**IN THE HIGH COURT OF NEW ZEALAND**
**AUCKLAND REGISTRY**

**CIV 2006-485-2535**

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| BETWEEN | COMMERCE COMMISSION<br>Plaintiff |
| AND | CARDS NZ LIMITED<br>First Defendant |
| AND | AND OTHERS |

**CIV 2006-485-2693**

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| AND BETWEEN | DSE (NZ) LIMITED<br>First Plaintiff |
| AND | AND OTHERS |
| AND | CARDS NZ LIMITED<br>First Defendant |
| AND | AND OTHERS |

Hearing: 26 June 2008

Counsel: L Theron for Commerce Commission
JL Land for DSE (NZ) Limited
AR Galbraith QC for Cards NZ Limited
CR Carruthers QC and MN Dunning for Visa International Service Association
JE Hodder and VL Heine for MasterCard International Incorporated
TL Clarke for ANZ National Bank Limited
HM McIntosh and JS Shaerf for American Express International (NZ) Inc - a non-party
IJ Thain and GF Weir for Diners Club (NZ) Limited - a non-party

Judgment: 29 July 2008 at 2.00 p.m.

## JUDGMENT OF RODNEY HANSEN J

*This judgment was delivered by me on 29 July 2008 at 2.00 p.m., pursuant to Rule 540(4) of the High Court Rules.*

*Registrar/Deputy Registrar*

*Date: ……..……..……..……..*

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[1] In proceeding CIV 2006-485-2535, the Commerce Commission alleges that the firms and banks which operate the Visa and MasterCard credit card systems have breached ss 27 and 30 of the Commerce Act 1986 (the Act). The Commission seeks declarations, injunctive relief and pecuniary penalties.

[2] In associated proceedings under number CIV 2006-485-2693, a group of major retailers seek damages caused by the alleged anticompetitive conduct of the same defendants. Both claims are to be heard in the last quarter of 2009.

[3] Cards NZ Limited (Cards) and Visa International Service Association (Visa International) (together Visa), which operate the Visa card system, and MasterCard International Incorporated (MasterCard), which operates the MasterCard system, seek non-party discovery from American Express International Inc (American Express) and Diners Club (NZ) Limited (Diners Club) which respectively operate the American Express and Diners credit card systems.

[4] The Commission neither supports nor opposes the application but sought to be heard in relation to some aspects of it. All other parties abide by the decision of the Court.

**Commission's case**

[5] Both Visa and MasterCard operate what is known as a four-party or open-loop payment card system. The four parties are:

a) The issuer, usually a banker, who is licensed by the scheme operator to issue cards.

b) The cardholder who uses the card to buy goods and obtain cash.

c) The merchant who accepts the card in payment for goods and services.

d) The acquirer, usually a bank and also licensed by the scheme operator, who pays the merchant the value of a transaction less a fee called the merchant service fee (MSF).

[6] The acquiring bank is reimbursed by the issuing bank for the payment made to the merchant less a fee known as a multilateral interchange fee (MIF). The issuing bank is, of course, paid by the cardholder from whom it will also receive card fees and interest.

[7] The payment system operated by American Express and Diners Club is known as a three-party or closed-loop system. In this system the functions of the issuer and acquirer in a four-party system are assumed by the scheme operator. The scheme operator pays the merchant the value of a transaction less the merchant service fee and the cardholder pays the scheme operator the value of the purchase.

[8] The Commission says Visa and MasterCard and their respective issuing and acquiring banks have entered into a contract agreement or understanding which has the purpose, effect or likely effect, of controlling or maintaining the MSF charged by acquirers to merchants. This is said to arise as a result of the MIF fee establishing a "floor price" for the MSF. As the acquiring banks compete with one another to supply services to merchants, the schemes are said to contain a price fixing provision contrary to s 30 of the Act.

[9] The arrangements are said to also have the purpose or effect of substantially lessening competition, contrary to s 27 of the Act, either through the deeming provisions of s 30 or because of the way in which the MIF fee operates in association with rules agreed between the participants. The rules include conditions that:

a) Banks must require that merchants do not exact a surcharge from cardholders ("the no surcharge rule").

b) Acquiring banks must accept MasterCard/Visa cards equally and without discrimination and treat all cards the same and must require merchants to do the same ("the no discrimination rule").

c) Acquiring banks must accept all MasterCard/Visa cards regardless of issuer and require merchants to do the same ("the honour all cards rule").

**Discovery sought**

[10] MasterCard and Visa initially sought discovery of a wide range of documents relating to the operations of American Express and Diners Club. The scope of the orders proposed had narrowed significantly by the end of the hearing, partly as a result of exchanges which had taken place beforehand and partly because of concessions made in the course of the hearing. Ultimately, both applicants sought the following orders:

*American Express*

Documents in relation to:

1. The range of merchant discount fees by reference to particular merchant sectors and, to the extent not reflected in contractual arrangements provided by way of representative sample under 4 below, the costs associated with a merchant accepting an American Express card and the benefits of doing so;

2. To the extent not indicated in contractual documents provided by way of representative sample under 4 below, the costs associated with holding an American Express card and the benefits of doing so;

3. The factors taken into account in setting the merchant discount fees, and the methodology by which this is done, including as to any transfer pricing or internal allocation policies;

4. Those items in the letter dated 22 May 2008 from Russell McVeagh to Chapman Tripp which it was indicated American Express would provide.

*Diners Club*

Documents in relation to:

1. The range of merchant discount rates by reference to particular merchant sectors and as to what other costs (if any) are payable by merchants (e.g. processing costs);

2. The factors taken into account in setting the merchant discount fees, and the methodology by which this is done, including as to any transfer pricing or internal allocation policies;

3. Those items in the letter dated 17 June 2008 from DLA Phillips Fox to Chapman Tripp which it was indicated Diners would provide.

[11] In each case documents are to include:

a) Management and board reports;

b) Financial models;

c) Monthly management accounting reports which set out the allocation of costs to individual expense items in detail as to merchant fees and rewards/other incentives;

d) Accounting manuals which set out in detail how expenses are to be classified within the code of accounts in use;

e) Detailed listing showing the make-up of the individual items charged to each category of accounts in use.

**Non-party discovery – jurisdiction**

[12] An order for discovery may be made against a non-party under r 302 of the High Court Rules which provides:

(1) This rule applies if it appears to the Court that a person who is not a party to a proceeding (the person) may be or may have been in the control of 1 or more documents or a group of documents that the person would have had to discover if the person were a party to the proceeding.

(2) The Court may, on application, order the person—

(a) to file an affidavit stating—

(i) whether the documents are or have been in the person's control; and

(ii) if they have been, but are no longer, in the person's control, the person's best knowledge and belief as to when they ceased to be in the person's control and who now has control of them; and

(b) to serve the affidavit on a party or parties specified in the order.

(3) An application for an order under subclause (2) must be made on notice to the person and to every other party who has filed an address for service.

(4) The Court may not make an order under this rule unless satisfied that the order is necessary at the time when the order is made.]

[13] By subpara (1) an order may be made if it appears that the non-party may be (or may have been) in the control of documents that the non-party would have had to discover if it were a party to the proceeding. An order may not be made, however, unless the Court is satisfied that the order is necessary at the time it is made: subpara (4).

[14] The general criterion of relevance is, accordingly, imported into the rule but made subject to the further requirement of necessity. The threshold requirement is, therefore, that the documents sought relate to a question in the proceeding, in the sense that it is reasonable to suppose that it will contain information which may, either directly or indirectly, enable the party seeking discovery either to advance its own case or to damage the case of its adversary - *Compagnie Financière et Commerciale du Pacifique v Peruvian Guano Co* (1882) 11 QBD 55 (CA).

**Relevance**

[15] As refined in the course of argument, the applicants submit that the discovery sought from the non-parties is relevant and necessary to:

a) Market definition; and

b) The nature and function of interchange fees and their relationship to merchant charges.

*Market definition*

[16] In its amended statement of claim the Commission pleads the markets affected by the alleged anticompetitive conduct are the markets in New Zealand for:

a) The supply of merchant acquiring services in respect of Visa card transactions ("the Visa Acquiring Market"); and

b) The supply of merchant acquiring services in respect of MasterCard card transactions ("the MasterCard Acquiring Market").

In the alternative, an acquiring market for merchant acquiring services in respect of both credit cards is relied on.

[17] The defendants contend for a much wider market comprising a payment systems market in which Visa and MasterCard (and other credit card schemes, including American Express and Diners) compete against one another and other payment services such as EFTPOS cards, cheques and cash.

[18] Mr Carruthers QC and Mr Hodder submitted that the documents sought are necessary to enable the market definition analysis to be conducted. They argued that a full picture of the relevant potential market is required, including the products being offered and the price range at which particular transactions occur. This was said to be necessary in order for experts to consider the substitutability or otherwise of American Express and Diners cards from the point of view of cardholders and merchants.

[19] It is open to question that market definition will involve a choice between those advocated by the Commission and the defendants respectively. The Commission accepts that there may be a wider market in which American Express and Diners Club compete with Visa and MasterCard but says such a market could coexist with the alternatives postulated by the Commission.

[20] It is also possible, as Mr McIntosh submitted, that in what is essentially a price fixing case, the metes and bounds of the market will not be determinative. Proof that the parties competed in a competitive market may be sufficient – see *Australian Competition and Consumer Commission v J McPhee and Son (Australia) Pty Limited* (1997) ATPR 41-570 at 43,921.

[21] Assuming, however, that the range of services encompassed by the market will be a critical issue, I am unable to accept that documents of the kind sought by the applicants meet the test of relevance. Market definition turns on whether goods or services are, as a matter of fact and commercial common sense, substitutable – s 3(1A) of the Commerce Act. The question of whether the products or services comprising the wider payment systems market are substitutable for the credit card services offered by Visa and MasterCard will not turn on the information which the applicants hope to obtain from discovery. The MSF payable under the American Express and/or Diners schemes and the way they are calculated will not be determinative. The relevant market will be determined by reference to evidence (unlikely to be controversial) relating to the essential features of the industry and readily available to the parties themselves. I agree with Mr McIntosh that the applicants have not shown that in relation to market definition there is any fact in issue to which the discovery sought is relevant.

*Interchange fees and merchant charges*

[22] The second way in which the documents are said to be relevant is for the purpose of and forming an analysis of the nature and function of the MIF and its relationship to charges to cardholders and merchants.

[23] A key element of the applicants' case at trial relates to the two-sided nature of the credit card market. In a two-sided market a product or service caters for two different customer groups. An example is the print media which provides a service to both advertisers and readers. In the same way, a credit card system is designed to serve the differing but complementary needs of both cardholders and merchants.

[24] The applicants say the MIF is a necessary and legitimate mechanism employed by joint venturers to shift a portion of the revenue from the acquiring banks to the issuing banks – *National Bancard Corporation v Visa USA* (1986) 779 F2d 592 at 602-3. The objective is said to be to balance demand between cardholders and merchants so as to maximise volume.

[25] The applicants claim that in a three-party system, such as those operated by American Express and Diners Club, the allocation of costs and revenue is carried out internally to the same effect, namely, to produce asymmetric pricing on the two sides of the market. Yet, lacking an arrangement, it could not be caught by s 27 or s 30 of the Act.

[26] The applicants contend that documents that will shed light on the way that American Express and Diners Club allocate costs and fix merchant charges are relevant to the issues raised by their defence. They want to demonstrate, if necessary as part of a counterfactual analysis (to import a term more familiarly encountered in proceedings under s 36 of the Act), that the MIF is a legitimate balancing mechanism which has its equivalent in a three-party system.

[27] Mr McIntosh and Mr Thain, for American Express and Diners Club, argued that an examination of the way in which American Express and Diners Club allocate revenue and costs and set their merchant charges could not assist the competition analysis required by the proceeding. They submitted that there is no analogy that can helpfully be drawn between the way in which American Express and Diners Club fix charges to merchants (which differ in material respects in any event) and the way in which the MIF is determined in a four-party system. They say that, for the purpose of exploring the anticompetitive implications of the MIF, the relevant comparison or counterfactual is not with a three-party system but a four-party system in which the MIF is "floating" and the subject of separate agreements between participants.

[28] I also have difficulty with the proposition that a three-party system in which cost and pricing decisions reside in a single party, could provide the conditions for analysing the behaviour of firms operating in a four-party system. The focus of the

Commission case is on agreements made between competitors and their effect on the prices they charge. Their conduct must be analysed in the conditions in which it took place for the purpose of determining whether it had the proscribed purpose or effect in the pleaded market. I cannot see how the question of whether the defendants' conduct had the purpose or effect of lessening competition in the circumscribed market relied on by the Commission could be determined by reference to a three-party system.

[29] But the *Peruvian Guano* test casts a wider net than documents that might be necessary for the purpose of establishing what has occurred in the market relied on by the Commission. It is sufficient that the discovery sought may assist the applicants to advance their case. Mr Galbraith QC, for Cards NZ Limited, said his client would argue at trial that s 30 is inapplicable (or, if applicable, the joint venture defence in s 31 applies) because the central setting of the MIF is a necessary function of a legitimate joint venture. He said it should be regarded from an economic perspective as equivalent to the unilateral conduct which occurs in a three-party system. He said, furthermore, that Cards would show that in law and in fact it, and not the banks, set the MIF for the Visa market in New Zealand. Cards will maintain that the ability to balance the two sides of the market through a centrally set MIF is essential if four-party systems are to compete with three-party systems that can directly set prices to merchant.

[30] These are arguments which reasonably call for consideration of a three-party system and an examination, at least at the level of principle, of the way in which costs are allocated and merchant charges fixed. I am persuaded that documents generally in the categories identified could assist laying a groundwork for a defence which includes these elements. They meet the threshold of relevance.

**Necessity**

[31] The power to order non-party discovery (as with an order for particular discovery against a party) is subject to the requirement that the order is necessary at the time it is made. Such orders are to be distinguished from the right of general discovery against a party which is unfettered by the requirement of necessity.

[32] In this context "necessary" means reasonably necessary – *Krone NZ Technique Limited v Connect-A-Systems Limited* (1988) 2 PRNZ 627 and *Clear Communications Limited v Telecom Coroporation New Zealand Limited* HC WN M 119/93 30 March 1993 where McGechan J said at 8:

> The categorisation lies somewhat indefinitely between absolute essentiality, and mere desirability. Otherwise, the power to order, or not, is fully discretionary. In the exercise of that discretion there is no predisposition for or against third party discovery.

[33] Subject to a consideration of the scope of the proposed orders and of matters bearing on the exercise of the discretion to order discovery, I am satisfied that an order is necessary at this stage. Although the hearing will not take place until the last quarter of 2009, there is a timetable in place which requires the plaintiffs to serve fact and industry evidence and lists of documents for the agreed bundle on 14 November 2008. The Commission has said that discovery would have to take place before the end of August in order to give the plaintiffs time to consider the additional documents and take them into account in preparing evidence. That plainly requires any discovery orders to be made now.

**Discretion**

[34] Both American Express and Diners have filed affidavits by senior managers. They show that compliance with the orders sought by the applicants in their initial applications would be a massive undertaking and highly disruptive to their normal business activities. The burden would be particularly onerous for Diners whose New Zealand operation is modest.

[35] Both deponents say the task is complicated by the generality of the discovery sought. They complain that the categories of documents listed are broad, in some cases indeterminate. Mr David O'Brien of American Express says that only a small number of staff members would have the qualifications and experience to undertake the task. He thought the exercise would take more than 3-4 months.

[36] Both American Express and Diners Club say that many of the documents sought are commercially sensitive. They are concerned about the risk of disclosure

to competitors (including the applicants) and merchant customers, the plaintiff retailers among them.

[37] The non-parties have not had an opportunity to comment on the orders ultimately sought by the applicants, except for the specific categories referred to in correspondence. However, there is no reason to think that the concerns voiced in the affidavits in relation to the orders originally sought will not apply to the draft orders submitted by the applicants. There are fewer categories but they are broad and the range of documents requiring consideration extensive. Many will be of a confidential nature.

[38] I am satisfied that it would be oppressive to order the non-parties to provide discovery in the terms sought. It is sufficient to contemplate what would be involved for American Express. It is required to identify documents (including but not confined to those described) which, over a six-year period, relate to the range of merchant discount fees fixed and the costs and benefits associated with a merchant accepting an American Express card. Or to consider the task for Diners Club of identifying documents over the same period which relate to the factors taken into account in setting merchant discount fees, particularly in the light of the evidence of Mr Francis Krymen that merchant discount fees are set on a case by case basis.

[39] On the information available to me, the burden would be disproportionate to the benefit that the applications would derive – *AMP Society v Architectural Windows Limited* [1986] 2 NZLR 190 at 197. While I have accepted that the information relating to the way in which American Express and Diners Club fix merchant fees might be relevant and helpful to the way in which the applicants propose to mount their defence, I have no real sense of its likely probative value. I received nothing in the way of expert evidence which might have informed such an assessment. An affidavit in reply by a chartered accountant explained how company records could provide information about the attribution of costs and revenue between the issuing and acquiring sides of the American Express and Diners Club businesses, but no expert economic evidence was filed.

[40] The concern that the orders sought may risk the disclosure of commercially sensitive information is a further element of oppression, though not one I have needed to weigh. But it should not be overlooked that the information sought goes to the heart of the non-parties' decision-making. Their concerns about the risk of disclosure are entirely understandable. In *Clear Communications v Telecom*, McGechan J said at 9:

> This is not an area in which a Court should impose absolutes, but there may often be room for a view that even where information is crucial to a litigant, if its release (despite all practicable protections) would be very seriously harmful to a non litigant, innocent of involvement, discovery as a matter of overall justice should not be ordered. There must be a limit to which outsiders are to be devastated by the problems of others.

*A fortiori* when it has not been shown that the information is crucial to a litigant.

[41] Finally, in the exercise of my discretion, I would, if necessary, also have given weight to the disruption which would ensue if, as Mr O'Brien said, it would take 3-4 months to comply with the order. The timetable orders in place leading to the trial at the end of next year are acknowledged to be tight. It seems realistic to suppose that the timetable would be disrupted and the fixture jeopardised if the orders were made. The interests of other litigants and the wider public interest, having regard to the subject matter of the proceeding, also weigh against the making of orders.

**Limited discovery**

[42] Discovery of some relevant American Express and Diners Club documents has already occurred or is available. The applicants have been able to source information about the operations of American Express and Diners from other sources. Some information is publicly available; Diners standard merchant and cardholder terms and conditions and cardholder fees, for example, are available on its website. Further documents could be discovered by the parties themselves. Nine of the ten plaintiff retailers are Diners' merchants. Until October 2002, Diners was wholly owned by the National Bank, now part of ANZ National Bank Limited, one of the defendants. The retailer plaintiffs are all customers of American Express.

[43] At the conclusion of protracted correspondence and negotiations between the applicants and the non-parties, in an effort to achieve agreement, both American Express and Diners Club recorded the information each would be prepared to provide voluntarily. The offers were made on condition that they would finally dispose of the applications and subject to the payment of costs and appropriate conditions of confidentiality. The correspondence is referred to as the fourth category of the draft orders sought against American Express and the third category of orders sought against Diners Club.

[44] Ordinarily I would be hesitant to use such proposals as the basis for an order. But the correspondence was on the record and clearly implies that, subject to appropriate conditions for costs and confidentiality, discovery of the categories of documents specified will not involve the unacceptable level of oppression that would arise from the other orders sought.

[45] I am minded to make orders generally to give effect to the offers in the correspondence on the basis that the documents referred to meet the tests of relevance and necessity, but as I did not hear from the applicants or non-parties on the conditions which should attach to such an order, I will defer doing so. This will provide the applicants and non-parties to agree on terms. I will make formal orders on receipt of consent memoranda. If necessary, a telephone conference of counsel for the applicants and non-parties can be convened to address any outstanding issues.

**Result**

[46] The applications for non-party discovery are granted to the limited extent set out in [45].