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Your reference	Our reference	Date
Ms M A Williams	PSG Leon/N A Hlatshwayo/JV 1583776	27 June 2008

Dear Madam

SUBMISSION IN RESPECT OF THE DRAFT COMPETITION AMENDMENT BILL, 2008 PUBLISHED ON 5 JUNE 2008 – BILL NUMBER B31-2008 ("the Bill")

1. Introduction

1.1 We represent MasterCard International Incorporated ("**MasterCard**"), a global payment and transaction processing business which facilitates the processing of domestic and international transactions through its four party payment system ("**the MasterCard scheme**"). The MasterCard scheme encompasses a network of financial institutions, cardholders and merchants who each obtain value through the use and acceptance of payment cards displaying the MasterCard®, Maestro® or Cirrus® brand ("**the MasterCard Mark**") (collectively, "**MasterCard cards**").

1.2 The parties involved in a four party payment system transaction are the merchant, the acquirer (ie the merchant's bank), the issuer (ie the cardholder's bank) and the cardholder. MasterCard, as the system provider, is not a party to the payment

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transaction, but provides a co-operation enabling service which allows the transaction to take place, through the obligations which each of the financial institutions owes to MasterCard as well as the obligations between the issuer and the cardholder and the acquirer and the merchant respectively.

1.3 The MasterCard scheme is characterised by its interoperability (ie the guarantee that any of the hundreds of millions of payment card displaying the MasterCard Mark can be used at more than 26 million acceptance locations around the world including more than 140,000 acceptance locations in South Africa, irrespective of the identity of the financial institution which issued the card or the creditworthiness of the particular cardholder presenting it). South Africans benefit as they are not restricted to using their MasterCard card issued, for example, by Nedbank only at merchants or ATMs serviced by Nedbank, but are free to use those cards anywhere in South Africa or indeed the world, where the MasterCard Mark is displayed.

1.4 Such interoperability is preserved by MasterCard's Honour All Cards Rule[1] ("**the HACR**") which applies compulsorily to all participants in the MasterCard scheme. The South African Reserve Bank ("**the SARB**") correctly recognized the essentiality of interoperability in payment systems, in a document entitled "**The National Payment System Framework and Strategy: Vision 2010** "[2] which states, *inter alia*, that one of the main strategic objectives of the SARB is to "**enhance and maintain the interoperability and operational effectiveness of the payment system**"[3] and that "**a major objective of implementing standards**

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1 An essential feature of a four-party system is that a card issued by any issuer may be used at any merchant and acquired by any acquirer. This feature is guaranteed by the so-called "honour-all-cards" rule. This requirement goes to the core of the scheme as it guarantees issuers equality of access and non-discrimination, and ensures consumers the ubiquity of the card: Section 9.11.1 of the MasterCard By laws and Rules

2 The National Payment System Framework and Strategy: Vision 2010 document published by the SARB in 2006 available at:http://www.reservebank.co.za/internet/Publication.nsf/LADV/DAA203A3059201E4422571570025D8F3/$File/Vision2010.pdf

3 The National Payment System Framework and Strategy: Vision 2010 document at page 13

is to enhance security and enable interoperability within the payment system."[4](our emphasis)

1.5 An interoperable payment system, which permits new entrants the ability to join the payment system without the cost and delay of having to enter into a single agreement with any (let alone every) other participant, requires a set of default settlement terms. In addition to the HACR, the MasterCard scheme includes other default terms of trading which also serve to lower entry barriers to new participants and ensure that small participants are not prejudiced by reason of their size.[5]

1.6 Many of these default terms of trading have been considered extensively by the South African Competition Commission's Banking Enquiry ("**the Enquiry**"). While the publication of the full report is awaited, the Executive Overview[6] reveals the following conclusions:

1.6.1 no aspect of the MasterCard scheme breaches the Competition Act. To the contrary, certain default terms of the scheme are expressly found to be necessary;

1.6.2 there is no recommendation to amend the Competition Act in relation to a "**complex monopoly**." To the contrary, other regulatory steps are recommended which are considered to be a better option;

1.6.3 the potential for debit cards to replace cash and cheques should be promoted.

1.7 Clause 4 of the Bill, however, proposes a new section 10A be inserted into the Competition Act, 1998 ("**the Competition Act**"), and introduces the concept of a "**complex monopoly**" to South African competition law. The proposal is not only

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4 The National Payment System Framework and Strategy: Vision 2010 document at page 21

5 These default terms include the standards for presenting a transaction into the MasterCard scheme, the grounds for reversal, the timing of payment settlement between financial institutions, and the settlement amount including any interchange fee

6 The Executive Overview is available at:http://www.compcom.co.za/banking/documents/sum%20docs/screen_sum.pdf] – See pages 29 to 33

unworkable in practice, but runs contrary to the findings and recommendations of the Enquiry. On receiving the Enquiry's report, the South African Competition Commissioner ("**the Commissioner**") made the following comment:

> **"The banking sector is ripe for innovation on the back of new business processes and technologies. Already we are seeing responses consistent with the direction of this report, which can fuel this dynamism. We look forward to the continued co-operation of the banks to find solutions to these complex matters."** [7]

1.8 MasterCard believes that the uncertainty which will be introduced into South African competition law through the proposed amendment will lead to a lack of investment in the financial sector and discourage the very innovation and dynamism sought by the Commissioner.

1.9 The legislative proposal, in its current form, would appear to have the potential to outlaw four party payment schemes, such as MasterCard's. This, in turn, would force the operators of such schemes either to radically restructure their businesses (eg to adopt less open business models) to the detriment of South Africa consumers and merchants, or even to withdraw from South Africa altogether. Rendering four party schemes inoperable would place South Africa outside the world economy, thus threatening commerce in general and the stability of the South African economy in particular.

1.10 MasterCard's concerns are:

1.10.1 the proposed clause 10A is too vague. It will give rise to regulatory uncertainty, unpredictability and risk penalising innocent, pro-competitive conduct;

1.10.2 the uncertainty created by the proposed legislation will, at a minimum, discourage the financial investment required to promote innovation;

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7 Paragraph 4 of the South African Competition Commission's Press Release dated 25 June 2008

1.10.3 enforcement of the proposed legislation will unduly divert the South African Competition Commission's ("**the Commission's**") resources away from inquiring into so-called anti-competitive behaviour to the conduct of expensive inquiries into complex monopolies for which:

1.10.3.1 the legislature provides no guidance;

1.10.3.2 there is no helpful international precedent; and

1.10.3.3 the potential exists, to achieve more harm than good.

1.10.4 the concept of a "**complex monopoly**" is not generally accepted internationally and in some jurisdictions it has been removed altogether as an outdated concept.[8] If the concept of a complex monopoly is adopted, South African law will, without good reason, diverge from the international standard.

2. Interpretation of the proposed section 10A

2.1 Under the proposed section 10A(1), a complex monopoly is deemed to exist in any market if:

> **"(a) at least 45% of the goods or services in that market are supplied to, or by, two or more firms; and**
>
> **(b) the firms referred to in paragraph (a) conduct their respective business affairs in a co-ordinated manner, irrespective of whether those firms do so voluntarily or not, or with or without agreement between or among themselves, or as a concerted practice.**

2.2 It is difficult to conceive of any market which will not fall within the ambit of the proposed section 10A(1)(a), apart from a monopoly market (ie where one firm

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8 In the United Kingdom, the Fair Trading Act, 1973 incorporated the concept of a complex monopoly. The concept was removed from English law by the Enterprise Act, 2002

supplies all of the goods or services in a market). Where there is more than one participant in a market, it is inevitable that these firms will supply or be supplied with 100% of the products or services in that market. Accordingly, section 10A(1)(a) is, with respect, meaningless.

2.3 The uncertainty created by section 10A(1)(a) is compounded by section 10(A)(1)(b) which introduces a new concept of acting in a "**co-ordinated manner**." The Competition Act, already proscribes "**co-operative or co-ordinated conduct**" in the definition of a "**concerted practice.**"[9] This sub-section is therefore an example of legislative overreach.

2.4 Under the proposed section 10A(2),"**Participation of a firm within a complex monopoly is prohibited-**

(a) if the market within which the complex monopoly subsists is characterized by-

(i) restriction on supply;

(ii) a lack of innovation;

(iii) exploitative pricing;

(iv) exclusionary acts;

(v) high entry barriers;

(vi) uniform pricing, similar trading conditions or other indicators of parallel conscious conduct; or

(vii) other similar characteristics; and

(b) the complex monopoly has the effect of substantially preventing or lessening competition in that market."

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9 Under section 1 of the Competition Act, "**concerted practice**" means "**co-operative or co-ordinated conduct between firms, achieved through direct or indirect contact, that replaces their independent action, but which does not amount to an agreement**"

2.5 Each of the listed market characteristics gives rise to considerable uncertainty. In particular, it is not clear what is intended by:

2.5.1 "**restriction on supply**" – all markets are subject to a restriction, or limit on supply. In addition, it is not clear whether an agreement or arrangement between suppliers to restrict supply is necessary to contravene this sub-section. It appears that the requirement would be satisfied where a particular supplier in a market (whether part of the complex monopoly or not) chooses to operate at less than its full capacity. This may be for completely legitimate reasons, such as to ensure the continued viability of producing a particular resource by reducing output while market prices are low so as not to over-supply a market.

2.5.2 "**a lack of innovation**" – whether a market lacks innovation is highly subjective and there is nothing in the Bill that offers guidance in this regard.

2.5.3 "**exploitative pricing**" – this expression appears to introduce a new standard that is presumably intended to be different from an "**excessive price**"[10], as defined in the Competition Act. The phase is not defined and it is unclear under what circumstances a price would be considered to be exploitative.

2.5.4 "**exclusionary act**" – although this phrase is defined in the Competition Act,[11] it is difficult to see how a market could be "**characterized**" by an exclusionary act. In addition, it is widely recognised that an exclusionary act, in itself, is not necessarily anti-competitive.[12] Indeed, most, if not all, licence

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10 Under section 1 of the Competition Act, "**excessive price**" means "**a price for a good or service which-**

(aa) bears no reasonable relation to the economic value of that good or service; and

(bb) is higher than the value referred to in subparagraph (aa)";

11 Under section of the Competition Act, "**exclusionary act**" means "**an act that impedes or prevents a firm from entering into, or expanding within, a market**"

12 Competition Commission v. South African Airways (Case Number 18/CR/Mar01), paragraph 108

or distribution agreements will contain restrictions (eg geography of distribution) which have been found to be pro-competitive.[13]

2.5.5 **"high entry barriers"** – again, this term is not defined and is highly subjective. Some sectors, such as retail banking are designed to have high entry barriers, for example, capital adequacy requirements in order to mitigate systemic risk[14]. Where high entry barriers are required in a market to benefit the South African economy, there is no reason for competition law to draw an adverse inference against that market's participants.

2.5.6 **"uniform pricing, similar trading conditions or other indicators of parallel conscious conduct"** :

2.5.6.1 the MasterCard scheme comprises necessary default terms of dealing between its participants none of which breach the Competition Act and many of which have been supported by the Enquiry.[15] If such default terms were prohibited by this sub-section, innocent conduct would be presumed to be anti-competitive and an inappropriately high evidential burden would be placed on the market participants to rebut the requirement set out in section 10A(2)(b);

2.5.6.2 moreover, the proposal would have the effect of distorting competition between four party schemes such as MasterCard which necessarily impose default trading terms, and three party schemes such as American Express, which have no need for such terms given their single company structures. In a three party scheme, the system operator typically has a direct relationship between both the cardholder and the merchant and can internalise comparable default terms of the

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13 See, for example, *National Association of Pharmaceutical Wholesalers and Others v Glaxo Welcome (Pty) Ltd and Others* (29/CAC/Jul03) [2005] ZACAC 2; [2005] 1 CPLR 102 (CAC) (18 February 2005) and *National Association of Pharmaceutical Wholesalers and Others v Glaxo Welcome (Pty) Ltd and Others* 68/IR.JUN 00

14 Section 64 of the Banks Act, 1990

15 See pages 29 to 30 of the Executive Overview

MasterCard scheme through its price setting and other contractual terms;

2.5.6.3 it is not clear what would constitute "**similar trading conditions**" or what is intended by "**indicators of parallel conscious conduct**." This will leading to a considerable period of uncertainty until case law develops these terms.

2.5.7 "**(b) the complex monopoly has the effect of substantially preventing or lessening competition in that market.**" The Bill offers no guidance as to what would substantially prevent or lessen competition;

2.5.8 It appears that the market characteristics listed in the proposed section 10A(2) need not necessarily relate to the firms accused of participating in a complex monopoly, but rather to the market in which they participate. It is concerning to observe that this sub-section does not look for conduct that would lessen competition, but assumes guilt through the mere existence of two or more distributors of a product or two or more licensees of a brand or service, in any market.

3. Regulatory uncertainty will lead to a lack of investment in innovation

3.1 Since 2003, the Reserve Bank of Australia ("**the RBA**") has implemented a series of regulations affecting the domestic payment card industry. In part, this intervention was driven by a belief that aspects of the payment system in Australia were inefficient and anti-competitive.[16]

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16 See **Debit and Credit Card Schemes in Australia: A Study of Interchange Fees and Access, Reserve Bank of Australia and Australian Competition and Consumer Commission** (ACCC), October 2000; *Reform of Credit Card Schemes in Australia: IV Final Reforms and Regulation Impact Statement, Reserve Bank of Australia*, August 2002; and *Reform of the EFTPOS and Visa Debit Systems in Australia: Final Reforms and Regulation Impact Statement, Reserve Bank of Australia,* April 2006

3.2 CRA International has published a report on the effect of the RBA's intervention, which stated, *inter alia*, that: [17]

3.2.1 market regulation can reduce the incentives to invest in a market by creating uncertainty about the returns that can be realised from investments;

3.2.2 several public submissions to the RBA noted that regulation in the payment system introduces a level of uncertainty that has had an inhibiting effect on investment decisions;

3.2.3 the Australian Bankers' Association noted: "**the risk of sub-optimal levels of investment and innovation are very real**."[18]

3.3 Consequently, the regulatory uncertainty caused by the RBA has been a factor in reducing the incentives to invest in the payments system and a lack of innovation and development.[19] At a time when investment in innovation and productivity in South African retail banking is of such public importance together with the need to ensure the stability of the retail banking sector, the legislature should be mindful of the unintended consequence of introducing such uncertain regulation.

4. Administrative Resources

The administrative burden on the Commission to give effect to the proposed section 10A will be substantial and an enormous drain on the public funds. The Commission will be required to conduct expensive inquiries into the existence of complex monopolies and will be required to justify its findings in extensive, complicated and uncertain litigation which is almost certain to arise.

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17 The CRA International Report was commissioned by MasterCard and is available at:http://www.mastercard.com/us/company/en/ourcompany/cra_intl_report_on_regulatory_intervention.html

18 The Australian Banking Association's submission to the Australian Reserve Banks 2007/08 Payment system review available at : http://www.rba.gov.au/PaymentsSystem/Reforms/RevCardPaySys/Pdf/aba_31082007.pdf

19 Reform of the Australian Payment System – Preliminary Conclusions of the 2007/08 review published in April 2008

5. International jurisprudence on complex monopolies

5.1 The concept of a "**complex monopoly**" simply does not exist in other major competition law regimes, around the world, including the competition jurisprudence of the European Union, Canada, Australia and the United States. Moreover, the United Kingdom specifically decided to abolish its complex monopoly regime when it modernised and updated its competition law regime in 2002. The Enterprise Act 2002 ("**the Enterprise Act**") repealed the complex monopoly provisions that had existed under the Fair Trading Act 1973 ("**the Fair Trading Act**").[20]

5.2 As far as the United Kingdom is concerned, the following points bear emphasis:

5.2.1 first, even when the United Kingdom had a complex monopoly regime under the Fair Trading Act, it did not prohibit participation in the complex monopoly. The complex monopoly regime entitled the Competition Commission, following a referral by the Office of Fair Trading ("**the OFT**") to:[21]

5.2.1.1 examine whether market participants with a collective share of supply of at least 25% engaged in conduct that prevented, restricted, or distorted competition and/or operated against the public interest; and

5.2.1.2 determine what, if any, remedial action was required.

5.2.2 second, at the time of considering abolition of the complex monopoly regime, the Government of the United Kingdom, in the Enterprise White Paper ("**the White paper**"), a consultation document that preceded the Enterprise Act, stated that the collective share of supply test was "**of little value as in almost every market, it is possible to name or define companies who collectively have a share of supply of 25% or more.**"[22] The White Paper also described the law relating to the Competition Commission's decision

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20 It should also be borne in mind that, in terms of the Fair Trading Act, the duties of the Director for Fair Trading were far wider than merely addressing pure competition law issues, but also included unfair business practices.

21 'See section 7 of the Fair Trading Act, 1973

22 'Productivity and Enterprise: A world class Competition Regime' Cm 5233 (2001)

making vis-à-vis complex monopolies as **"a rigid structural framework ... that is difficult to work with."**[23]

5.2.3 third, the Department of Trade and Industry (**"the DTI"**), the then division of the UK Government overseeing competition matters, envisaged that the removal of the concept of a complex monopoly would make the competition law regime more transparent and create greater certainty for business which, in turn, would assist with long term planning.[24] The removal of the concept of a complex monopoly was also aimed at modernising the United Kingdom's competition law regime so as to align it with that of the European Union as well as its major trading partners such as the United States. In addition, the DTI expressed the view that the competition law reforms, including the removal of the concept of a complex monopoly, would be more supportive of enterprise and would assist economic growth.[25]

5.2.4 fourth, the United Kingdom's complex monopoly provisions were replaced by part 4 of the Enterprise Act which empowers the OFT to request the United Kingdom's Competition Commission to investigate a particular market, if it has reasonable grounds to suspect that one or more features of a market prevent, restrict or distort competition in that market in connection with the supply or acquisition of any goods or services in the United Kingdom. Following a referral by the OFT, the Competition Commission must determine whether any feature or combination of features, of the relevant market actually prevents, restricts or distorts competition. This pure competition test replaced the previous public interest test applied under the Fair Trading Act.[26]

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23 'Productivity and Enterprise: A world class Competition Regime' Cm 5233 (2001)

24 Address by Melanie Johnson MP, Minister for Competition, Consumers and Markets, Department of Trade and Industry in the United Kingdom on 20 March 2002 at IFS Enterprise Bill Conference, Arundel House

25 See footnote 14

26 Explanatory Notes to Enterprise Act 2002 published by the Department of Trade and Industry of the United Kingdom on 3 December 2002: available at: http://www.opsi.gov.uk/Acts/acts2002/en/ukpgaen_20020040_en_1

5.3 The European Union has never had legislation analogous to the complex monopoly provisions that existed in the United Kingdom and that are now proposed for South Africa. As in the case of the United Kingdom's modernised competition regime, the European Commission is entitled to conduct sector inquiries where the trend of trade between Member States, the rigidity of prices, or other circumstances suggest that competition may be restricted or distorted within the common market.[27]

5.4 In the United States:

5.4.1 attempts to challenge "**shared monopoly**" under US antitrust law, a theory akin to the proposed concept of a complex monopoly, have been consistently rejected by US courts, and ultimately abandoned by US enforcement agencies.[28]

5.4.2 attempts to argue that the Sherman Act, which regulates monopolies, could be interpreted more broadly to prohibit a shared monopoly have been consistently rejected by US courts. For example, in dismissing a claim that four telecommunications companies had violated section 2 if the Sherman Act by attempting jointly to monopolise the market for international telex services, the court asserted that "**an oligopoly, or a shared monopoly, does not in itself violate § 2 of the Sherman Act.**"[29] As summed up in a leading antitrust treatise:

> "**Lower courts consistently have rejected the shared monopoly theory in the absence of any allegation of a conspiracy to monopolize, not permitting Section 2 to be**

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27 Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, Article 17

28 *ABA Section of Antitrust Law, Antitrust Law Developments* (6th ed. 2007) at page 322

29 *Consolidated Terminal Systems, Inc. v. ITT World Communications, Inc.*, 535 F.Supp. 225, 228-29 (S.D.N.Y. 1982)

invoked as a tool to challenge oligopolies engaged in parallel but non-collusive conduct." [30]

5.4.3 section 1 of the Sherman Act prohibits "**contracts, combinations, and conspiracies**" in restraint of trade.[31] Section 2 of the Sherman Act prohibits monopolisation as well as attempts and "**conspiracies**" to monopolise.[32] To establish that a group of companies has violated section 1, or that they have conspired to monopolise, in violation of section 2 of the Sherman Act, a government or a private plaintiff must show that the companies had a "**unity of purpose or a common design and understanding, or a meeting of minds in an unlawful arrangement**."[33] In addition it must be shown that a single firm has or is likely to obtain monopoly power. There is simply no violation of these statutes in a market in which no one firm has or is likely to obtain monopoly power, and where there is no "**agreement**" among companies in the market to coordinate their conduct in an anti-competitive manner.

5.4.4 the US Federal Trade Commission ("**the FTC**") conducted a lengthy investigation of the US ready-to-eat breakfast cereal manufacturers on a "**shared monopoly**" theory in the 1970's, this case " **floundered when the FTC found no basis for recognizing [this offence] except under facts that would also establish an 'agreement' or 'understanding' among oligopolists to orchestrate their behavior.**"[34]

5.4.5 according to the former Chairman of the FTC, Timothy J. Muris, this and similar FTC enforcement initiatives "**failed to serve consumer interests**

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30 *ABA Section of Antitrust Law, Antitrust Law Developments* (6th ed. 2007) at 322, citing, among other cases, *Flash Elecs. v. Universal Music & Video Distrib. Corp.*, 312 F.Supp.2d 379, 396-97 (E.D.N.Y. 2004)("The idea of a 'shared monopoly' giving rise to Section 2 liability repeatedly has been received with skepticism by courts who have squarely addressed the issue."); In *re Coordinated Pretrial Proceedings in Petroleum Prods. Antitrust Litig.*, 782 F.Supp. 481, 486 (C.D. Cal. 1991)("sharing by numerous competitors of monopoly power" does not violate Section 2). See also P. Areeda & H. Hovenkamp, *Antitrust Law* ¶ 810g (2nd ed. 2002) ("lower courts ... have been more categorical, concluding that § 2 simply does not countenance such an offense.")

31 The Sherman Act 15 U.S.C. (1890)15 U.S.C. § 1

32 The Sherman Act 15 U.S.C. (1890)15 U.S.C. § 2

33 *American Tobacco Co. v. United States*, 328 U.S. 781 (1946)

34 A. Areeda & H. Hovenkamp, *Antitrust Law* ¶ 810g (2nd ed. 2002). See *In re Kellogg Co.*, 99 F.T.C. 8 (1982)

owing to a basic misdiagnosis of commercial phenomena. ... It is now widely accepted that major elements of the FTC's antitrust policy of the 1970s were not based on sound economics."[35]

6. Conclusion

6.1 MasterCard believes that the proposed clause 10A could have a negative effect on its ability to offer its co-operation enabling service to cardholders, merchants and customer banks in South Africa as clause 10A, in it current form, is unworkable and inconsistent with the findings of the Enquiry. This, in turn, would undermine the whole MasterCard scheme and the significant benefits it brings to the South African economy.

6.2 The concept of a complex monopoly is no longer followed by any significant competition law jurisdiction. By embracing it now, South Africa would place itself outside the focus of the international standard.

6.3 The activities of banks and card payment associations, such as MasterCard, are already extensively regulated and may be even more so if the Banking Enquiry's recommendations are effected. Any additional restriction imposed by the introduction of the concept of a complex monopoly is not necessary, would have a detrimentally effect on consumers and amount to legislative overreach, in view of the fact that the Commission already has sufficient powers to conduct enquiries and investigations.[36]

6.4 The proposed legislation will, moreover, distort competition between four party payment schemes, such as MasterCard, and three party payment schemes such as American Express.

6.5 Regulation should be employed only if there is clear evidence of a market failure and only if there is reason to believe that regulation is likely to benefit consumers.

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35 *Looking Forward: The Federal Trade Commission and the Future Development of U.S. Competition Policy,*" Remarks by Timothy J. Muris, Chairman Federal Trade Commission, Milton Handler Annual Antitrust Review (Dec. 10, 2002) at nn 68, 69, available at: http://www.ftc.gov/speeches/muris/handler.shtm

36 Under section 21 and sections 46 to 49A of the Competition Act

The proposed legislation is likely to discourage investment in the financial sector and, consequently, the innovation envisaged by the Commissioner.

Yours faithfully

WEBBER WENTZEL