BUDDLEFINDLAY
NEW ZEALAND LAWYERS

13 August 2018

To
David Shaharudin, Nicola Hulley, Gavin McNeil, and Harry Holden
Commerce Commission

Level 13, 55 Shortland Street
PO Box 105-222
Auckland

44 The Terrace
PO Box 2351
Wellington

From
Dipti Manchanda
Tony Dellow

By Email
david.shaharudin@comcom.govt.nz
nicola.hulley@comcom.govt.nz
gavin.mcneil@comcom.govt.nz
harry.holden@comcom.govt.nz

Dear David, Nicola, Gavin, and Harry

Ingenico/Paymark: cross-submission on behalf of Verifone on the letter of issues

1. We are making this cross-submission on the Commerce Commission's letter of issues for Ingenico Group SA's application for clearance to acquire Paymark Limited on behalf of Verifone.

2. The submissions by Ingenico, Paymark, and the Vendor Banks, and the report prepared by NERA, on the letter of issues make four main points:

   (a) Paymark does not have market power, because it is constrained by the availability of payment methods that do not involve S2I transactions. Those include:

      (i) S2A transactions, which other providers can process using their own infrastructure; and

      (ii) emerging payment methods that bypass the need to use Paymark's switch.

   (b) Paymark does not have market power, because Verifone (and/or Payment Express) could choose to build their own S2I links.

   (c) Paymark has, and the merged entity will continue to have, the incentive to maximise the volume of transactions processed on Paymark's switch. The merged entity would not have the incentive to increase the cost of S2I transactions, because doing so would drive volume away from Paymark's switch and towards S2A transactions processed by Paymark's competitors, as well as emerging payment methods. Banks could facilitate and encourage that shift.

(d) Even if the merged entity did increase the price of S2I transactions, that would not result in a substantial lessening of competition, because doing so would increase the popularity of emerging payment methods and payments by cash.

Summary of Verifone's cross-submission

3. The submissions by Ingenico, the Vendor Banks, Paymark, and NERA:

(a) greatly exaggerate the change and disruption facing the payment processing industry, and the constraint that emerging payment methods could provide;

(b) incorrectly dismiss the difficulties associated with building S2I links that would remove rivals' dependence on access to Paymark's S2I processing capability, and overstate the constraints that Verifone and Payment Express are able to provide;

(c) ignore the fact that, even if the proportion of transactions that are S2I transactions reduces, merchants will continue to require full S2I processing capability for at least the next decade. As a result, the merged entity will continue have market power that it could exert to lessen competition in the processing of other types of transactions, and in downstream terminals markets. The merged entity will be in a position to pursue a foreclosure strategy without running the risk of losing transaction volume; and

(d) appear to proceed on the assumption that the competition problems posed by the proposed transaction are limited to price increases for processing S2I transaction, and almost entirely ignore the competition problems that are likely to arise from the vertical integration of Paymark and a terminals provider.

4. We discuss further below.

The submissions exaggerate the change and disruption facing the payment processing industry, and the constraint that emerging payment methods could provide

5. The submissions place great emphasis on an increase in the proportion of S2A transactions, and the corresponding decrease in the proportion of S2I transactions, processed in recent years, and work being conducted by Payments NZ and various banks on developing an API framework.

6. The shift from S2A to S2I transactions referred to in the submissions has largely been due to the uptake of contactless payments. The submissions suggest that this trend is likely to continue, and show that emerging payment methods will be extremely popular. According to the submissions, this reduces the importance of Paymark's S2I infrastructure, and will constrain the merged entity's conduct in respect of S2I transactions.

7. For the following reasons, Verifone submits that:

(a) the shift to S2A transactions is not as significant as the submissions suggest, and is unlikely to continue at a rate that would make S2I transactions irrelevant; and

(b) emerging payment methods, including any that would rely on an API framework, will not have a significant impact on the proportion of transactions that are S2I transactions.

The shift to S2A transactions is not as significant as the submissions suggest

8. Ingenico submits that "the proportion of STA transactions is rapidly increasing at the expense of STI transactions",[1] and then provides a graph from MBIE's issues paper on *Retail payment systems in New Zealand* as evidence of that so-called rapid increase.

9. Verifone submits that this trend not as significant as the submissions suggest, and is also unlikely to continue. Further, the main consequence of any shift to more S2A transactions that might result from the proposed transaction would not be an increase in competition for the long-term benefit of consumers, but a significant increase in costs for merchants and, ultimately, consumers.

10. The graph Ingenico relies on actually shows that the shift has not, in fact, been rapid at all. Over the 27 month period covered by the graph, the percentage of transactions that were S2I transactions only decreased by a net 10-15%. At the end of the period, S2I transactions still accounted for almost 65% of all transactions.

11. At best, as shown by the charts in **Appendix 1**, if the trend Ingenico points to continues at the rate depicted in the MBIE graph, after five years, S2I transactions would continue to account for **[REDACTED]** of all transactions. S2I transactions would not be eliminated for at least 10 years, but probably much longer. That is clearly well outside the two year period usually considered by the Commission, and would provide the merged entity with more than enough time to foreclose competition.

12. However, even that assessment overestimates the ability of merchants and the merged entity's rivals to use contactless payments to resist anti-competitive conduct by the merged entity, for two reasons.

13. First, the factors that have driven the increase in contactless S2A transactions depicted in the graph are unlikely to continue to have the same importance going forward. The trend up to now has been driven by an increase in contactless S2A transactions, which was itself the result of banks beginning to issue scheme debit cards with contactless chips, and merchants beginning to accept contactless payments. Consistent with the slowdown in the trend towards contactless S2A transactions over the last 18 months shown in **Appendix 2**, those factors are unlikely to produce further material decreases in S2I transactions, and increases in contactless S2A transactions, of any significance:

(a) Most contactless transactions occur with the top 15 transacting merchants (including Woolworths/Countdown, Foodstuffs, The Warehouse, McDonalds, Z Energy/Caltex, BP, and Mobil). The banks and card schemes entered into commercial arrangements with those merchants to incentivise them to accept contactless payments, which helped offset the additional fees they would incur as a result of an increase in the number of S2A transactions

[1] Paragraph 22 of Ingenico's submission on the letter of issues.

they would process (since contactless debit transactions are processed as S2A, rather than S2I), and fees for accepting contactless payments.

(b) Among other, smaller merchants, contactless acceptance remains low. Of the merchants connected to Verifone's switch, fewer than 20% of merchants accept contactless payments. Verifone expects that the level of uptake of contactless payments would be similar for merchants connected to Paymark's switch. There is little evidence to suggest that smaller merchants are becoming more willing to pay the additional fees associated with accepting contactless payments. In fact, there have been recent, high profile examples of merchants (such as Burger King) removing their contactless capability. Verifone submits that the percentage of merchants that accept contactless payments is a far more accurate and informative measure of the significance of the trend away from S2I transactions towards contactless S2A transactions than the overall percentage of transactions that are contactless.

14. The chart in **Appendix 3** shows the number of merchants connected to Verifone's switch that accept different transaction types. As the chart shows, the trend towards contactless S2A transactions has been driven by a small proportion of merchants, and a significant number of merchants continue to only accept S2I transactions.

15. The reason that so many merchants continue to resist accepting contactless transactions is that accepting them significantly increases their costs. Verifone estimates that the difference to a merchant between accepting an S2I transaction (which is free to a merchant) and a contactless S2A transaction is at least 100 basis points per transaction. Tellingly, a greater percentage (over 20%) of merchants connected to Verifone's switch refuse to accept any S2A transactions at all, than accept contactless payments.

16. Even if the banks reduce the fees associated with accepting S2A transactions:

(a) that would not necessarily make connecting to a rival's switch any more attractive. Merchants connected to the merged entity's switch would presumably also benefit from those decreased fees; and

(b) the result of an accelerated shift towards S2A transactions in order to respond to a foreclosure strategy by the merged entity would still be a substantial increase in costs for merchants, and ultimately consumers. In the last 12 months, Verifone processed **[REDACTED]** of S2I transactions on its network. If we adopt the generous assumption that banks will reduce the fees associated with accepting contactless S2A transactions by, say, 25% to 75 basis points per transaction, and that Verifone's S2I transactions will become contactless debit S2A transactions, that would still result in an increase in merchants' costs of **[REDACTED]** per annum. That creates significant scope for the merged entity to take steps to foreclose its competitors, without risking significant losses in its transaction volume that might result from merchants switching to S2A transactions that its competitors are able to process independently of Paymark.

17. Second, Verifone is only able to process S2A transactions for ANZ-acquired merchants. Even if S2A transactions become more attractive to merchants, that will only facilitate competition between Verifone and the merged entity for one subset of merchants.

18. In any case, and most importantly, for the reasons Verifone has already provided, and as discussed again later in this submission, even if S2A transactions (whether contactless or swipe/dip) become more popular, that will not make the ability to process S2I transactions any less important to merchants.

Emerging payment methods will not have a significant impact on the proportion of S2I transactions

19. The submissions' contention that the proposed transaction will not substantially lessen competition because emerging payment methods will maintain a strong level of competition in the market is simply not tenable.

20. The main evidence the submissions provide in support of their contention that the merged entity will be constrained by emerging payment methods, and the threat they pose to Paymark's ongoing relevance, is the purported rapid increase in the proportion of transactions that are contactless STA transactions. As discussed above, the uptake of contactless payments is beginning to plateau, and S2I transactions continue to account for the majority of all transactions.

21. The submissions also refer to the availability of card-not-present payment methods. However, those payment methods do not provide any constraint on Paymark (and will not provide any constraint on the merged entity) in the provision of payment processing services to bricks and mortar merchants:

    (a) payment processing methods that bypass the need for a switch, such as POLI, have been available for a number of years. However, they have had no material impact on the volume of transactions processed using a switch, or merchants' preferences for accepting payments;

    (b) ANZ FastPay, BNZ PayClip, and Westpac GetPaid all require access to a switch. Those solutions are, in effect, low cost terminals with low functionality, aimed at the micro-merchant sector of the market. That sector of the market tends to be highly price sensitive, and tends to be even more reliant on Paymark's S2I processing capability than other merchants; and

    (c) ApplePay and AndroidPay currently do no more than allow consumers to use their phones instead of their cards to make payments, and also require access to a switch. In addition, they account for a very low proportion of all transactions, despite the high market penetration of Apple and Android operated phones.

22. The contention in the submissions that the merged entity would be constrained by the development of an API framework that could be used to process S2I transactions is, in Verifone's view, fanciful.

23. First, no APIs are in fact available yet, and it is not clear if or when they will become available. It is extremely speculative to assume that APIs will become available in a reasonable period of time, or that access would be priced at a level that provides merchants with a real alternative to S2I transactions. There is no obligation on banks (who, in the case of the Vendor Banks, may be

influenced by the terms of their service agreements with the merged entity), issuers, or anybody else, to progress the API project. Progress to date has been limited to the establishment of a voluntary working group, and a pilot programme to test two possible standards. The working group has not:

(a) agreed a format for APIs;

(b) established a commercial model for access to, and transactional use of, APIs; or

(c) agreed a governance model to ensure access to, and consistency across, APIs.

24. In any case, APIs are unlikely to been seen by bricks and mortar merchants as a real alternative to more traditional payment methods. APIs may be useful to make peer-to-peer payments, and possibly digital payments, but their utility is more limited for in-store payments. Merchants require a payment acceptance process that is simple for both merchants and consumers. APIs will not meet that requirement, as they will present significant challenges to merchants in terms of receiving payment confirmation, and the settlement and reconciliation process. This is consistent with the fact that APIs have not had a material effect on merchants' acceptance of traditional card payments in other jurisdictions, such as Australia and the UK, which have regulatory regimes that require banks to participate in the development of APIs, and have made significant progress towards developing open API options.

25. Finally, the submission by Paymark that the merged entity will be constrained by the ability of consumers to pay by cash is curious. In Verifone's view, the continued presence of cash as a payment method demonstrates the persistence of payment methods in, and difficulty associated with removing payment methods from, the market. Cash is a very high-cost payment method. Despite the steps that banks have taken to incentivise consumers and merchants to reduce the number of cash transactions that occur, merchants and consumers continue to use cash. Verifone does not see any reason to believe that attempts by the banks to encourage further uptake of S2A transactions or emerging payment methods would be any more successful in rendering a payment method such as S2I obsolete.

The submissions incorrectly dismiss the difficulties associated with Verifone or Payment Express building their own S2I links, and overstate the constraints Verifone and Payment can provide

Difficulties associated with building S2I links

26. Ingenico, Paymark, and the Vendor Banks all dismiss the difficulties associated with building new S2I links that Verifone and Payment Express have identified. Those difficulties include:

(a) the number of links required;

(b) the cost of building each individual link;

(c) the need for co-operation from numerous counterparties to enable the links to be built (and the impact that the Vendor Banks' proposed services agreements with the merged entity would have on their incentives to co-operate);

(d) the time associated with building each link; and

(e) the risk that, if even just one or a few of the necessary links are not built, investment in all other links would have been wasted.

27. However, their submissions appear to provide no evidence to suggest that building new S2I links, to remove any dependence on Paymark's switching infrastructure, is a viable option for Verifone or Payment Express.

28. Verifone has already:

(a) submitted on the number of links required, and the fact that a switching solution that is only able to process some S2I transactions would not be acceptable to merchants. This is particularly the case for larger merchants whose volumes are required for a switch to achieve scale. Verifone submits that further engagement with merchants (such as Woolworths and through Retail NZ) may assist the Commission to confirm merchants' requirements; and

(b) **[REDACTED]**.

29. The submissions attempt to cast doubt on the difficulties Verifone has identified, by quoting statements Verifone made around the time Verifone purchased Eftpos New Zealand about its intention to build its own links.

30. The reasons Verifone did not build its own links are as identified in Verifone's previous submissions:

(a) **[REDACTED]**. Unlike in other jurisdictions (such as Australia), New Zealand does not have any regulations that require banks to facilitate the building of new links. **[**

[REDACTED].

(b) **[REDACTED]**

BUDDLEFINDLAY
NEW ZEALAND LAWYERS

[REDACTED].

31. Verifone expects that, if Verifone or Payment Express attempted to build new links, Paymark would **[REDACTED]**. In addition, building a new set of S2I links is now even less economic than before:

(a) Over five years have passed, meaning that five years of potential benefits associated with Verifone having its own links have been lost. This affects the cost-benefit analysis of building new links today, with or without the proposed transaction;

(b) The current wholesale switching agreement expires in 2020, **[REDACTED]**; and

(c) It appears that, with the proposed transaction, it will become even more difficult to secure the necessary cooperation from the Vendor Banks to build new links. **[REDACTED]**.

Limited constraints provided by Verifone and Payment Express

32. The submissions describe Verifone and Payment Express as strong competitors in the switching market backed by successful global companies, who have also successfully won volume and connections from Paymark.

33. Those submissions are inconsistent with the fact that market shares in the switching market have remained relatively stable over a number of years. Despite their attempts to compete vigorously, Verifone and Payment Express have had extremely limited success in winning transaction volume from Paymark. The only change to market share of any significance resulted from **[REDACTED]**. The proposed transaction can only exacerbate that position.

34. The submissions also argue that Paymark is the 'sole' switching option for only a low percentage of overall transactions. However, the fact remains that Verifone can only provide switching services to ANZ merchants, and Paymark is the only switching option for most S2I transactions. Paymark has used its position as the only option for many S2I transactions to retain other transactions as well. For example, Paymark was able to **[REDACTED]**. Verifone estimates that

around 85% of all transactions are processed by Paymark, made up of transactions for merchants who are directly connected to Paymark's switch as well as **[REDACTED]**.

35. In the circumstances described above, it is extremely difficult to see how Verifone or Payment Express could compete effectively against Paymark for Paymark's existing, or any new, transaction volume.

36. Finally, the submissions grossly overstate the significance of the activities of Verifone and Payment Express in other countries to their ability to provide effective competition in the New Zealand market:

    (a) unlike in other jurisdictions, New Zealand does not have regulations that facilitate the build of new links; and

    (b) as Ingenico (and presumably the Vendor Banks) will be well aware, it is not common for global businesses to allow their business in one country to be cross-subsidised by others.

Even if other payment methods increase in popularity, the merged entity will continue to have market power

37. Even if other payment methods for which the merged entity will not control essential inputs (such as S2A transactions or emerging payment methods) become more popular over time, that will not be sufficient to constrain the merged entity.

38. This is because:

    (a) merchants will be forced to have the merged entity process their S2I transactions, either directly or indirectly. The merged entity will control the only links to most issuers in New Zealand, and there is no real prospect of Verifone and/or Payment Express building a complete set of alternative links; and

    (b) merchants, particularly those merchants whose volumes are necessary for Verifone, Payment Express, or other providers to achieve scale, will not accept a payment solution that limits their ability to accept S2I transactions. Verifone expects that engagement by the Commission with merchants (including **[REDACTED]** and through Retail NZ will confirm this.

39. The NERA report is directed at establishing the importance to Paymark's business of maintaining transaction volume. That may be true, but the merged entity's position as the sole provider of an essential input (being S2I processing capability) will enable the merged entity to pursue a foreclosure strategy without risking any significant loss in transaction volume. From a merchant's perspective, the ability to accept S2A transactions is a complement, and in many cases merely an optional complement, to the ability to accept S2I transactions – and the merged entity will be the only switch with the infrastructure to be able to provide both.

BUDDLE FINDLAY
NEW ZEALAND LAWYERS

The submissions focus on price increases for S2I transactions, and ignore the likely vertical effects of the proposed transaction

40. The submissions by Ingenico, Paymark, and the Vendor Banks largely fail to address concerns that the merged entity will have the ability and incentive to foreclose competition in markets other than the processing of S2I transactions. In particular, they do not address the merged entity's ability and incentive to foreclose competition in downstream terminals markets.

41. As well as being in a position to continue to apply an "all or nothing" approach to processing rivals' S2I transactions (and thereby make any case to begin building their own S2I links uneconomic), the merged entity would be in a position to:

   (a) extend its "all or nothing" approach to require any switch that uses Paymark's infrastructure to process S2I transactions to also process S2A transactions, removing any limited constraint that S2A transactions might be able to provide;

   (b) impose its own requirements for the connection of terminals to its switch, manipulate those requirements, and reduce the quality of switching services provided to terminals that are not Ingenico terminals, in order to maximise its own revenue. It would be able to do this unconstrained by the threat of losing terminal connections to another switch;

   (c) limit the uptake of emerging payment methods in which the merged entity does not have an interest, by offering merchants complete payment processing bundles of S2I processing services, S2A processing services, terminals, and another payment method, while limiting the availability (or increasing the price) of S2I processing services to merchants who acquire any other services included in the bundle from the merged entity's competitors.

42. Ingenico has made a passing reference to the fact that, in Germany, it has maintained Easycash as a terminal agnostic switch. However, that submission conveniently ignores that, unlike New Zealand, Germany has more than one switch capable of processing each transaction type. This was one of the main factors the Bundeskartellamt took into account in clearing Ingenico's acquisition of Easycash (see the case summary B4-90/09 attached as **Appendix 4**), and means that a foreclosure strategy would be far more likely to result in a loss in transaction volume, and therefore carry a far lower chance of succeeding, in Germany than in New Zealand. In Germany, Ingenico/Easycash appears to face much stronger competition from rival switches than Paymark faces in New Zealand. For example, according to the Bundeskartellamt's case summary on *Electronic cash: Banking associations implement commitments* (B4-94/14), as at 30 March 2015, Ingenico was one of the three largest payment network operators in Germany, each of which had a market share of only approximately 20%.

Concluding remarks

43. The submissions from Ingenico, the Vendor Banks, and Paymark, and the supporting report from NERA, provide no evidence to support the Commission granting clearance. Merchants will continue to require S2I processing capability for years to come, even as other transaction methods increase in popularity. Merchants will have no choice but to, directly or indirectly, purchase that capability

BUDDLEFINDLAY
NEW ZEALAND LAWYERS

from the merged entity – and, as a result, the merged entity could also require merchants to purchase complements to that capability (such as payment terminals) from the merged entity. The merged entity will have the ability and incentive to foreclose competition, with the overall effect of a substantial lessening of competition in payment processing markets.

Confidentiality

44. Confidentiality is sought for the information in this submission that is in square brackets and highlighted. We are also providing a public version of this submission, with the confidential information redacted.

45. Verifone requests that it be notified of any request made under the Official Information Act for the confidential information, and be given the opportunity to be consulted as to whether the information remains commercially sensitive at the time that the request is made.

46. These requests for confidentiality are made because the information is commercially sensitive and disclosure would be likely to unreasonably prejudice Verifone's commercial position.

Yours sincerely

Tony Dellow
Partner

Direct: 64 4 498 7304
Mobile: 64 21 349 651
Email: tony.dellow@buddlefindlay.com

Dipti Manchanda
Senior Solicitor

Direct: 64 4 498 7340
Email: dipti.manchanda@buddlefindlay.com

BUDDLE FINDLAY
NEW ZEALAND LAWYERS

APPENDIX 1: The trend towards S2A transactions

[REDACTED]

BUDDLEFINDLAY
NEW ZEALAND LAWYERS

[REDACTED]

BUDDLEFINDLAY
NEW ZEALAND LAWYERS

[REDACTED]

BUDDLEFINDLAY
NEW ZEALAND LAWYERS

APPENDIX 2: The trend towards S2A transactions over the last 18 months

[REDACTED]

BUDDLEFINDLAY
NEW ZEALAND LAWYERS

APPENDIX 3: Number of merchants accepting each transaction type

[REDACTED]

BUDDLEFINDLAY
NEW ZEALAND LAWYERS

APPENDIX 4: Bundeskartellamt case summary B4-90/09

See attached.