Ministry of Economic Development Discussion Document

"Cartel Criminalisation"

Submission by MasterCard International Inc.

INTRODUCTION AND EXECUTIVE SUMMARY

1. MasterCard International Inc (MasterCard) welcomes the opportunity to make a submission on the important issues raised in the Ministry of Economic Development's Discussion Paper "Cartel Criminalisation" (Discussion Paper).

2. MasterCard is the proprietor and operator of one of the world's largest and most successful payment systems. Efficient payment system networks are indispensable to the New Zealand economy. They play an essential role in facilitating fast and efficient commercial transactions for vendors throughout the country, allowing business to flourish. In the tourism sector particularly, MasterCard's international acceptability is a crucial component for generating revenue from overseas visitors. MasterCard payment systems thus contribute directly to the government's objectives of growing the economy, creating jobs, raising income levels and attracting overseas investment. Legislation which affects payment system networks will therefore have far-reaching consequences for the economy as a whole.

3. This review is a unique opportunity to carefully consider the scope of the cartel provisions in the Commerce Act 1986 both generally, and as they apply to networks. The Ministry's challenge is to ensure that the provisions are crafted in such a way as to avoid capturing legitimate and efficiency-enhancing activity, and so as not to create market distortions or impede economic growth.

4. This submission is structured as follows:

   4.1. The MasterCard payment system;

   4.2. The need for criminal sanctions;

   4.3. The special position of payment system networks; and

   4.4. MasterCard's proposals for reform.

5. MasterCard's contact for the purposes of this submission is:

Carl J. Munson, Jr.
Group Executive & Associate General Counsel
MasterCard International Incorporated
2000 Purchase Street
Purchase, New York 10577-2509
United States of America

Phone: +001 (914) 249 5514
Fax: +001 (914) 249 4261
Mobile: +001 (914) 255 0349

THE MASTERCARD PAYMENT SYSTEM

— Overview

6. MasterCard Incorporated is listed on the New York Stock Exchange and its principal operating subsidiary is MasterCard International. The MasterCard group has existed in some form since 1966.

7. MasterCard is the owner of the family of well-known, widely accepted payment card brands including MasterCard®, Maestro® and Cirrus®. MasterCard markets its portfolio of brands and programmes through its customers who are generally either principal members of MasterCard and who participate directly in MasterCard's business or who are affiliate members of MasterCard and participate indirectly in MasterCard's business through a principal member.

8. As at December 31, 2009, MasterCard had approximately 2,400 principal members and 20,400 affiliate members worldwide.

9. MasterCard has a three tiered business model of franchisor, processor, and advisor:

    9.1. As franchisor it enters into licence agreements with its customers (which are typically financial institutions) under which those customers are entitled to use the MasterCard marks and participate in the MasterCard payment system in return for which they agree to abide by certain requirements which are necessary for the operation, security and overall success of the system;

    9.2. As processor, it connects its members around the world. The operability of the MasterCard network depends on integration between MasterCard's systems and those of its customers so as to ensure the virtually instantaneous transfer of data. Through its sophisticated global network, MasterCard undertakes authorisation, clearing and settlement of transactions;

    9.3. Through MasterCard Advisors, the largest and only global consultancy focused on the payments industry, MasterCard's financial institutions benefit from a wide range of consulting, information and other services to enable them to maximise the value of their cards businesses. MasterCard Advisors offers advice in five key areas: payments strategy; member profitability; operations improvement; business/portfolio management; and risk management.

— Payments systems industry is highly competitive

10. MasterCard operates in the global payments market, which consists of all forms of payment including:

    10.1. paper—cash, personal cheques, money orders, official cheques, travellers cheques and other paper-based means of transferring value;

    10.2. cards—credit cards, charge cards, debit cards (including Automated Teller Machine ("ATM") cards), pre-paid cards and other types of cards; and

    10.3. other electronic and emerging payments such as wire transfers, electronic benefits transfers, bill payments, Automated Clearing House payments and mobile devices, among others.

11. MasterCard programmes compete against all forms of payment. As a result of a global trend, electronic forms of payment such as payment cards are increasingly displacing paper forms of payment, and card brands such as MasterCard, Visa, American Express and Diners Club are benefiting from this displacement. However, cash and cheques still capture the largest overall percentage of worldwide payment volume. In New Zealand, EFTPOS, which is the dominant electronic payment instrument, is a key competitor.

12. Within the MasterCard payment network itself, MasterCard's customers compete with each other for the business of cardholders and merchants through intrabrand competition. The MasterCard payment systems network creates the platform which enables this competition to occur.

— The success of MasterCard

13. MasterCard continues to respond to the competitive challenges it faces and it has been very successful in doing so. MasterCard's business has grown considerably in recent years. Comparing full year operating information from 2006 with full year operating information in respect of 2008, MasterCard's worldwide purchase volume increased by 31% driven by increased cardholder spending on a growing number of MasterCard cards. Over the same period, growth in the number of MasterCard cards issued increased by 17% and the number of purchase transactions processed increased by 21%. Given this success it is clear that MasterCard is satisfying a market need. In 2009, worldwide purchase volume rose 1.7%, on a local currency basis. Revenues for 2009 grew 2.1%, from US$5.0 billion to US$5.1 billion. The company also generated net income of US$1.5 billion for the year.

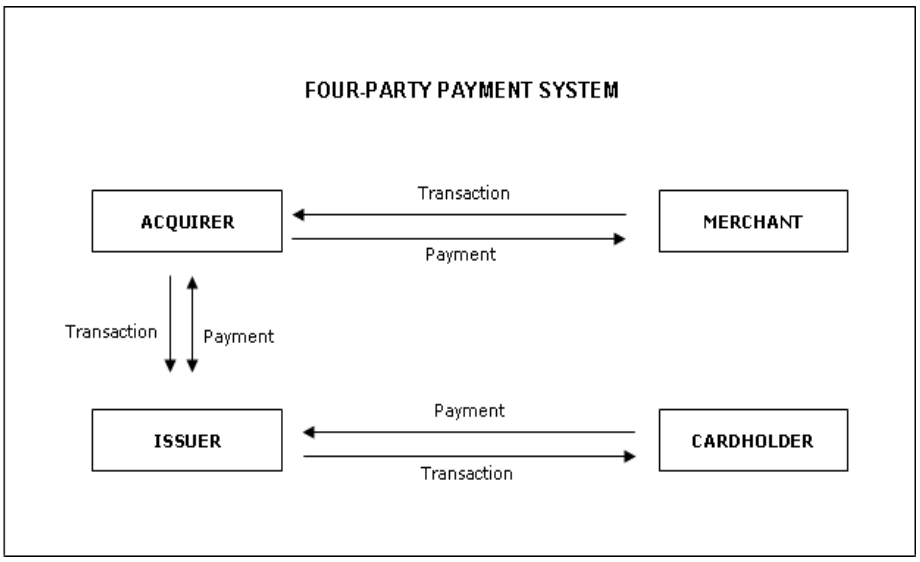
14. In 2009, MasterCard processed 22.4 billion transactions, a 6.9% increase over the number of transactions processed in 2008. The gross dollar volume reported on cards carrying the MasterCard brand was approximately US$2.5 trillion. As at December 31, 2009, MasterCard was accepted at 29.9 million locations around the world. As of December 31, 2009, the company's customers had issued 1.6 billion MasterCard and Maestro-branded cards worldwide.

15. At the end of 2008, approximately 144,000 merchants around New Zealand accepted MasterCard cards and 1.2 million MasterCard credit cards had been issued by financial institutions in New Zealand. In 2008, 75 million transactions were made on MasterCard cards with a gross dollar value (**GDV**) of approximately NZD$8.6 billion.

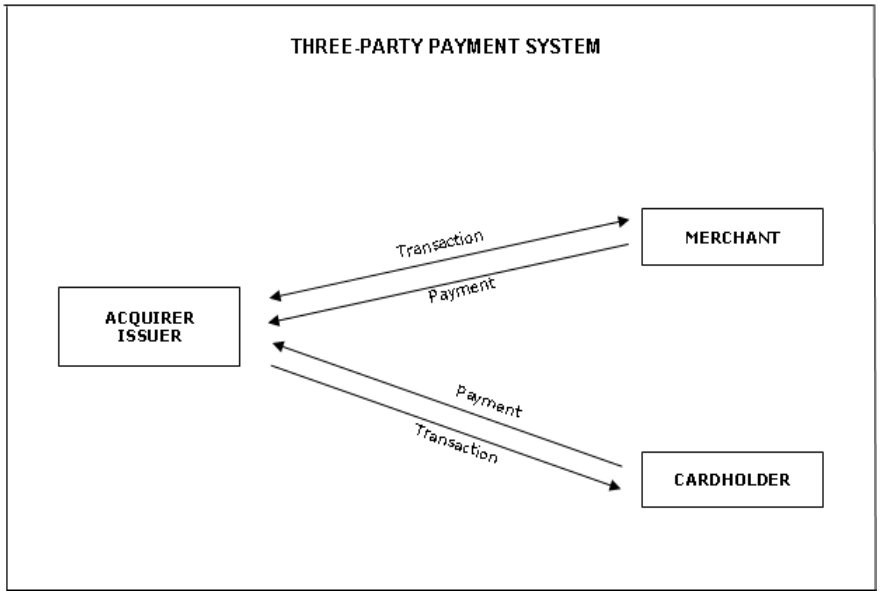
16. The importance of global networks to a country such as New Zealand cannot be underestimated. Effective payment systems enable New Zealand to connect with and participate in the global economy by providing a critical link among financial institutions, businesses, cardholders and merchants across the globe.

— How it all works …

17. MasterCard (and Visa) operate what is termed a "four party" or "open loop system" as shown by the following diagram:



18. This is in contrast to what are termed "three party" or "closed loop" systems which consist of the cardholder, the merchant and the system provider. Examples of three party systems include American Express, Diners Club and many proprietary or store cards such as Q Card, Farmers Card, and the GE Credit Line card.



19. As evidenced by their success, four party schemes offer substantially more benefits in comparison with three party schemes. These include:

    19.1. more vigorous competition between issuers and between acquirers for the business of cardholders and merchants;

    19.2. more extensive geographic coverage. Because cardholders and merchants can use different banks, the system allows a wider geographic reach;

    19.3. lower fees. Four party schemes are typically less expensive than three party schemes, especially for merchants;

19.4. increased card circulation because more banks are involved, cardholders can access payment service facilities in more locations and merchants can broaden their customer base;

19.5. mutual benefit of brand promotion and development.

20. However, four party payment schemes have attracted a degree of scrutiny both in New Zealand and overseas because of their default rules. In order to provide the payment card service to its customers, a four party scheme must be capable of permitting:

20.1. the cardholder to purchase goods or services from the merchant;

20.2. the merchant to submit the transaction to the acquirer and to be reimbursed on a more or less guaranteed basis for the amount of the transaction less a merchant service fee;

20.3. the acquirer to submit the transaction to the issuer for settlement and to be reimbursed for the transaction amount less the interchange fee; and

20.4. the issuer to collect payment from the cardholder for the purchases made, either soon after the transaction, as with a debit card, or after an interest free period, as in the case of a credit or charge card.

21. The core feature of the MasterCard Scheme is that it enables issuers and acquirers who may be on different sides of the world and who may have no direct technology or operating relationship with each other to conduct a payment transaction. In order for a card issued by one such bank to be accepted at a merchant acquired by another, where the only commonality is the MasterCard brand that appears on the consumer's card and on the merchant's door, a set of minimum default rules have been established to which all the Scheme's participants have agreed to abide. Without the commercial certainty provided by such default rules, any four party scheme would find it extremely difficult if not impossible to attract participants.

22. Those default rules[1] cover such matters as:

22.1. prudential and other requirements for participating in the system;

22.2. the basis upon which merchants may accept cards;

22.3. the terms of settlement between issuers and acquirers including, for example, the level of interchange. (MasterCard does not have anything to do with the nature or level of fees charged by issuers or acquirers to their customers).

23. The fact that MasterCard prescribes certain default rules as requirements for participation in its payment system network meant that MasterCard attracted the scrutiny of the New Zealand Commerce Commission. In 2006 the Commission commenced proceedings against MasterCard and its member banks.[2] This litigation was

[1] http://www.mastercard.com/us/company/en/whatwedo/merchant_rules.html

[2] A parallel action was commenced against Visa and the banks, and the Commission's proceeding was joined by an action brought by a group of large retailers.

settled in late 2009, with no admission of liability by MasterCard. Despite its decision to settle, MasterCard disagreed strongly with the basis for the Commission's case and the Commission's interpretation of the Act. The Commission's case was principally based on section 30 of the Commerce Act, alleging that the interchange fee provisions, together with certain of the other default rules, "controlled or maintained" the charges levied on merchants by acquiring banks.

24. This type of (attempted) over reach of section 30 illustrates why MasterCard does not support Option One in the Discussion Paper (criminalisation of current provisions). Section 30 contemplates a more truncated analysis compared to that which is required by sections 27 and 36. No formal market definition analysis is required under the section. There is no explicit ability to weigh up any pro-competitive effects of the alleged price fixing, with any anti-competitive effects. The blunt instrument of section 30 is simply inapt as a basis for assessing an activity with the complexity and sophistication of payment system (and possibly other) networks.

THE NEED FOR CRIMINAL SANCTIONS

25. MasterCard is not in a position to know whether the current New Zealand cartel penalties are sufficiently deterring cartel conduct and offers no comment on that issue. Rather it makes the following observations in relation to criminal penalties generally.

26. In MasterCard's view the key issue is to ensure that the offence provisions are sufficiently well crafted that they apply to conduct which is egregious without impugning that which is not and can be applied with a high degree of predictability.

27. The need for appropriately crafted offence provisions arises whether or not criminal penalties are introduced, but obviously the effects of over reach and/or uncertainty will be more serious when criminal penalties apply.

28. The risks arising from overreach and uncertainty are greater for a small economy such as New Zealand. New Zealand contributes a very small share of the revenue of most multinationals and is not an essential market.

— Uncertain criminal provisions offend the rule of law

29. Overbroad or uncertain offence provisions will offend fundamental principles of the rule of law which require that citizens are governed by rules that are fixed, knowable and certain. "The criminal law is not a tool to be deployed wherever someone may do wrong. As a regulatory device, it is a bluntly coercive, morally loaded sledgehammer, something to be used sparingly and with care".[3]

30. In addition, attempts to impose criminal penalties in areas of significant uncertainty of application is likely to meet judicial reluctance to find breaches in the first place. This is likely to undermine the price fixing regime rather than enhance it.

31. The Court of Appeal touched on these difficulties in *New Zealand Bus Limited v Commerce Commission* [2008] 3 NZLR 433, which also contains discussion of the approach to *per se* type offences.

32. In *New Zealand Bus Limited* the Commission alleged that the acquisition by NZ Bus of 74% of Mana Coach Services Limited substantially lessened competition and so contravened section 47 of the Act. The Commission also sought to establish accessory liability against the shareholders in Mana's parent company. The Court of Appeal noted that the imposition of accessory liability under section 83 of the Commerce Act was closely analogous to the criminal law requiring both an *actus reus* and a degree of knowledge based on intention.

> In relation to overtly collusive activity such as cartels and price fixing, the *actus reus* can appropriately be regarded as inherently wrong, and something like the North American *per se* approach to antitrust liability can make sense. In *Broadcast Music, Inc.* v *Columbia Broadcasting System, Inc*., 441 US 1 at 8 (1979), the United States Supreme Court held that certain agreements or practices are so "plainly anticompetitive" and so "lack redeeming virtue" that they are conclusively presumed illegal without further examination. What is to be regarded as a *per se* wrong is contentious; the area is not static, and may be reviewed from time to time as to what is to be regarded as bad *per se* behaviour. See generally, Black *Conceptual Foundations of Antitrust* (2005) at 62-93. However, that is not the context

[3] Simester & Brookbanks *Principles of Criminal Law* (3rd ed, 2007) at 719

of this case, where the central difficulty is prospectively knowing whether an acquisition of shares is going to have the effect of substantially lessening competition in the relevant market. See Castle and Writer "More than a little wary: Applying the criminal law to competition regulation in Australia" (2002) 10 CCLJ 5 at 13: "[w]hen one introduces the inherent ambiguity of economic criminality, the traditional view of criminal responsibility based on a view that all criminal acts are wrong at some fundamental level … begins to fall down" (at para 129).

33. The Court then explored whether a strict criminal analogy was the correct approach to section 83 and identified a number of problems which would need to be addressed for this to be appropriate. First, it noted that the principle that the law should only resort to criminal law principles when the particular acts complained of are "always harmful to society". This was, in the Court's view, problematic in competition law terms when the harm caused by allegedly "illegal" acts was more ambiguous and it is possible to "accidentally" breach the statute (at para 131).

34. The practical overreach of accessory liability was, in the Court's view, significant. There are "real consequences not just for the company which is caught, but also for corporations which may choose to compete less aggressively as a result, with significant ramifications for consumers" (at para 134).

— Uncertain provisions harm competition

35. The stultifying effects of poorly drafted offence provisions on beneficial economic activity would be compounded if criminal offences were introduced to the Act in its current form.

36. As the Discussion Paper notes (paragraph 75) the current civil prohibitions are framed in a broad manner. In the litigation referred to previously, the Commerce Commission advanced a particularly strained interpretation of section 30. It essentially attempted to treat the MasterCard Scheme as if it were a classic vertical distributorship. It did this by ignoring the two-sided nature of the payment and characterising the market as having upstream (network) and downstream (acquiring) components. As explained above, a four party payment system is not a vertical arrangement but rather a loop, in which the consumer deals with the merchant, the merchant with its acquirer, the acquirer with the consumers' card issuer, and the issuer with its cardholder – who is also the consumer – thus closing the loop.

37. As a practical example of the type of detriment to competition which uncertainty can cause, the Commission's pursuit of this strained interpretation meant that a potential new member of the MasterCard Scheme did not proceed with issuing cards. GE Money, a multi-national specialist provider of consumer finance, joined the MasterCard scheme in 2006 in order to start issuing MasterCard credit cards in New Zealand. Shortly after obtaining its licence, but prior to it issuing any cards, the litigation was commenced. GE relinquished its licence as a condition of being released from the litigation. To date it has not sought to re-enter the market.

— Only egregious conduct should be caught

38. The United States has the most experience of any jurisdiction with criminal anti-trust law. Under United States law only the most egregious and obvious types of conduct are prosecuted (i.e. secret agreements among independent businesses that are intended to manipulate market prices or carve up the market). The Department of Justice has published an Antitrust Primer for Federal Law Enforcement Personnel, at

http://www.justice.gov/atr/public/guidelines/209114.htm. It states in the Introduction, "The purpose of this Primer is to provide federal law enforcement personnel with a quick overview of antitrust conspiracies that constitute felony violations of federal law. Specifically, the Antitrust Division wants to share with you the hallmarks of price-fixing, bid-rigging, and market allocation agreements and thereby dispel the commonly-held notion that such criminal antitrust conspiracies can be proven only by sophisticated economic analysis." The point that criminal prosecution should only apply to a narrow set of hardcore antitrust violations and not to rule of reason-type cases is made clear in a Department of Justice article titled "Criminal Enforcement of Antitrust Laws: The US Model": "At the same time, the Division focuses its criminal enforcement only on hard core violations. By focusing narrowly on price fixing, bid-rigging, and market allocations, as opposed to the "rule of reason" or monopolization analyses used in civil antitrust law, we have established clear, predictable boundaries for businesses. This narrow focus also helps conserve prosecution and judicial resources by reducing the number of potential cases and also by reducing the complexity of proof: proving the existence of an agreement establishes the violation without the need for the detailed economic testimony common in civil antitrust actions."[4]

39. In the section titled "Price Fixing, Bid Rigging, and Market Allocation," it describes the elements of a Section 1 offence as follows: "Criminal prosecution under Section 1 of the Sherman Act requires only the existence of concerted action in restraint of trade — specifically, an agreement among competitors to fix prices, rig bids, or allocate markets. The agreement must be between two or more independent business entities or individuals. *No overt acts need be proved, nor is an express agreement necessary.* The offense can be established either by direct evidence from a participant or by circumstantial evidence (such as bids that establish a pattern of business being rotated among competitors). The conspiratorial agreement must occur in, or affect, interstate or foreign commerce."

40. It goes on in this section to describe how "conspiracies" are proved by stating, "In most Sherman Act prosecutions, prosecutors allege and prove an oral agreement and overt acts. Proof of the agreement usually comes from the testimony of the conspirators about what was said by the conspirators when they agreed or about what they understood the agreement to be. The witnesses upon whom the government relies are typically present or former middle- or upper-level management people. Overt acts can include secret meetings among corporate representatives, the issuance of price lists, the submission of bids, phone calls among companies to exchange bid numbers or other customer information, and the use of code words to conceal the conspiracy. Proof of such overt acts generally comes from the testimony of conspirators, supported by documents, such as bids, price lists, price quotations, transmittal letters, telephone records, appointment books, job estimates, and expense account records. Such documents are important pieces of evidence and also can corroborate the testimony of principal witnesses. Purchasing agents and other victims also provide helpful testimony about how they were deceived and cheated by the conspirators, which can have a substantial impact with a jury."

41. It is this type of conduct at which any criminal sanctions need to be aimed.

[4] Address by Thomas O. Barnett, Assistant Attorney General, Antitrust Division, U.S. Department of Justice, at the Fordham Competition Law Institute's Annual Conference on International Antitrust Law and Policy New York, New York, September 14, 2006.

THE SPECIAL POSITION OF NETWORKS

42. The Discussion Paper records general agreement that "agreements, concerted practices, or arrangements which are reasonably related to the lawful realisation of cost-reducing or output-enhancing efficiencies" should be excluded from the cartel provisions. "The type of efficiency enhancing integration is most commonly seen in joint ventures, franchises, and networks." [para 106]

43. MasterCard agrees. This reflects standard economic thinking that such arrangements enhance rather than harm competition. Networks require a degree of co-operation between multiple entities that are often competitors. When the degree of co-operation reaches the level of the creation of a branded service, such as a payment card, that co-operation requires the taking of decisions which in other contexts might be deemed to be anti-competitive even though, in the network context, they are not. This concept has been recognised in a number of cases.

— Case law

44. One of the leading cases is *Broadcast Music Inc v* CBS 441 (US) 1 (1979). This case involved an action brought against BMI by CBS alleging, among other things, that BMI's practice of issuing blanket music licences was price fixing. BMI represented tens of thousands of publishing companies, authors and composers. Rather than offer individual licences, it offered blanket licences, which permitted the licensees to perform all of the music in BMI's catalogue at prices determined by BMI.

45. The Court held the blanket licence was not a naked restraint of trade with no purpose except stifling competition, but accompanied the integration of sales, monitoring and enforcement against unauthorised copyright use. Rather, it responded to the practical difficulty that individual licensing was virtually impossible.

46. It stated:

> This substantial lowering of costs, which is of course potentially beneficial to both sellers and buyers, differentiates the blanket license from individual use licenses. The blanket license is composed of the individual compositions plus the aggregating service. Hence, the whole is truly greater than the sum of its parts; it is, to some extent, a different product. The blanket license has uncertain unique characteristics: It allows the licensee immediate use of covered compositions, without the delay of prior individual negotiations, and great flexibility in the choice of musical material. Many consumers clearly prefer the characteristics and cost advantages of this marketable package, and even small performing-rights societies that have occasionally arisen to compete with ASCAP and BMI have offered blanket licenses. Thus, to the extent the blanket license is a different product, ASCAP is not really a joint sales agency offering the individual goods of many sellers, but is a separate seller offering its blanket license, of which the individual compositions are raw material. ASCAP, in short, made a market in which individual composers are inherently unable to compete fully effectively.

47. Further:

> Joint ventures and other cooperative arrangements are also not usually unlawful, at least not as price-fixing schemes, where the agreement on price is necessary to market the product at all.

> Here, the blanket-license fee is not set by competition among individual copyright owners, and it is a free for the use of any of the compositions covered by the license. But the blanket license cannot be wholly equated with a simple horizontal arrangement among competitors. ASCAP does set the price for its blanket license, but that license is quite different from anything any individual owner could issue. The individual composers and authors have neither agreed not to sell individually in any other market nor use the blanket license to mask price fixing in such other markets. Moreover, the substantial restraints placed on ASCAP and its members by the consent decree must not be ignored. The District Court found that there was no legal, practical, or conspiratorial impediments to CBS's obtaining individual licenses; CBS, in short, had a real choice.

48. *BMI* was followed in *Nabanco* v *VISA* 596 F. Supp 1231, in which the plaintiff *Nabanco* alleged that the method employed by Visa to set and determine the interchange fee involved price fixing and was anti-competitive. The District Court concluded that:

> IRF should be analysed under the rule of reason because it is an agreement on the terms of interchange necessary for VISA to mark its product and be an effective competitor. Prohibiting IRF would therefore undermine 'interbrand' competition, 'which is the primary concern of the antitrust law.' Even if IRF were not necessary to market the product, it should be analyzed under the rule of reason because it is an agreement internal to a type of joint venture which yields efficiencies beneficial to competition, that its members, acting alone, could not offer, and which allows the venture to offer a product which is different from, and greater than, the sum of the individual products of its members.

49. The Court of Appeal (11th circuit) agreed with the District Court's conclusion that:

> … in deciding whether a challenged practice is subject to rule of reason or per se analysis, the court must inquire into whether the practice, on its face, always or almost always tends to restrict output or instead is likely to assist the creation of economic efficiency. *NaBanco*, 596 F. Supp. at 1253. Rigid line-drawing must be avoided and close attention given to procompetitive, efficiency-creating integration that is accomplished as the result of an anticompetitive, yet ancillary, restraint. We conclude that the district court properly determined that the IRF was not a naked restraint of competition and therefore not per se price fixing proscribed by Section 1 of the Sherman Act.

50. It is because of the recognition of these pro competitive effects, that the United States' position is that joint venture pricing is dealt with as part of a rule of reason (i.e. a full section 27 type analysis) rather than through the truncated per se approach. As was stated in *Copperweld Corp v Independence Tube Corp* 467 US 752 at 768:

> [C]ombinations such as ... joint ventures ... hold the promise of increasing a firm's efficiency and enabling it to compete more effectively. Accordingly, such combinations are judged under a rule of reason, an inquiry into market power and market structure designed to assess the combination's actual effect.

51. Similarly in *Texaco v Dagher* the US Supreme Court confirmed that the pricing decisions of a legitimate joint venture do not fall within the narrow category of activity which is per se unlawful.

— MasterCard Scheme

52. The MasterCard Scheme is an archetypical example of the type of an arrangement which is efficiency-enhancing. It:

    52.1. Enables the participants to produce a product (global payment system) which none could offer on their own. To quote *BMI*, the sum is greater than the whole of the parts.

    52.2. Creates, fosters, and sustains both intrabrand and interbrand competition;

53. In order to function however, it requires a degree of cooperation and standardisation (as reflected in the default rules and standards). This co-operation is necessary in order to create competition which would not otherwise exist.

54. Applying cartel rules to networks risks the outcome that they cannot function as efficiently, if at all. This can be illustrated by a comparison of three and four party payment networks. Four party payment networks are larger than three party. They have geographic reach, scale, and scope. Generally their costs are lower than three party networks. Three party networks appear to be less efficient. However, because the various activities are held within a single entity they have not attracted the scrutiny of regulators as have four party systems. This is despite having many if not all the same rules.

55. Clearly, if cartel rules were applied to payment networks, this would mean the elevation of form over substance and put the more efficient, open schemes at risk.

MASTERCARD'S SUGGESTIONS FOR REFORM

56. MasterCard submits that the Ministry of Economic Development should adopt Option Three in the Discussion Paper, and develop a greenfields regime applicable to cartel conduct. For reasons which are outlined earlier in this submission, the current regime has proved problematic. It has been in force in its current form for nearly 25 years. As noted, this review represents a unique opportunity to consider the regime afresh in light of current experience and best practice overseas developments.

57. Within that greenfields review, the principal focus of MasterCard's submission is on the effective and appropriate treatment of payment system networks. To be clear, MasterCard is not proposing that payment system networks should be exempt from scrutiny under the Commerce Act. Its position is rather that the more nuanced analysis available under section 27 is the appropriate place in which to consider the real impact of payment systems (and indeed other networks or platforms) on competition.

58. There are a number of ways in which this could be approached.

59. One option is to redesign section 30 so as to more clearly exclude activities which are efficiency-enhancing or contain pro-competitive outcomes than does the current provision. This would effectively involve moving section 30 away from a *per se* offence to a *rule of reason* offence.

60. This would be consistent with the international trend away from judging conduct according to a *per se* standard. This trend recognises that the "accelerating globalisation of the legal, economic, and social environment … is no longer an appropriate test to scrutinise modern business agreements."[5] Most recently in *Leegin Creative Leather Products Inc v PSKS Inc* 552 US 877 2007, the US Supreme Court held that vertical price restraints should be assessed under *rule of reason* rather than under *per se* as had historically been the case.

61. Despite this trend, MasterCard believes that there is a continuing role for per se offences. This is because there are some forms of conduct which are universally condemned — principally "naked price fixing". A per se offence still has a role to play in relation to that conduct.

62. If section 30 is to be retained as a per se offence, then MasterCard agrees that the current provision must be amended to provide that the alleged principal offenders are in competition at all levels of the supply, production, or distribution chain [Discussion Paper para 207]. Otherwise there is a risk vertical arrangements (which are generally regarded as exhibiting pro competitive characteristics) will be caught.

— A specific network exemption

63. MasterCard submits that the better policy option is to include in the Commerce Act a provision which makes clear that networks are not subject to the cartel provision in section 30, through a specific network exemption. The cartel provisions of the Commerce Act have not been amended since the Act was first passed in 1986. Since that time the world has seen a technological explosion. The Commerce Act needs to

[5] See Adam Weg "Per se treatment: an unnecessary relic of antitrust litigation" 60 Hastings LJ 1535; and Thomas A Lambert "Dr Miles is dead. Now what?: Structuring a rule of reason for evaluation minimum resale price maintenance" 50 Wm & Mary L Rev 1937.

take into account the growing complexity and interdependence of agreements and commerce both domestically and abroad. Agreements involving the use of technology such as payment system networks promote competition, innovation, and increased efficiencies both within and across markets. In this type of field of commerce, dynamic efficiency is very important because of the focus on innovation and investment. Bad legislative policy choices can thus do more damage than in more traditional static models of business.

64. As a starting proposition, MasterCard suggests the following by way of a Network Exemption.

> Nothing in section 30 of this Act shall apply to a provision of a license, contract or agreement between, or an arrangement entered into or understanding arrived at by, the operator and participants in a network if the provision, arrangement or understanding is related to the business or operation of the network or the delivery of the network's services. Without limitation, provisions, arrangements and understanding related to the price of the network's services, the allocation of cost among the network participants and the policies, rules and practices of the network are covered by this exemption. Without limitation, "network" shall include financial networks, payment networks and telecommunication networks.

65. A broad exemption is appropriate. In economic terms a network is characterised by externalities. It is likely to be almost impossible to craft a legal definition of "network". The Commerce Act contains a number of economic terms (market power, substantially lessening competition) which do not have precise legal meaning and which have been developed by the Courts over time. Further, as noted, networks are generally in technologically complex and innovative industries. The risk in "locking down" the exemption is that it ceases to be appropriate as new forms of network develop.