COMMERCE COMMISSION
NEW ZEALAND
Te Komihana Tauhokohoko

11.04/40582

Chapman Tripp
23 Albert St
Auckland

Attention: Colin Fife

11 July 2018

Dear Colin

Letter of Issues - Ingenico Group SA / Paymark Limited

1. We refer to the application (the Application) dated 20 April 2018 from Ingenico Group SA ("Ingenico") to acquire up to 100% of the shares in Paymark Limited ("Paymark") (the merger).

2. At this stage, we are not satisfied that the merger would not give the merged entity the ability and incentive to foreclose rival terminal suppliers, harming competition for merchants seeking terminals or those seeking a solution that integrates a terminal and a digital payment service (for online card payments).

3. In reaching the preliminary views set out in this letter, we have considered information provided by Ingenico, Paymark and the vendor banks as well as information gathered from industry participants. The Commission has not yet made any final decisions on the issues below (or any other issue) and our views may change, and new competition issues may arise, as the investigation continues.

4. We will advise you if we identify any further issues during our analysis of the proposed merger that are not discussed in this letter.

5. We are available to meet with Ingenico to discuss this letter.

Timeline

6. The Commission would like to receive submissions and supporting evidence from Ingenico on the issues raised below. We request that Ingenico provides this by close of business on 25 July 2018 and provides a public version at the same time.

7. If other parties indicate to us that they intend to make a submission on this letter, we will be requesting that they do so by close of business on 25 July 2018, and that they provide a public version of their submission.

8. All submissions received will be published on our website with any appropriate redactions.

The concerns we are testing

9. Paymark is the main supplier of switching services in New Zealand. It also provides digital payment services. Paymark does not have a payment terminals business. The main structural change that would arise from the merger would be the vertical integration of Paymark with Ingenico, a major New Zealand supplier of payment terminals.

10. The key concern we are testing at this stage is whether the merger would give the merged entity the ability and incentive to use its position in the supply of switching services to make it more difficult or costly for its rivals to compete for the supply of terminals (either at the wholesale or retail level of the market or both) (foreclosure effects). This could have the effect of harming competition, both for customers seeking only terminals and those seeking an integrated terminal and digital payment service. References to "payment solution" should be taken as including both customers seeking terminals alone and those seeking an integrated terminal and digital payment service.

11. Without the merger, there would not be the same ability or incentive to foreclose rivals competing to supply payment solutions because Paymark does not currently supply terminals.

12. In the sections that follow, we discuss:

    12.1 the scope of the markets that are relevant to analysing these concerns – that is, those markets relevant to switching services, the supply of terminals and digital payment services;

    12.2 the appropriate counterfactual by which to assess the merger; and

    12.3 the possible foreclosure effects of the merger.

Market definition

13. The markets that are relevant for the issues of concern are those related to switching services, terminals and digital payment services.

The markets for the supply of terminals and digital payment services

14. Ingenico submitted in the Application that the relevant markets for terminals and digital payment services are:[1]

    14.1 the national market for the wholesale supply of payment terminals and terminal connectivity to resellers ("the wholesale terminal market");

    14.2 the various regional markets for the re-sale supply of payment terminals and terminal connectivity to merchants ("the retail terminal markets"); and

    14.3 the national market for the provision of digital payment services ("the digital payment market").

15. These market definitions seem appropriate; however, our assessment does not turn on the precise boundaries of these markets. Our concerns over terminals could affect suppliers at both the wholesale and retail level. For convenience we use the term "terminal suppliers" to refer to both levels.

The market for switching services

16. For switching services, Ingenico submits that the relevant market is the national market for the provision of payment switching and processing services for electronic transactions ("the switching market").[2] Ingenico's proposed market definition includes the two main types of transactions that need to be processed in New Zealand:[3]

    16.1 switch-to-issuer ("S2I"), which is used for EFTPOS and scheme debit cards that are inserted or swiped; and

    16.2 switch-to-acquirer ("S2A") used for all other transactions, including contactless and card-not-present debit card transactions and all credit card transactions.

17. We are considering a market definition that is narrower than what Ingenico has proposed. The degree of substitution between S2I and S2A transactions becomes relevant when assessing the ability of Paymark to foreclose rivals. As we explain in more detail below:

    17.1 Paymark is the only switch operator with a full set of S2I and S2A links, while rival switch operators Verifone and Payment Express have a limited set of S2I and S2A links; and

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1 The Application at [56].
2 The Application at [63].
3 The Application, Figure 1.

17.2 it is more difficult to build the capability to process S2I transactions (which requires links with a large number of card issuers) compared to building S2A links (which requires only building to a merchant's acquirer bank).

18. At present a large proportion of payments in New Zealand (around 70% by number of transactions) are S2I transactions.[4] Only Paymark has the capability to process S2I transactions independently. We are considering the extent to which merchants and/or banks could move customers from payment types that use S2I to those that use S2A.

18.1 If it were easy for merchants and/or banks to move customers from payment types that use S2I to those that use S2A, then Paymark's ability to foreclose rival terminal suppliers may be limited. Verifone and Payment Express could compete against Paymark for switching services through offering S2A processing only.

18.2 If, instead, it was difficult for merchants and/or banks to move customers from payment types that use S2I to those that use S2A then Paymark's ability to foreclose would be stronger. In this case, Paymark's switch would continue to be a necessary input for terminals that merchants use.

19. Ingenico has submitted that S2I and S2A transactions are substitutable on the demand side, suggesting that banks and merchants could steer customers from S2I payment types to S2A payment types.[5] For example, if processing S2I transactions became less attractive to banks or merchants, they could encourage (or force) their customers to use credit cards or contactless debit cards.

20. At this point, we are not satisfied that such substitution would be sufficiently fluid to allay our concerns over foreclosure. We accept merchants and banks have some ability to influence customer choice of payment type. However, given the large proportion of transactions that use S2I, the ability to process S2I transactions is likely to remain important to merchants for some time to come.

21. Merchants require a terminal that can process all, or a large proportion of, payment types that customers wish to use. The inability to accept a payment type could inconvenience a merchant's customer and lead them to buy elsewhere. It would be difficult for a terminal supplier to effectively compete for a merchant without the ability to process the majority of payment types. Until S2I transactions account for a small proportion of transactions, and merchants no longer view S2I as necessary for their business, terminal suppliers will be reliant on Paymark to provide full switching services.

22. For these reasons, it may be appropriate to define separate markets for S2I and S2A transactions. We have not reached a view on this yet. However, regardless of the

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[4] See for example, the Application, Figure 9.

[5] The Application at FN 15.

appropriate market definition, our assessment will reflect the differences in capability of the various switch operators to process different types of transactions when we consider the market power of the merged entity. These differences affect the ability of the merged entity to foreclose rival terminal suppliers.

23. We seek further evidence to support Ingenico's claim that banks and merchants could steer customers from S2I to S2A payment types in an effective and timely manner.

The counterfactual

24. To assess whether an acquisition is likely to substantially lessen competition in a market, we compare the likely state of competition if the acquisition proceeds (the scenario with the acquisition, often referred to as the factual), with the likely state of competition if the acquisition does not proceed (the scenario without the acquisition, often referred to as the counterfactual).[6]

With the merger

25. With the acquisition, Ingenico would acquire control of Paymark. The acquisition would create a single integrated firm with aligned incentives that provides switching services, terminals and digital payment services.

26. At this time, we are not satisfied that other switch operators such as Verifone and Payment Express will not face greater barriers to compete with Paymark for switching services as a result of the acquisition. We discuss this further at paragraphs 38-42. However, in summary:

    26.1 Verifone relies on Paymark to provide a full service for S2I transactions for non-ANZ issued cards (and Payment Express currently uses Verifone for S2I transactions);

    26.2 these terms are under negotiation for renewal and the merger may provide the incentive for the merged entity to make these terms less attractive than the terms in the current agreement or those which have been negotiated so far for the renewed agreement;

    26.3 if the terms of the agreement for access to Paymark's switch become less attractive post-merger, Verifone may find it more difficult to compete in the switching market in the with-the-merger scenario; and,

    26.4 it is unclear how commercially viable it is for Verifone and/or Payment Express to build their own links to bypass Paymark.

27. The sale and purchase agreement ("the SPA") between Ingenico and Paymark's vendor banks (Westpac, BNZ, ANZ and ASB) may reduce the incentive for the vendor

[6] Commerce Commission *Mergers and Acquisitions Guidelines* (July 2013) at [2.29].

banks to switch to Paymark's rivals compared to the without-the-merger scenario. [[7]

27.1

27.2]

28. We consider in paragraphs 53-56 how these terms may affect the banks' behaviour.

29. We are also still considering whether these features are directly related and necessary to Ingenico's offer to purchase Paymark (and therefore whether they form part of the merger). Whether the restrictions are directly related and necessary to the deal, or not, we consider that these features are likely to form a part of the factual. We invite submissions and supporting evidence on this.

Without the merger

30. At this stage, we consider that without the merger, there are two likely scenarios, both of which entail Paymark being owned by an independent party without a terminal business:

    30.1 Paymark continues to operate under its current ownership structure – the status quo scenario; and

    30.2 Paymark is sold to an alternative purchaser, without a presence in New Zealand terminal, digital payments, or transaction switching markets – the alternative purchaser scenario.

31. We consider there is a real chance Paymark will continue under its current ownership. [[8]

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32. We also consider there is a real chance of Paymark being sold to an alternative purchaser without the merger. This is because:

    32.1 [[9]]In addition, Ingenico has submitted in the Application that "the sale of Paymark to an alternative purchaser at

[7] [
]
[8] [
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some point in the future is not inconceivable".[10]

32.2 [

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33. At this stage, it does not appear that the choice of counterfactual makes a material difference to the issues of concern. In both scenarios Paymark would not be vertically integrated into the supply of terminals. However, we invite submissions and any supporting evidence on this issue.

Foreclosure

34. A substantial lessening of competition can arise when one party acquires another party that is not a competitor in the same market, but is a participant in a related market. This can occur where the acquisition gives the acquiring firm a greater ability and/or incentive to engage in conduct that prevents or hinders rivals from competing effectively in either market (known as "foreclosing rivals").[11] Ways in which a firm could achieve this include: raising their costs; withholding an important input; or bundling "must have" products with products that rivals can compete for. For example, by increasing the price of an input or degrading its quality, it may weaken the ability of rivals to compete.

35. We are assessing whether the necessary conditions for foreclosure to occur are satisfied:

    35.1 the merged entity has the ability to foreclose rivals, through possessing market power for the provision of switch services, and having the means to foreclose (such as by being able to raise rivals costs or withhold an input);

    35.2 that, as a result of the merger, the merged entity would have the incentive to foreclose its rivals due to the additional profits it has the potential to gain from the increased supply of terminal and/or digital payment services; and

    35.3 that foreclosure of rivals would have an adverse effect on competition for customers seeking a payment solution through either higher prices or a reduction in quality, service or innovation.

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[9] [ ]

[10] The Application at [92].

[11] Commerce Commission *Mergers and Acquisitions Guidelines* (July 2013) at [5.1-5.2].

Will the merged entity have the ability to foreclose rivals?

Will the merged entity have market power?

36. The ability to foreclose requires that the merged entity has market power in at least one level of the market. We consider that the merged entity would be likely to have market power for the supply of switching services. The main issues we have considered, regarding whether the merged entity has market power for switch services, are:

    36.1 the current ability of switch operators to process the necessary transactions;

    36.2 the ability to build new links in order to process the necessary transactions; and,

    36.3 the countervailing power of banks.

37. Ingenico submitted that there are two full capability switch providers in New Zealand: Paymark and Verifone.[12] Paymark has agreements with around 50 card issuers and merchant acquirers.[13] Our view is that Verifone does not currently have the same capability as Paymark for either S2I or S2A transactions.

    37.1 First, Verifone has significantly fewer S2I links to financial institutions than Paymark. Verifone has a link with ANZ which it can use for S2A or S2I transactions where ANZ is the card issuer. Verifone does not have S2I links with any other issuer. Instead it has an agreement with Paymark to process those transactions (known as the "wholesale agreement").

    37.2 Second, Verifone does not have S2A links with any major bank aside from ANZ. This means it cannot provide switching services for any merchant that wishes to use a bank other than ANZ as their acquiring bank. Verifone has an agreement with Paymark that allows Verifone to connect its terminals to Paymark's switch (known as the "aggregation agreement"). However, Verifone does not act as the switch provider and the agreement does not allow Verifone to offer access to the switch to other terminal suppliers. As such we do not consider the aggregation agreement reduces the market power that the merged entity would have for switching services.

38. Verifone therefore can only offer a viable alternative to Paymark's switch for ANZ-acquired merchants. Those ANZ-acquired customers can choose between using a Verifone branded terminal connected to Verifone's switch or a terminal connected to Paymark's switch.

39. The ability for Verifone to compete effectively for ANZ-acquired merchants relies on it accessing Paymark's switch on reasonable terms under the wholesale agreement.

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12 The Application at [64].

13 [ ]

The wholesale agreement expires in 2019. The parties are currently negotiating to renew the agreement however the new terms are not yet finalised.
[
][14]

40. Even if the proposed new terms on offer for the renewed wholesale agreement are sufficient to allow Verifone to continue to compete for ANZ-acquired merchants, it is unclear whether these terms will be accepted by the parties before the Commission decides on the merger or that they would endure post-merger. It is possible that the merger will change Paymark's incentives in respect of terms that it offers to Verifone for the wholesale agreement.

    40.1 Without the merger, Paymark will set terms taking into account the benefits it would obtain as the only full service switch operator.

    40.2 With the merger, the merged entity will set terms also taking into account its terminal business. Under this scenario, the merged entity could be incentivised to set higher prices for wholesale access to its switch, so it can encourage merchants that use a payment solution that relies on the Verifone switch to move to a payment solution that uses the merged entity's services.

41. If the merger creates an incentive to capture the terminals and digital payments services that current rely on Verifone's switch, then the merged entity could:

    41.1 offer terms on the wholesale agreements that are less desirable to Verifone than those currently on offer or withdraw the contract; or

    41.2 even if the current terms for the wholesale agreements are agreed to, find other ways to frustrate the effectiveness of the wholesale agreements such as degrading the links or imposing other costs on Verifone.

42. Payment Express also operates a switch. Although it has some links with banks, it uses Verifone (via the Paymark wholesale agreement) for S2I transactions. Payment Express does not have any agreements with Paymark for wholesale access to its switch. [ ].[15] We see no reason why the terms that Payment Express may be able to negotiate with the merged entity would be better than those that Verifone could or that, even if these were entered into, these terms would necessarily endure. For these reasons, we consider Payment Express currently imposes limited constraint on Paymark for switching services.

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[14] Verifone Submission on Ingenico Paymark Statement of Preliminary Issues, 4 May 2018 at [36]; Ingenico/Paymark: Response on behalf of Verifone to cross-submissions by Ingenico, Paymark and the Vendor Banks on the Commission's Statement of Preliminary Issues, 21 June 2018 at [26] and [27].

[15] Paymark cross-submission on issues raised in submissions on the Commission's 23 April 2018 Statement of Preliminary Issues at [12] and [13].

43. We seek further evidence to assess whether the merged entity is planning to offer Verifone wholesale and aggregation terms which are similar terms to the terms presently offered.

44. A possible alternative to negotiated access to Paymark's switch is for rivals to build their own links. There are contrasting views on the how plausible this is.

    44.1 Ingenico and others have submitted that Verifone and Payment Express could build links to financial institutions.[16] Paymark submitted that it is not necessary to build links to all issuing banks to offer a credible offering to merchants: building links to only the four acquirers would cover 88% of transactions; building to the top ten issuers would cover 99% of transactions.[17] [ ].[18] [ ][19]

    44.2 Verifone has submitted that it will be commercially challenging to build links to the issuers due to the risks and costs of undertaking the exercise.[20] Verifone estimated that to provide any real constraint on Paymark it would need to build links to all 29 issuers in New Zealand. Verifone indicated that the cost to build each link is between $500,000-$1million and so the total cost would be at least $15 million.[21] [[22]]

45. Our current view is that the necessary number of bilateral links to be a credible alternative is likely to be: greater than four as Paymark suggests; but less than the 29 that Verifone suggested. It is unclear if merchants would find a terminal that can process 88% of transactions attractive when compared to a terminal that can process all transactions. Building enough links to process the vast majority of transactions (say ten links in order to process 99% of transactions) may, however, be attractive to some merchants. In particular, if building only ten links allows the

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16 See for example: Cross-submission by Vendor Banks on the submissions to the SOPI, 5 June 2018 at [15 – 21]; Paymark – cross-submission on the issues raised in submissions on the Commission's 23 April 2018 Statement of Preliminary Issues at [10].

17 [ ]

18 Paymark – cross-submission on the issues raised in submissions on the Commission's 23 April 2018 Statement of Preliminary Issues at [17].

19 Paymark – cross-submission on the issues raised in submissions on the Commission's 23 April 2018 Statement of Preliminary Issues at [14-15].

20 Ingenico/Paymark: Response on behalf of Verifone to cross-submissions by Ingenico, Paymark, and the Vendor Banks on the Commission's Statement of Preliminary Issues 21 June 2018 at [21].

21 Verifone submission on the Commission's Statement of Preliminary Issues, 4 May 2018 at [41].

22 [ ]

switch operator to avoid significant costs of building and maintaining links, they may be able to offer their service at a discount to Paymark's full service switch.

46. There is contrasting documentary evidence on the extent to which the threat of building links to financial institutions imposes a constraint on Paymark. For example:

46.1 An ANZ document considers that building the necessary links would be a [ ]:[23]

[ ]

46.2 A Paymark document appears to identify the advantage it possesses from having the S2I links, although this also appears to impose costs on Paymark:[24]

[

]

46.3 [[25]]

[

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47. We continue to assess the evidence on the ability to build alternative links. However, at this point, we are not satisfied that Verifone's threat to build out is sufficient to impose a significant constraint on Paymark.

47.1 To become a viable alternative to Paymark requires building enough links to cover a large proportion of the cards that are issued. This may entail at least ten links in order to cover 99% of transactions.

47.2 Although each link may only take a few months to build, it relies on each party being motivated to invest in the time and cost of completing the project. Banks and other financial institutions may view a second full service switch as beneficial, but may have other priorities. For example, an internal

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[23] [ ]provided in response to 30 May 2018 information request at 18.

[24] [ ]provided in response to 24 April information request at [6].

[25] [ ]

Paymark document notes that
[ ]:[26]

[
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47.3 Even a small chance of failure or delay applied across many issuers creates a significant chance that the project will not be successful. The risk of failure may in turn adversely affect the motivation of parties to invest time in building the links in the first place. The proposed terms of the SPA (the volume commitment and non-solicitation clause) may also affect the incentives of the banks to build links.

48. We seek further evidence to help assess:

48.1 which view of the costs and difficulty of building links to banks is more likely; and

48.2 how many links are necessary for a credible switching business.

49. Ingenico submitted that card issuers and acquirers have countervailing power, in particular the five largest trading banks (ANZ, ASB, BNZ, Westpac and Kiwibank) which together make up almost [ ]% of Paymark's transactions.[27] Ingenico submitted that the banks are incentivised to ensure that the payment industry remains attractive for merchants, and that their transaction costs remain low by playing rival switches off against one another.[28] We have considered the extent to which:

49.1 banks have countervailing power; and

49.2 whether their incentives are sufficiently aligned with merchants such that they will exercise that countervailing power to protect merchants from any adverse effects from the merger.

50. Our current view of the evidence is that banks are likely to have some countervailing power, but we are still considering whether this will be sufficient to prevent adverse competitive effects.

50.1 First, we recognise that the banks have at least some ability to influence merchant and customer choice of payment type. For example, the banks could encourage the use of S2A payment systems (such as contactless) over S2I transactions, or direct to account payment systems that do not require any switch processing. This substitution trend is already occurring to some

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[26] [ ], provided by Paymark in response to 24 April request for information at 3.

[27] The Application at [144].

[28] The Application at [145].

degree. The move would reduce the market power that Paymark has as a result of having those S2I links. The inclusion in the SPA of volume commitments seems to reflect Ingenico's view that the banks have some power to switch volumes to competitors. However, as noted earlier, we are unsure whether such substitution would be sufficiently strong to materially reduce merchant reliance on Paymark's S2I switch capability.

50.2 Second, the banks could build (or threaten to build) new S2A or S2I links with Verifone and/or Payment Express. Building S2A links would enable the bank to offer the terminal suppliers that serve its merchants another choice to process S2A transactions, which would threaten the merged entity's revenues. However, it is unclear whether the threat to build S2I links would impose a credible constraint on the merged entity. Although the banks could also build (or threaten to build) S2I links with Verifone, to be a credible threat it relies on Verifone also building S2I links to many other card issuers. An individual bank would have no control over that process to build S2I links with other financial institutions. Furthermore, the merged entity could defeat this process by strongly motivating just one major financial institution not to build an S2I link to a rival. So long as a significant number of customers wish to use cards that use S2I links, competing switch providers will continue to be reliant on Paymark's switch.

51. We are still considering whether the banks' incentives would be sufficiently aligned with merchants to prevent adverse competitive effects. The vendor banks have stated that their main focus is on ensuring the best customer service to their merchants, and that if quality of service was to drop on the Paymark switch, [ ][29] The opportunity to offer a good variety of options to their merchants is likely to provide some motivation to take actions to support other terminal and switch providers. However, the banks may also take into account other factors in choosing how they operate. The banks may also be driven by financial returns from the payment systems their merchants choose.

52. The SPA includes a new service agreement between Paymark and the vendor banks that may inhibit or reduce the incentive of the banks from exercising their countervailing power. The terms of the agreement include:

52.1 [

52.2]

[29] Cross-submission by Vendor Banks on the submissions to the SOPI, 5 June 2018 at [3(d)].

53. [[30]].[31]

54. It is unclear the extent to which the [ ] will incentivise the banks to use Paymark's switch and inhibit rivals from competing. It may be feasible for rivals to [ ]or use alternative strategies to gain customers. For example, [ ], rivals could instead use those funds to incentivise merchants to use their switch.

55. [ ].[32]
[
]
We are still considering the impact that this clause will have on the banks' incentive to exercise countervailing power. However, we note that:

55.1 rivals of the merged entity may find it hard to compete for merchants [ ];[33] and,

55.2 if the merged entity engages in foreclosure conduct (as set out in paragraphs 59-61) that makes rivals less competitive, then the merged entity could worsen in its own offer without being "demonstrably uncompetitive".

56. We seek further evidence to assess whether banks have sufficient ability and incentive to use their countervailing power to protect merchants.

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[30] [ ]

[31] Cross-submission by Vendor Banks on the submissions to the SOPI, 5 June 2018 at [44].

[32] Cross-submission by Vendor Banks on the submissions to the SOPI, 5 June 2018 at [40].

[33] [
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57. To conclude, based on the evidence to date, we are not satisfied that the merged entity would not have significant market power for the supply of switching services. We reach this preliminary view because:

    57.1 Paymark is the only full capability switch and Verifone and Payment Express rely on Paymark to process their S2I transactions;

    57.2 it would be costly and risky for Verifone and Payment Express to build their own S2I links; and,

    57.3 at this point, we are not yet satisfied banks would have sufficient ability or incentive to protect merchants from harm arising from the merger.

Means to foreclose rivals

58. Aside from market power, the merged entity would need to have the means to foreclose rivals through either significantly raising their costs or rendering them unable to supply the market. We consider that the merged entity could have several options to significantly harm rivals should it have the incentive to do so. The range of options depend on whether the terminal is currently connected to Paymark's switch or one of its rivals' switch, and the conduct could adversely affect rivals at either the wholesale or retailer level.

59. Terminals that are connected to Paymark's switch must adhere to certain standards (some of which are set by the card schemes and some by Paymark) and also pay connection charges. For those terminals that are connected to Paymark's switch, the means through which the merged entity could significantly harm terminal rivals include:

    59.1 increasing fees for certifying rival terminals for use with Paymark, or making it harder for rival terminals to obtain certification;

    59.2 degrading the quality of the connection between rival terminals and Paymark's switch (such as slow processing or lost transactions); and/or

    59.3 increasing the transaction or connection fees to merchants using rival terminals (potentially while also reducing fees for Ingenico terminals).

60. Those terminals that are not connected to Paymark's switch (that is those connected to Verifone or Payment Express's switch) do not have to adhere to Paymark's terminal standards. However, the merged entity would still have the means to significantly harm rivals. This might include:

    60.1 raising wholesale and/or aggregation fees to rival switches that need access to Paymark's switch, in particular for S2I transactions; and,

    60.2 degrading the service provided to rival switches that need access to Paymark's switch.

61. We are also considering whether the merged entity could also use bundling or tying in order to harm rivals. For example, the merged entity could require merchants to use Ingenico terminals if they wish to use Paymark's switching service or offer significant discounts if merchants purchase Ingenico terminals with Paymark's switching services.

62. The impact of such conduct could adversely affect competition for all merchants that use terminals. This includes those merchants that seek to purchase an integrated payment processing solution including both terminals and digital payment services. If the merged entity leveraged its market power into the terminals market to encourage merchants to change suppliers of terminals and digital payments solutions, rivals may be unable to compete for customers seeking integrated terminal and digital gateway services solution.

63. We seek further evidence on whether the merged entity would be able to engage in such conduct.

Will the merged entity have the incentive to foreclose?

64. We are considering whether the merger is likely to create an incentive to foreclose rivals. As an independent firm, Paymark would set its terms for connecting to its switch taking into account only the profits it would gain on switch services. As a result of the merger, the merged entity will also supply terminals. Integrating with a terminal business could incentivise the merged entity to foreclose rivals competing to supply payment solutions that include terminals, using one of the means described in the previous section.

65. Ingenico has submitted the merger would not change its incentive to foreclose.[34] Ingenico submitted that Paymark's revenue and gross margin in the upstream switching market would necessarily suffer from lost transaction revenue that it currently receives compared to remaining terminal agnostic. This is because: merchants can use non-Ingenico terminals and non-Paymark switches to process their payments; and, revenue generated by Paymark's switch far outweighs any additional revenue from increased terminal share. Ingenico has also submitted that it "wishes to invest in smoothing and speeding the software certification process and [ ]".[35]

66. The merged entity would have the incentive to foreclose rivals if it expected gains from the conduct to be greater than losses.

    66.1 The merged entity would gain margins from supplying Ingenico terminals (plus spares, support etc.) and potentially digital services to merchants which currently use rival payment solutions, but which would take up the merged entity's services post-merger.

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[34] The Application at [129].

[35] Ingenico cross submission on issues raised in submissions on the Commission's 23 April 2018 Statement of Preliminary Issues, 24 May 2018 at [8].

66.2 The merged entity would lose switching margins associated with those merchants that leave Paymark's switch for a rival one in response to the foreclosure attempt (losing margins on connectivity fees to the merchants and switching fees to financial institutions) or choose to no longer use a terminal or make fewer transactions (in particular, S2I transactions). Merchants may leave Paymark for a different switch supplier if Ingenico terminals did not suit them and/or if changing the terminal was costly compared to changing the switch provider. However, the merged entity may not lose much switching margin since:

66.2.1 merchants leaving Paymark would likely switch to Verifone and/or Payment Express, who may need to access Paymark's switch to serve them; and,

66.2.2 if the merged entity increases the price of access to its switch, it may foreclose Verifone and Payment Express from providing their payment solutions (and therefore prevent merchants from switching away from the merged entity).

67. We seek further evidence on how rival terminal suppliers are likely to respond if they faced conduct such as set out above.

68. We note that Ingenico internal documents indicate that it plans to increase its sales of terminals. For example, a board document identifies:[36]

68.1 a strategic rationale of the merger is to [ ]; and,

68.2 [ ]

69. [ ].[37] [ ].[38]

70. We seek further evidence to clarify Ingenico's post-merger plans and why it considers it does not have the incentive to foreclose rivals.

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[36] [ ]provided in response to 4 April 2018 information request at 2 and 8.

[37] [ ]provided in response to 4 April 2018 information request at 3.

[38] [ ]

Will the conduct reduce competition?

71. The ultimate question when considering concerns over foreclosure is whether the conduct would have the likely effect of substantially lessening competition. Even if the merged entity has the ability and incentive to foreclose rivals, there may not be an adverse effect on competition. This may be because (for example):

    71.1 The merger generates such efficiencies that they offset the competitive harm from the foreclosure.[39] Vertical integration can create efficiencies. For example, vertical integration can result in lower prices because the overall mark up chosen by an integrated firm tends to be lower than two non-integrated firms who each set their own mark up. Vertical integration can also help align incentives between two firms in the supply chain which makes it easier to innovate. For example, the combination of a switch and terminal may make it easier for the merged entity to bring new products and services to the market compared to the counterfactual.

    71.2 Rivals can find alternative ways to serve customers that do not rely on those services for which the merged entity has market power. Other constraints can also prevent the merged entity from raising prices. For example, Ingenico has submitted that the merged entity would be constrained by rapid technology change and emerging payment methods.[40]

72. We are still considering whether the factors above would be sufficient to prevent a substantial lessening of competition. We seek further evidence on:

    72.1 the efficiency benefits arising from the merger; and,

    72.2 the likely impact on the merged entity from emerging payment methods.

Next Steps

73. We seek further submission and supporting evidence from Ingenico on the issues and preliminary views raised in this letter, and in particular the matters identified at paragraphs 23, 29, 33, 43, 48, 56, 63, 67, 70 and 72.

74. We request that Ingenico provides this by close of business on 25 July 2018 and provides a public version at the same time.

75. We are available to meet with Ingenico to discuss this letter. Please contact David Shaharudin at first instance to arrange any meeting.

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[39] Although efficiencies are relevant to our assessment, in practice these can be hard to evidence. It is up to the Applicant to satisfy us that the efficiencies would be realised in a timely fashion, they would not be realised without the merger, and that they would be passed on to consumers. Commerce Commission "Mergers and Acquisitions Guidelines" (July 2013) at 41.

[40] The Application at [128].

Yours sincerely

Richard Davidson