid down in
11 article 101(1), because it is ancillary to a main
12 operation that it is not anti-competitive in nature, it
13 is necessary to inquire whether that operation would be
14 impossible to carry out in the absence of the
15 restriction in question. Contrary to what the
16 appellants..."

17 Which I understood to be your clients:

18 "... claim, the fact that their operation is simply
19 more difficult to implement or even less profitable
20 without the restriction concerned cannot be deemed to
21 give that restriction the objective necessity required
22 in order for it to be classified as ancillary. Such
23 an interpretation would effectively extend that concept
24 to restrictions which are not strictly indispensable in
25 the implementation of the main agreement. Such

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1 an outcome would undermine the effectiveness of the
 2 prohibition laid down in article 1."
 3 Then 92 and 93 are important, but in the time I will
 4 go quickly to 94:
 5 "In ruling that only those restrictions which are
 6 necessary in order for the main operation to be able to
 7 function in any event may be regarded as falling within
 8 the scope of the theory of ancillary restrictions and
 9 the fact that the absence of the MIF may have adverse
 10 consequences for the function of the MasterCard system
 11 does not in itself mean that the MIF must be regarded as
 12 objectively necessary if it is still apparent from
 13 an examination of the MasterCard system in its economic
 14 and legal context that it is still capable of
 15 functioning without it. The General Court did not err
 16 in law."
 17 Again, have you had regard to -- it is not just
 18 a question of economic evidence because essentially what
 19 you are stating in your report -- you say so in terms
 20 really -- you say that article 101 does not apply
 21 because the MIF is so important to the MasterCard
 22 scheme. It is essentially what you are saying in your
 23 report, yes?
 24 A. Yes. For various reasons, I have arguments -- 101(1) --
 25 one category of reasons is, is it a restriction in the

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1 first place and I have arguments on: no, because it is
 2 bilaterals and it is not a restriction actually --
 3 acquiring competition isn't even restricted by common
 4 cost law. But indeed also I try to relate my economic
 5 evidence to the concept of objective necessity and there
 6 I have drawn the distinction between the European
 7 situation, or EC situation, which refers to the
 8 intra-EEA MIFs and domestic MIFs in the UK, in the
 9 relevant claim period and there I have laid out my
 10 evidence as to why the MIF was, in my mind, objectively
 11 necessary in those counterfactuals depending on what the
 12 other schemes do in competition.
 13 But in essence competition, or the MIF was
 14 objectively necessary -- although that is a legal
 15 concept -- it was necessary in my mind to allow
 16 MasterCard to remain competitive in this specific period
 17 in the UK that we have seen.
 18 Q. So that is one of the questions you have been asked to
 19 address, whether it is objectively necessary, and that
 20 is essentially the doctrine of ancillary restraints,
 21 because what is being asked is whether it is objectively
 22 necessary for the operation of the main transaction.
 23 The court has said you have to look at whether it is
 24 impossible and that is a question of law to a certain
 25 extent, but this is the ambit of what we are talking

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1 about, yes?
 2 A. Yes.
 3 Q. Now, you yourself just mentioned the word "objectively"
 4 necessary. What do you understand by the term
 5 "objectively"? You have applied it.
 6 A. Again I can only apply it as an economist, but if I look
 7 at the evidence and my own analysis, we are talking here
 8 about the MasterCard MIF that was in place. In the
 9 counterfactual in which the MasterCard MIF was much
 10 lower, as low perhaps as the claimants put it, then
 11 I think -- my objective analysis shows that you get
 12 significant competitive dynamics in the intra-scheme
 13 competition market. Now, those dynamics do depend
 14 of course on what Visa does. I have clearly shown,
 15 I think objectively, that if Visa -- if it is only
 16 MasterCard that goes down to that level, Visa stays the
 17 same and Amex is still also there, then the MasterCard
 18 scheme could not compete effectively, or probably would
 19 cease to exist in that market and therefore -- that was
 20 my ground for concluding in that scenario it is
 21 objectively necessary.
 22 There is also the other scenario of course, if Visa
 23 also goes down. I have also outlined that in my report.
 24 I think there it is less clear, I'm less clear overall
 25 how the legal tests would apply. To me economically it

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1 is clear that in that scenario, if both MasterCard and
 2 Visa went down, they would still struggle against Amex,
 3 so I have modelled it and clearly a lot of the premium
 4 business would be lost to Amex. But whether at that
 5 stage you would say they would go completely out of
 6 business, that I'm not clear about.
 7 Q. Again, just -- this may be a legal point but it governs
 8 the parameters of your economic evidence. When you are
 9 looking at a objective necessity, are you looking at
 10 objective necessity simply from the perspective of
 11 MasterCard or are you looking at it from the perspective
 12 of a four-party scheme?
 13 A. I think --
 14 Q. It is quite an important distinction.
 15 A. Yes, I think my analysis -- so the empirical evidence
 16 I have looked at MasterCard and I used the Maestro
 17 example. But actually my logic applies to any
 18 four-party scheme -- not to three-party schemes because
 19 they don't need a MIF to compete, but any four-party
 20 scheme. Any individual four-party scheme that is in
 21 competition with other schemes, four-party or
 22 three-party, if that scheme was the only scheme that was
 23 forced to go far down with its MIF, it would not be able
 24 to compete, it would be competed out of the market. So,
 25 in that sense, my analysis would also, if you flip it,

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1 apply to Visa if you flip it around and Visa were the
 2 only scheme to be forced to set its MIF lower.
 3 Q. I'm pleased you said that because I think at last you
 4 agree with something the European Commission has said,
 5 which is, if you take bundle E3.10, which is
 6 the Commission's survey again, tab 202, and turn to
 7 paragraph 52, page 4307, you said that essentially your
 8 economic approach applies to both Visa and MasterCard.
 9 You see there at -- I think we saw this yesterday -- but
 10 paragraph 52, where you see:
 11 "A restriction of competition may fall outside the
 12 scope of article 101, if it can be shown that it is
 13 objectively necessary for the existence of
 14 agreement ~..."
 15 And these are the important words:
 16 "... of that type or that nature."
 17 So a restriction of competition may fall outside the
 18 scope of 101 "if it can be shown that it is objectively
 19 necessary for the existence of an agreement of that type
 20 or nature", and that is what objective necessity is
 21 looking at, it is looking at whether a four-party scheme
 22 of that nature can exist without a MIF; do you accept
 23 that?
 24 A. Yes, so I think in terms of the nature, I'm talking
 25 about four-party credit card schemes and then in the

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1 specific context of the UK market over this claim
 2 period. We have seen it before but the Commission in
 3 a number of times refers then also to comparable payment
 4 card schemes in other member states and I don't think
 5 I have gone into a lot of detail on that but I think
 6 those payment card schemes are not good comparators for
 7 these purposes. They were all domestic debit card
 8 schemes with a monopoly acquiring business. So not
 9 really competing in the same sense with other payment
 10 card schemes as MasterCard and Visa were clearly in the
 11 claim period with each other and with Amex.
 12 From that perspective, if the question is about
 13 agreements of that type or that nature, I think we are
 14 talking here about four-party credit card schemes in the
 15 UK, in the relevant period.
 16 Q. With that in mind, that's your economic approach -- do
 17 you still have E1 open?
 18 A. Yes.
 19 Q. If you go to tab 3, which is the decision of the Office
 20 of Fair Trading. I think at the time you were involved
 21 in this and there are many references to the submissions
 22 of MMF, which is your client.
 23 A. Yes.
 24 Q. If go to page 224 of this document. Something that
 25 I showed Mr Perez and I will show you the transcript

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1 a bit later on. So it is at E1 at 224. Tab 3. This is
 2 an argument that -- a similar argument that MasterCard
 3 seems to be making in the present case. Summary of the
 4 arguments made. So this is under the heading that
 5 the MMF MIF -- so the MMF is your client as I understand
 6 it -- the MMF MIF must be set by reference to
 7 competitive restraints. This is what your client was
 8 submitting:
 9 "The OFT fails to recognise that freedom to set the
 10 MMF MIF ...(Reading to the words)... would put the
 11 scheme at a severe disadvantage."
 12 Then somebody else argues that without this freedom
 13 competition would be distorted, and you get the OFT's
 14 response:
 15 "In essence this argument suggests that the cost of
 16 additional features ...(Reading to the words)... the
 17 recovery of these costs is necessary."
 18 Now this is important:
 19 "On this basis otherwise unlawful conduct would
 20 become lawful ...(Reading to the words)... the recovery
 21 of the extraneous costs through the MMF MIF."
 22 And I promise it will be the last case I will take
 23 you to, I will take you to the British Airways case, but
 24 have you -- we will see in a moment Mr Perez was aware
 25 of this as a reason for -- in other words MasterCard

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1 can't say "I need a MIF to compete with Visa" and Visa
 2 can't then say "I need a MIF to compete with MasterCard"
 3 because it all becomes circular. Have you factored this
 4 in to your counterfactual in your report?
 5 A. I have explicitly made or recognised or set out that
 6 there are the two alternative counterfactuals, one in
 7 which both Visa and MasterCard go down, one in which
 8 MasterCard goes down and Visa stays up. I'm aware of
 9 the arguments pro and against. I have set out my
 10 reasons why I would actually prefer the scenario where
 11 Visa stays up but those were my reasons. I have set out
 12 the implications of both scenarios in my report.
 13 I think it is ultimately -- I think it is up here for
 14 the Tribunal to come to a view which of those scenarios
 15 are more relevant for the objective necessity questions
 16 but equally I would say later on for the damages
 17 question.
 18 Q. I promise it will be the last case. If you quickly go
 19 to the authorities bundle, which is the British Airways
 20 case. It looks as if it is 12.2, but it is 12.2. It
 21 just looks as 12.2. It is the very first tab, tab 8A.
 22 I'm just showing you the passage that the OFT relied on.
 23 It is not just the OFT's view it is relying on
 24 established jurisprudence from the European Court.
 25 I will give you the paragraph number. It is

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1 paragraph 70. The page number is 1499A.23.
 2 So here there was a complaint, British Airways were
 3 saying: you are only getting me, what about the others?
 4 And the General Court says:
 5 "Whereas in this case the Commission is faced with
 6 a situation where numerous factors give rise to
 7 a suspicion of anti-competitive conduct on the part of
 8 several large undertakings in the same economic sector,
 9 the Commission is even entitled to concentrate its
 10 efforts on one of the undertakings concerned while
 11 inviting the economic operators which have allegedly
 12 suffered damage as a result of the possibly
 13 anti-competitive conduct of the other undertakings to
 14 bring the matter before the national authorities."
 15 So, again, there in a counterfactual you have
 16 a situation where if somebody else is acting in the same
 17 way, they can be sued in damages. Were you aware of --
 18 Mr Perez was aware of this principle; were you aware of
 19 this principle when you did your first report?
 20 A. Sorry, of the principle about a damages claim?
 21 Q. Yes, that in other words when you are asking yourself
 22 the question whether Visa would accept the issuers, you
 23 are asking yourself the question whether issuers would
 24 apply to be licensees of Visa, whether you accept that
 25 the retailers would just sit back and do nothing, there

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1 are claims for damages against Visa if they are acting
 2 in the same anti-competitive way as MasterCard and
 3 I just am asking you whether you have factored into your
 4 counterfactual, which is a straight line migration down,
 5 whether you have factored in this possibility of some
 6 sort of check on Visa acquiring all this business
 7 because of a claim for damages?
 8 A. Again, I have set out both scenarios. I'm aware of the
 9 reasons why you are in one rather than the other. The
 10 British Airways -- I'm aware of this principle, that if
 11 one breaks the law and the other doesn't because the
 12 other one does it, yes, that is an interesting principle
 13 to think about in this case. I think now the question
 14 is about the possibility that when thinking about let's
 15 say in the situation where MasterCard was forced to
 16 lower its MIF, whether Visa, rather than being forced by
 17 that same intervention or the same regulator, whether
 18 they would do so on the commercial basis or for fear of
 19 a damages claim later. I think I have considered it and
 20 I think it is actually one of the reasons why I -- for
 21 the damages case certainly, for the damages
 22 counterfactual, why I think that is unlikely, or rather
 23 the other way round, why I think it is likely that even
 24 in the relevant claim period, why if MasterCard had gone
 25 down in that period, Visa would not by itself have gone

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1 down for fear of a damages claim or commercial
 2 consideration, because what we have actually observed --
 3 and that's why I think the UK Maestro is such a good
 4 comparator market in the same period -- there are
 5 differentials between MIFs and that's beneficial to the
 6 scheme that can put the higher MIF. I mean that's the
 7 essence of competition between schemes, that actually if
 8 they have a higher MIF they can benefit.
 9 So I think it would be -- it would have been
 10 speculative of me to say, well, Visa would have gone
 11 down just because they were facing a damages claim where
 12 I think commercially it would have been quite attractive
 13 for them to stay at a high level.
 14 Q. You don't think then that the possibility of a damages
 15 claim, the fact that Visa is being investigated, the
 16 fact as we established with Mr Perez, the Commission
 17 saying both schemes could be treated equally, what you
 18 have just said a few moments ago that what applies to
 19 MasterCard applies to Visa, you don't think that would
 20 have any check on the migration at all?
 21 A. I can only comment on what my impressions are but my
 22 impressions are that that whole period, the period that
 23 we are talking about was a very murky period with lots
 24 of uncertainty over what would happen and indeed what
 25 would be ultimately acceptable level of MIFs. In that

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1 period of uncertainty, I can't see -- schemes would
 2 change if they were forced to by regulators and if there
 3 was more certainty and indeed we are now in a new world
 4 with regulations so it is all clearer, so it is
 5 a separate world, but in those nine years of the damages
 6 claim period that we are talking about, I think it was
 7 a murky period in which it was quite unclear where --
 8 even what was the right level of MIF, domestic MIF, and
 9 where each scheme would have ended up. But that's just
 10 my impression, I can't give an expert opinion on that.
 11 Q. No, precisely.
 12 Can we just go to J2 and we will try and finish this
 13 before lunch.
 14 I want to go to two more bundles. J2-bundle and
 15 D3.1. Your second supplemental report at D3.1. Tab 6.
 16 So at tab 9 of J2, we have the evidence of Mr Perez
 17 and I will take this quickly because you have
 18 essentially agreed with what he has said.
 19 But in page 17 of the transcript, 1120, at the top,
 20 his evidence is that the two four-party schemes are
 21 similar. So:
 22 "Question: In this case, are you aware that
 23 MasterCard was arguing that the Visa exemption should
 24 apply to its methodology?
 25 "Answer: Yes.

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1 "Question: Why should the Visa methodology apply to
2 MasterCard?
3 "Answer: Because ... based on cost and therefore
4 similar."
5 I tried to get out of him "very similar", but he
6 just maintained "similar".
7 If you go to page 18 over the page. Again, it is
8 a pretty obvious fact. I ask:
9 "Question: What about just the mechanics of it?
10 Four-party schemes; do you at least accept that they
11 operate in a similar way --
12 "Answer: Yes."
13 We go on to page 38, which is where I asked him
14 about a note of a meeting, so his 1141, page 38. There
15 was a meeting between him and others and
16 the Commissioner, where the Commission said there would
17 be no discrimination against MasterCard and Visa.
18 I asked him about this principle of damages and he
19 was aware of it. So I'm just setting the scene at the
20 moment. I think you have accepted everything --
21 A. Yes.
22 Q. -- in your own evidence so far.
23 But then I would like to go to page 54. It starts
24 at 54 but the relevant bit is at 56, 57. If I give you
25 the context. At 54 I'm asking Mr Perez why he reduced

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1 the -- (Pause).
2 MR HOSKINS: This bit was this camera.
3 MR BREALEY: This bit was, not the fact that they were
4 similar. That is public knowledge, so thank you, but --
5 okay. Anyway, so I'm asking him -- this is what the CMA
6 said, that they had reduced rates in November 2014,
7 2015.
8 Then if you go to page 56, I'm asking him why
9 MasterCard did this -- I am grateful but it is a matter
10 of public knowledge, CMA website, that MasterCard
11 reduced its rates. And I'm asking why they did this.
12 (aside) Do you know whether 56, line 19 is
13 confidential? It is. So I won't read that out. It was
14 in camera.
15 I think I can mention a word, I would ask you to
16 note the word "perception".
17 A. Sorry where?
18 Q. I'm sorry Dr Niels, it is page 1159, page 56, line 19.
19 A. Yes.
20 Q. So at line 19 it starts?
21 "Answer: "So the issuers ..."
22 Yes? Then it goes on. Then you get "the
23 perception".
24 A. Yes.
25 Q. That is one of the reasons that he is saying that they

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1 reduced. Then over the page at 57 I say:
2 "Question: "So the greater ... the less risk".
3 You see that?
4 A. Yes.
5 Q.
6 "Question: That would apply ..."
7 At 12, as well as to ... And he says ...
8 Okay?
9 A. Yes.
10 MR BREALEY: I'm finding it a bit difficult, but --
11 MR JUSTICE BARLING: If there's going to be much of this --
12 MR BREALEY: No there isn't. I would ask you to bear that
13 in mind and then just go to the last document and
14 then ...
15 So that was his evidence and if you go to your
16 second supplemental report at page 621, this is in the
17 section 4, the competitive dynamics. This is where you
18 try and deal with Mr von Hinten-Reed's Australian
19 experience. So this is dealing with Australia. You
20 obviously know this?
21 A. Yes.
22 Q. One of the questions is, why did Amex not get a greater
23 market share, yes?
24 A. Yes.
25 Q. Bearing in mind what Mr Perez says, at 4.16, this is

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1 paragraph 4.16, 621. This is your own view as to why
2 Amex did not obtain a greater market share and you say:
3 "I consider that the constant threat of being
4 designated could have affected Amex's incentives such
5 that it did not pursue a strategy to increase its market
6 share considerably in Australia, as being designated
7 would have led to its charges being capped in a similar
8 way to MasterCard and Visa. There was no equivalent
9 threat of a regulation of Amex in the UK during the
10 claim period."
11 But what you are saying here is that the threat of
12 being designated does affect the card payments
13 incentives to pursue a strategy to increase market share
14 and I would suggest to you that that is a commonsense
15 view and one that equally applies to the Visa
16 counterfactual -- see what we have just seen -- and that
17 you should have factored this in to your Visa scenario 1
18 counterfactual.
19 A. Well, if I may comment on what the various bits that we
20 have just seen?
21 Q. Of course.
22 A. Also from what Mr Perez was saying.
23 The way I see it and I'm simplifying perhaps but
24 what I said earlier, the relevant claim period here was
25 a murky world. So, yes, the Commission may have been

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1 saying "We will treat you both the same", but still that
 2 was -- even that wasn't clear whether they actually did
 3 but it was intra-EEA MIF. For domestic MIF in the UK
 4 there was no -- it wasn't clear what was going to
 5 happen, what would be the right level and we had the UK
 6 Maestro example. That was for most of the claim period.
 7 We are now in the new world of regulation, where it is
 8 much clearer, they are all going to be treated the same
 9 including Amex, in as far as it uses issuers.
 10 So this current world is a different world and
 11 I understand Mr Perez's evidence is that yes a few
 12 things are happening in anticipation of the current
 13 world but it is still with the current world with
 14 regulation. The Australian example -- and again there
 15 are various interesting aspects of that Australian
 16 example and also why it is different from the UK
 17 example, but in Australia we are talking here there was
 18 a regulation in place and there was a mechanism whereby
 19 the authorities constantly kept an eye on Amex and
 20 I would say in response to the proposition that that was
 21 of a different nature because there was already
 22 a regulation from say Visa fearing that it would be
 23 treated, or its interchange fees would have to stay the
 24 same as MasterCard, even if the competition authority
 25 intervention were only against MasterCard. So I think

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1 you can't entirely compare the two.
 2 MR JUSTICE BARLING: Is that a good time?
 3 MR BREALEY: It is.
 4 MR JUSTICE BARLING: We are still on target?
 5 MR BREALEY: We are still on target and we will be in
 6 camera --
 7 MR JUSTICE BARLING: For the sake of those in court now, the
 8 likelihood is you are going to ask to be in camera more
 9 or less straight --
 10 MR BREALEY: I'm doing the Amex and then the Maestro and all
 11 that is --
 12 MR JUSTICE BARLING: All that is in camera. So most of the
 13 afternoon will be in camera?
 14 MR BREALEY: That's what I'm thinking.
 15 MR JUSTICE BARLING: Right. See you at 2 o'clock.
 16 (1.00 pm)
 17 (End of open session)
 18 (The short adjournment)
 19 (2.00 pm)
 20 (REDACTED CONFIDENTIAL SESSION)
 21 (4.00 pm)
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