Ingenico / Paymark

Vendor Banks' response to the Letter of Issues

3 August 2018

INTRODUCTION

1. The Vendor Banks are grateful to the Commission for setting out its initial concerns about the acquisition of Paymark by Ingenico in the letter of issues dated 11 July 2018 ("**LOI**").

2. As the Commission is aware, the Vendor Banks are the main source of Paymark's revenue. They are also the entities whose market offering is likely to be the most affected if the quality of Paymark's services drop or its prices increase. Consequently, the Vendor Banks were, and are, highly attuned both to the risks of competition being affected by this acquisition, and the consequences for the market if the status quo prevailed or another purchaser acquired Paymark.

3. For the reasons set out further below, the Vendor Banks are clear that the potential concerns set out in the LOI are not likely to arise from the transaction. There are also real risks in giving weight to concerns that are unlikely to materialise in any real world scenario. In the context of the current disruption of payment systems, the acquisition of Paymark by Ingenico is the best possible outcome for the New Zealand market. It creates an entity that may derive efficiencies from vertical integration, and so is incentivised to invest in a New Zealand switch at a time when the payments industry is in a phase of significant disruption. Different operators in the market have different perspectives on how that disruption will play out, and over what time horizon, but there is no question that it has already begun.

4. The current four-way bank ownership of this important piece of infrastructure is not optimal. Paymark is constrained by its ownership arrangements in its capital investment and decision-making. Ingenico, on the other hand, is already invested in New Zealand and has proven international experience in bringing innovation to other markets. It can better compete with the other international, vertically integrated payment solutions providers in market, Verifone and Payment Express, each of which is already well established and gaining market share at Paymark's expense. The Vendor Banks need strong competition in payment solutions for the benefit of their own market offerings and customer relationships, and in respect of Paymark, they need that business to be able to act more quickly and innovatively in response to market, unhampered by the current ownership structure.

5. It is for this reason that the Vendor Banks refused to agree to [ ] the current SPA represents the most competitive outcome for the market in this respect, [ ].

6. The submissions in opposition to this transaction from Verifone, Payment Express and Woolworths need to be considered in the context of the advantages each achieves in keeping Paymark constrained in its innovation and growth. Each is a materially larger entity than Paymark, with international expertise in switching services and payment solutions.[1] The Commission needs to carefully test submissions from those parties that suggest Paymark might have any ability or incentive to exercise market power. In particular:

   (a) Payment Express is the dominant provider of online switching services and payment gateways in New Zealand. It is a vertically integrated switching services and payment gateway provider, with businesses in New Zealand, Australia, Ireland,

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[1] At the time of writing, Verifone Systems, Inc's market cap is approximately US$2.5b; Payment Express transacts over US$40b of transactions per annum; Woolworths Group Limited's market cap is AU$39b; Paymark's transaction revenue in 2017 was approximately [ ], while its terminal provisioning revenue was about [ ] (see [25] of the clearance application).

Canada, Singapore, the United Kingdom, and the United States**,** and is the primary payment solutions provider to a large number of major merchants, including [ ]. Payment Express also has acquiring licences from Visa and Mastercard. Online payments are increasing rapidly (as set out in the NERA report), and will likely continue to do so over the next 5 years.

[ ].

(b) Verifone is a vertically integrated switch and terminal solutions provider with businesses in the United States, Brazil, Canada, Mexico, Europe, the Middle East, Australia, China, and New Zealand. Verifone is the payment solutions provider to major merchants such as [ ]. After the acquisition of ANZ's switch it chose to defer the capital investment in establishing S2I links, presumably taking the commercial view that the wholesale arrangement with Paymark allowed it to adequately compete and that the cost of links, or their replacements (API links), may come down over time, or the need for them may be obviated by emerging technology. Verifone's approach to its investment decisions does not provide any justifiable basis for precluding the vertical integration and innovation benefits of this transaction from the market as a whole.

With links to the five major New Zealand issuers / acquirers the Vendor Banks understand that Verifone could access approximately [ ] of all transactions.[2] [ ].

Verifone and Payment Express in combination clearly represent a credible bypass threat to Paymark today, and will continue to in the future. If this were not the case, then Paymark, acting rationally, would not have contracted to provide the wholesale switching services that it has to date. The Commission cannot ignore the impact of those existing wholesale terms on competition, unless it has evidence to suggest that Paymark would or could breach that contract. There is simply no such evidence, nor is there any evidence to suggest any action by Paymark could drive Verifone out of the New Zealand market for payment solutions.[3]

(c) Woolworths is a vertically integrated retailer in Australia and New Zealand**,** and is a switching services provider in Australia. It is actively engaged in payment solutions developments in Australia including API-based solutions.[4] [ ]. Woolworths appears to want to 'stop the clock' on the increase in S2A cards / transactions in market, but those changes are market led and are already occurring. The Vendor Banks are clear that having an independent market participant that can bring terminals and digital gateway innovation to market, and is invested in maintaining and developing S2I (as that is its competitive advantage) is the optimal outcome to maintain and enhance EFTPOS, as compared with continued bank ownership.

7. In contrast to the objectors, Paymark is a comparatively small company offering a narrow service solely in New Zealand, and based almost entirely on a single type of infrastructure, with a minor (and not particularly successful) payment gateway offering. S2I services based on Paymark's infrastructure have historically been provided cost-effectively, and so they have been, and currently are, well utilised. However, unless it can continue to invest and deliver greater efficiencies, it will be rapidly overtaken by new technologies, some of which are already

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[2] See Clearance Application at [144].

[3] There is no evidence that the transaction would cause Verifone to suffer a significant loss of scale, squeezing its margins and reducing its incentives to innovate and its competitive constraint on the merged entity (which is a material distinction from the view reached by the Commission in the Sky/Vodafone decision).

[4] See, for example, Woolworths' submission on the Dual-Network Cards and Mobile Wallet Technology Consultation Paper December 2016, as well as the work Optimation Group has undertaken with Woolworths on "Enterprise Awareness": http://www.optimationgroup.com.au/our-work/client-stories/woolworths-bringing-data-to-life/.

in market. The Commission must take them into account in its forward-looking assessment of the impact of the merger on competition.

8. In summary, the additional data and information provided below, and by NERA in response to the LOI, demonstrate that the initial premise of the LOI (at [9]) is overly simplistic and, in substance, not correct - Paymark is an important supplier of switching services in New Zealand, but without the merger, it will inevitably decline in importance. The merger provides the best outcome for competition in payment solutions in the New Zealand market.

CORRECT CONCLUSIONS IN THE LOI

9. The Vendor Banks agree that the Commission has correctly characterised some of the dynamics in the market as follows:

   (a) The status quo may well be the most competitive 'likely' counterfactual against which to assess the transaction ([31]). The Vendor Banks note that transaction will enhance competition in comparison to that counterfactual for the reasons set out below.

   (b) It is possible for Verifone and Payment Express to build new links to acquiring banks in order to bypass the Paymark system ([44]).

   (c) The Vendor Banks have countervailing power over Paymark, specifically as a customer of Paymark's services ([49] – [50]); as noted above, the Vendor Banks are the primary source of revenue for Paymark and potentially have the most to lose if the services are not competitive.

   (d) Consumer substitution from S2I transactions to S2A is occurring already ([50.1]), and as noted further below and in the NERA report, the data shows [ ].

   (e) Banks can build new links with Verifone and/or Payment Express [ ], which allows the banks to offer merchants another choice to process transactions ([50.2]).

   (f) The Vendor Banks are motivated to provide a high quality service to merchants ([51]), and have an ability to influence merchant and cardholder choice.

   (g) Rivals (such as Verifone and Payment Express) can offer alternative strategies, such as rebates or lower prices, to attract merchants to their switch ([54]). In addition, the current and future likely wholesale contract arrangements between Verifone and Paymark, and potentially also between Paymark and Payment Express, will continue to allow this competitive discounting to occur.

   (h) Banks view multiple switch providers as being beneficial ([47.2]), or, put differently, banks view having alternative and competing payment solutions, which may include multiple switch providers, as being beneficial.

10. An analysis of the impact of the merger based on the above findings necessarily leads the Commission to the conclusion that this transaction will not substantially lessen competition.

11. However, the Commission also made other statements and preliminary conclusions in its LOI which are not correct. These are as follows. We address these issues in the balance of this submission.

Countervailing power of banks and merchants

   (a) The Vendor Banks are confident that they, in combination with pressure from their customers, the major merchants, can and would steer cardholders to S2A payment types in an effective and timely manner in the face of a post-merger reduction in quality or increase in price of S2I switching services (cf. [23]). The growing use of

S2A in market, despite the incentives created by the current bank ownership of Paymark, indicates that the market pressure to develop alternatives to S2I are strong and are unaffected (and may be enhanced) by the transaction.

(b) The [ ] will not have a material impact on the banks' post-merger behaviour (cf. [29]) and this is clear from the fact that ownership of Paymark today (which is a much greater incentive to direct traffic via STI) does not affect the Vendor Banks delivering the payment solutions its customers want in the current market. [ ].

(c) The Vendor Banks' incentives are to offer a variety of terminal and switching services to merchants to meet their customer demand [ ] (cf. [51]). The Vendor Banks have both the ability and incentive to exercise their countervailing power in combination with the major merchants in this regard (cf. [56]).

Verifone and Payment Express' competitive positions

(d) There is no evidence to support a concern that the merged entity will not offer the same wholesale terms as the current negotiated terms with Verifone (cf. [43]). The Vendor Banks understand from Cameron Partners that [ ]. However, the current terms represent the minimum wholesale terms that will be available to Verifone in the factual and will continue to allow Verifone and Payment Express to access the Paymark network.

(e) Verifone / Payment Express are likely to build, or credibly threaten to build, more links in order to maintain competitive pressure on the merged entity (each of them, and in combination, are already credible competitors to the merged entity) and there are no material barriers to them doing so (cf. [44] – [48]).

(f) The merged entity does not have the incentive to increase fees or degrade the connection quality for rival terminals that use Paymark's switch, or raising costs / degrading quality to rival switches that access to Paymark's switch (cf. [59] – [60]) due to the strong competitive pressure exerted by the combination of Verifone and Payment Express, as well as the countervailing power of banks and merchants.

(g) The transaction does not change the merged entity's ability to foreclose rivals at all (cf. [11]). To the extent Paymark is constrained (or not) today, that is unchanged by the transaction. In terms of its incentive to engage in bundling / tying of Ingenico terminals with Paymark's switching services (cf. [61] – [63]) this is at best speculative, due to the competitive bypass threat exerted by banks and merchants in the context of the trends to S2A switching and developments in new technologies, as discussed in the NERA report accompanying this submission.

Efficiencies

(h) Any potential lessening of competition will be offset by material efficiencies (cf. [71.1]), as set out in the accompanying NERA report. The increase in countervailing power of banks and merchants arising from rapidly emerging technologies and payment methods ([71.2]) will continue and accelerate the competitive constraint on Paymark post-transaction.

MARKET CONTEXT

12. In its focus on the historical market structure, the Commission risks missing the way in which this market, and Paymark's services, have developed in the last few years. The most recent developments also provide clear evidence to demonstrate how payment services markets are developing over the near term, being the period that is relevant for any comparison of the impact of future with, and without, the transaction.

13. In the introduction to the LOI, the Commission refers to Paymark as "the main supplier" of switching services in New Zealand.[5] In fact, it is only one important supplier of switching services. Payment Express is by far the largest e-commerce switch provider in New Zealand (switching [ ] e-commerce transactions), and Verifone owns and operates its own switch as well as a switching a substantial further quantity of transactions through its wholesale arrangement with Paymark.

14. As the data shows (see paragraphs 22 and 23), there are a large quantity of transactions in market that either are not switched by Paymark or do not, or in the near term will not, need to be. Additionally, there are significant and readily foreseeable developments that will continue to place pressure on Paymark / Ingenico to deliver affordable, innovative and relevant switching services, or else be bypassed in the medium term. Examples of innovative payment solutions that do not utilise traditional switch networks include POLi, PayPal (Braintree), Account2Account, and PayHere.

15. It is this threat that has led to the Vendor Banks to recognise that [ ].

16. In contrast, Ingenico has access to global capability, R&D and experience in multiple international markets, and is best placed to bring global innovation to New Zealand. It can provide a competitive terminal and switching service in a market where use of switches is a choice, not a necessity, as standardised APIs facilitate multiple low cost direct links across the market. Further, Ingenico is more likely to arrive at an aligned strategic view than the current four competing owners (with differing switching needs and views on how best to respond to rapidly evolving market developments).

17. A market structure in which three leading global terminal providers, Verifone, Payment Express and Ingenico, are each vertically integrated and incentivised to deliver best in class switching services and terminals is the best market outcome for New Zealand in this next period of dynamic change in banking services. If the Commission declines this merger clearance, it is denying New Zealand consumers the benefit of significant efficiency gains, and it will cause consumers to suffer the consequences of unquantifiable, but material, dynamic efficiency losses as a result.

18. In considering the questions posed in its LOI, the Commission should keep in mind that:

    (a) Paymark is an important provider of switching services in New Zealand, but it is not the main provider for online / e-commerce transactions and, without the merger, it will inevitably decline in importance, as online / e-commerce transactions continue to grow and new payment technologies become more prevalent.

    (b) Only a relatively small percentage of transactions (approximately [ ]%) utilise Paymark's network as the sole switching option.

    (c) Verifone and Payment Express could readily build out their own competitive offering of direct S2I links for less than [ ] [ ], or they could elect to continue to utilise Paymark's existing links through a wholesale / aggregation agreement (which appears to be Verifone's approach). The access to Paymark's network which is available to Verifone and Payment Express through the wholesale / aggregation agreements is an important component of the market dynamics, both now and going forward, and needs to be considered by the Commission in that context.

    (d) New and emerging technologies will allow the building of links to be much cheaper in the near future [ ].

    (e) Banks and merchants have considerable countervailing power, which they can exercise to influence Paymark's pricing and services going forward.

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[5] [9] of the LOI.

(f) Ingenico is best placed to bring global innovation to New Zealand and will be a much better owner of the Paymark business going forward than the Vendor Banks or an alternative (eg private equity) purchaser.

VERY LITTLE IS CHANGED BY THE MERGER

19. As outlined in greater detail below, [ ].

20. The combination of the aggregation and wholesale agreements into a single set of terms [ ]. With the change in commercial incentives it is unlikely (ie speculative) to suggest that historical behaviour in respect of the wholesale arrangements would arise in the future. With and without the merger, Verifone will provide the same level of constraint on Paymark [ ] and there is no basis to speculate that different or better terms would be available to Verifone in the counterfactual. Indeed, it is more likely that better terms would be available in the factual, as Ingenico seeks to incentivise S2I switching where Paymark has made a significant investment. There is, at worst, no difference between the factual and counterfactual in this respect; if anything, the factual is more likely to see enhanced incentives to use EFTPOS.

21. When Verifone's ability to constrain Paymark is coupled with [ ], in both the factual and the counterfactual, Paymark will plainly not have an ability or incentive to engage in foreclosure strategies.

Countervailing power of banks and merchants

Transactions that could bypass Paymark

22. Currently, there is only a relatively small percentage of transactions for which utilising Paymark's links is the sole switching option. There is a significant quantity of transactions that are currently able to bypass Paymark's network, including:

(a) all ANZ-acquired transactions, as Verifone has already built S2I and S2A links with ANZ. This amounts to approximately [ ]% of transactions;

(b) all S2A transactions acquired by BNZ, Westpac or ASB. This amounts to [ ]% of transactions; and

(c) [ ]. This amounts to approximately [ ]% of transactions.

Effectively, there is only approximately [ ]% of transactions for which utilising a Paymark link is the sole switching option. These transactions are predominantly:

(d) S2I transactions where [ ] is the issuer;

(e) S2I transactions where KiwiBank is the issuer; and

(f) S2I transactions where the issuer is one of the smaller 24 card issuers operating in New Zealand.

23. That percentage also looks likely to decrease further in the near future, in particular given:

(a) [ ];

(b) the percentage of S2I transactions is decreasing, with a shift to an increasing number of S2A transactions (as discussed further in the NERA report); and

(c) new and emerging technologies will allow the building of links to be much cheaper, which will affect the build versus buy decision that Verifone and Payment Express face. In particular, standard industry API links are likely to reduce reliance on traditional S2I links within the next few years (as discussed further in paragraph 70 below).

24. Verifone and Payment Express have submitted that it would be difficult to build their own links.[6] However, both Verifone and Payment Express have been building a number of their own links in the market over the last few years (as described in paragraph 22 above and paragraphs 30 and 33 below), and the Vendor Banks are of the view that Verifone and Payment Express are overstating this difficulty (essentially global switching service providers with switching infrastructure in numerous jurisdictions claiming to be unable to afford to build links in New Zealand).

Dual acquiring and merchant links

25. It is entirely possible for merchants to use dual acquiring services in order to put competitive pressure on providers if a product or service is not meeting the customer's requirements. Larger merchants are also able to exercise competitive pressure by taking, or threatening to take, their transaction volumes elsewhere – in some cases building their own links to do so. For example:

    (a) [ ] currently utilises a dual acquiring service. This solution indicates that if a large merchant elects to use Paymark for its debit volumes, it does not necessarily follow that Paymark will also win all of that merchant's credit volumes. As such, large merchants have demonstrable countervailing power to demand unique solutions, which may involve switching away from Paymark.

    [ ]

    (b) [ ] and Countdown both have established direct links to Verifone;

    (c) [ ]; and

    (d) [ ].

26. [ ]

Verifone's position

27. The Commission needs to be clear that Verifone is a global competitor of Ingenico. Verifone is itself already vertically integrated, operating a terminal supply and switching business in New Zealand. Verifone has the capability to bring global innovation to New Zealand which Paymark, under current bank ownership, would not be well placed to match - however, Verifone is perhaps concerned that the likely innovation Ingenico will bring to market will require Verifone to invest in matching its competition.

28. Renewed pressure on a global competitor of Verifone's scale to invest in the New Zealand market must be seen in the context of Verifone's strategic decision to enter into a wholesale agreement with Paymark to, at least temporarily, save itself the investment involved in replicating the links that the EFTPOS NZ switch had when owned by ANZ. [ ]. It is now unhappy at the prospect that it might have to invest again, to continue to innovate and gain customers from Paymark as a more effective competitor under Ingenico ownership. However, that is a good thing for competition and the market as a whole.

29. Recently, Paymark and Verifone have [ ].

30. In the past few years, Verifone has built out a number of direct links, including a direct link to [ ], a direct link to Countdown, and a direct link to Payment Express (meaning that, if Verifone

[6] [44] of the LOI.

does not wish to build further links itself, it could instead piggy-back off Payment Express' links and/or share the costs of building new S2I links).

31. Verifone also has a direct link with Paymark, and its decision to delay investing any further in infrastructure and innovation in this market (notwithstanding the relatively low cost of establishing a competitive set of direct links), and to instead utilise Paymark's infrastructure, is a product of Verifone's own build versus buy analysis. Potentially, Verifone now perceives more benefit in establishing API links with issuers rather than transitional S2I links, and therefore proposes to continue to utilise Paymark's existing S2I links in the immediate future until it has established its own network of API links. Globally, Verifone is highly experienced in running a switch utilising API links.[7]

Payment Express' position

32. Like Verifone, Payment Express is also a vertically integrated operator in New Zealand, having its own switching and terminals businesses, whilst also operating online payment gateways and holding a dominant position in e-commerce transactions (switching [ ] e-commerce transactions among merchants in New Zealand). Payment Express also has a broader relationship with Ingenico (being a significant purchaser of Ingenico terminals), which gives Payment Express some level of countervailing power over Ingenico as well.

33. Payment Express has, however, been far more active in establishing direct links than Verifone and has already built a significant number of links (as discussed in paragraph 22 above, as well as direct links to Visa and MasterCard), and the Vendor Banks understand [ ]. The Vendor Banks also understand that Payment Express has built links to Verifone, and is thereby able to utilise Verifone's direct links as well as its own (for example, switching S2A transactions for ANZ-acquired merchants, and S2I transactions where ANZ is the issuer, via Verifone's direct links with ANZ, rather than via the Paymark network). The scope of Payment Express' reliance on the Paymark network is therefore relatively limited and likely to become even more limited over time.

The [ ]

34. The LOI references the SPA containing "volume commitments" from the Vendor Banks.[8] The Vendor Banks wish to reiterate that the [ ] are not volume commitments. No volume guarantees or underwrites were offered to bidders during the sales process, [ ]. The Vendor Banks provide some additional context to the [ ] below.

35. [ ]

36. [ ]

37. [ ]

38. [ ]

(a) [ ]; and

(b) [ ].

[7] See for example: https://www.programmableweb.com/api/verifone-open; https://gigaom.com/2012/08/29/verifone-opens-sail-payment-platform-to-developers/.

[8] See [47.3], [50.1], and [ ].

As noted at 11(b), [ ]. However, regardless of whether the [ ] are taken as forming part of the transaction, or as simply part of the factual, their practical effect on the Vendor Banks' behaviour will be minimal.

The [ ]

39. The LOI notes that the [ ] may mean that [ ], those rivals may find it difficult to compete for merchants.[9]

40. As previously noted, [ ]. Verifone and Payment Express are not prohibited from marketing their own products to Paymark customers, or otherwise enticing them to change providers.

41. The limited nature of the [ ], and the restrictions on its application, mean that it will not significantly affect the Vendor Banks' incentives to exercise their countervailing power. As noted below, and in previous discussions with the Commission, the Vendor Banks' focus is on providing a high quality service to merchants. If the quality of Paymark's service was to drop following the transaction, merchants using Paymark's switch would be incentivised to move away from that service, [ ].

The alternative purchaser counterfactual

42. The Vendor Banks remain of the view that, if the sale to Ingenico does not proceed, Paymark is likely to remain under their ownership for the foreseeable future. As previously discussed, the Vendor Banks believe that Ingenico will be a significantly better owner of the Paymark business than the Vendor Banks, and [ ].

43. While the Commission appears to consider there is a real chance of a sale to an alternative purchaser,[10] [ ]. Any alternative counterfactual being contemplated by the Commission must give consideration to such factors.

44. The Vendor Banks agree with the Commission that the choice of counterfactual does not make a material difference to the issues of concern,[11] since Paymark is likely to be less competitively significant under ongoing Vendor Bank ownership or if it was purchased by an alternative bidder. Ingenico is likely to be the best owner for Paymark and deliver the best market outcome for New Zealand into the future.

Paymark <u>does not have market power</u> in the market for switching services

Verifone and Payment Express will provide credible constraints on the merged entity

<u>Pricing of the wholesale and aggregation agreements</u>

45. As the Vendor Banks have previously submitted, from discussions with Cameron Partners they understand that the current negotiations relating to the wholesale pricing [ ].

46. As noted in the Vendor Banks' cross-submission, [ ].

47. The LOI suggests that the merged entity will take into account its terminal business, and may be incentivised to set higher prices for wholesale access to its switch, to encourage merchants using a Verifone switch to move to the merged entity.[12]

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[9] [55.1] at LOI
[10] [32] of the LOI.
[11] [33] of the LOI.
[12] [40.2] of the LOI.

48. NERA's analysis indicates that Paymark's business model is highly sensitive to volume loss and, rather than limit access to its switch, it would be incentivised to avoid losing volume to other switches and/or bypass options that are available.

<u>Building new links</u>

49. The LOI outlines the Commission's current thinking in relation to how many links a rival would have to build in order to have a credible offering to merchants. The Commission considers it likely that more than four links would be required,[13] and possibly up to ten.[14]

50. As noted above:

    (a) Verifone has established S2A and S2I links with ANZ;

    (b) Payment Express has S2A links with ASB, BNZ and Westpac; and

    (c) [ ].

51. [ ].

52. While there have been differing views on the exact cost of building a new S2I link (and the Vendor Banks consider that Verifone's figure of $500,000 to $1m referred to in the LOI significantly overstates that cost), even using what the Vendor Banks consider to be a relatively conservative estimate of between [ ] per link, the cost to Verifone or Payment Express of building out S2I links to the five largest issuing banks would be approximately [ ] (given that some links already exist in market). Even if the number of links built increased to the 10 largest issuers, the total cost to Verifone or Payment Express of building out those S2I links would still only be approximately [ ].

53. In the context of the switching and terminals markets, and given the significant resources available to both Verifone and Payment Express, this is a relatively modest investment. As noted in the clearance application, Paymark's transaction revenue in 2017 was approximately [ ], so Verifone's suggestion that [ ] does not seem to stack up. And while Verifone may submit that that is the case, Verifone's view is clearly not shared by [ ].

54. Further, since Verifone and Payment Express already utilise a direct link between themselves and can piggy-back off each other's links, they could elect to build half of those links each - meaning the individual cost to Verifone or Payment Express of having a direct S2I link to each of the five largest issuing banks would be approximately [ ] (or approximately [ ] to have direct links to each of the 10 largest issuers).

55. Verifone and Payment Express cannot sensibly sustain that Paymark has market power based on its network of S2I links, given that they could each readily establish a competitive offering of direct S2I links for less than [ ] ([ ]), or could avoid that investment cost by electing to utilise Paymark's existing links (an approach which Verifone seems more inclined to adopt).

Ability for banks to exercise countervailing power

Incentives to offer a variety of high-quality services to merchants

56. The Vendor Banks have previously submitted that their focus is on ensuring the best customer service to their merchants, and that if quality of service was to drop on the Paymark switch, [ ].

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[13] [45] of the LOI
[14] [47.1] of the LOI

57. There are already examples of the Vendor Banks using providers other than Paymark where those other providers' offering provides a better service for merchants. [ ]

58. Collectively, the Vendor Banks make up the main source of Paymark's revenues and can exercise competitive pressure by taking, or threatening to take, their business elsewhere. S2A links already exist in market, and the cost of and timeframe for building S2I links would not be prohibitive for those banks, as discussed further in paragraph 52 above.

Whether [ ] disincentivise switching to a rival switch

59. The Vendor Banks have previously submitted that [ ].[15] As noted in the LOI, it is feasible for rivals to offer [ ] and incentives for customers to switch [ ].[16] [ ].[17]

60. [ ].

The merged entity will not have the ability or incentive to pursue a foreclosure strategy

No incentive to raise prices / degrade quality

61. The LOI asks if the merged entity pursued a foreclosure strategy by requiring merchants who wish to access Paymark's switch to use Ingenico terminals, whether the merged entity's decrease in switching revenue would be offset by the increase in terminals revenue.

62. As discussed in the NERA report, a formal vertical arithmetic analysis of the merged entity's incentives would be difficult to undertake, particularly due to the many options available to merchants (and their differing impacts on Paymark's margins), as well as the nature of the broader dynamics in the payments industry. However, NERA notes that Paymark is highly sensitive to volume loss and could stand to lose significant switching revenues (from merchant administration fees and per-transaction margins) as a consequence of pursuing a foreclosure strategy. NERA concludes that in order to ensure demand for its switch continues (particularly given the industry drive towards new and innovative payment solutions that do not necessarily require a switching service), the merged entity would be incentivised to foster innovation and competition at the terminal level, rather than foreclosing access to the switch which might otherwise encourage greater utilisation of bypass options and accelerate volume leaving the Paymark network.

No incentive to engage in anti-competitive bundling

63. The LOI states that the merged entity may use bundling or tying to harm its rivals, for example, by requiring merchants to use Ingenico terminals if they want to use Paymark's switch, or by offering significant discounts to merchants who do so.[18]

64. The Vendor Banks are of the view that bundling is in most instances pro-competitive, as it offers customers attractive options for integrated products / services offerings at a cost saving. As noted above, the Vendor Banks aim to provide the most attractive and high quality offering to merchants, and it is ultimately the merchant's choice as to what product / service they wish to use.

65. Further discussion regarding the merged entity's incentives are discussed in the NERA report.

[15] See Vendor Banks' cross submission at [44].
[16] LOI at [54].
[17] Vendor Banks' cross submission at [44].
[18] LOI at [61].

Efficiencies and rapidly emerging technologies offset any competitive detriments

Efficiencies

66. The transaction will result in a significant number of economic efficiencies, as outlined in the clearance application,[19] and in NERA's report.[20] These efficiencies include Ingenico's ability to introduce technological developments to New Zealand payment services that may not otherwise be introduced or developed.

67. Ingenico is a sophisticated global payment services provider. It has the ability and advantage of investing in R&D overseas, and bringing that new technology to New Zealand virtually cost-free.

68. As noted above, the industry trend is that proprietary debit will continue to diminish if no further investment in it is made. Ingenico has the resources and capability to make such investment in new alternatives to proprietary debit (where, under current bank ownership there is no clear mandate to do so), and to bring innovation from overseas markets to the New Zealand market at minimal cost. Paymark will have the ability to offer new payment types directly to customers, particularly given the rapid expansion and anticipated uptake of API services in New Zealand. Paymark is positioning itself as a player for these services; for example, with its open payment platform, as well as services such as Ping[21] and Online EFTPOS.[22]

Emerging technologies

69. The Vendor Banks have spoken to the Commission on this point in interviews and calls.

70. There is significant evidence that:

(a) as discussed in the NERA report, there is a shift to an increasing number of S2A transactions, meaning that the reliance on Paymark's S2I services will be significantly reduced in the near future;

(b) in addition, new technologies and payment systems (some of which are already operational and others which will be implemented very soon), which bypass Paymark's switch altogether, are becoming more popular. This will also reduce market reliance on switching services significantly. Ingenico is best placed to extend and guide Paymark's transition into offering more of these new technologies and systems.

(i) Standard industry APIs will make bill payments and electronic credit easier. There are currently [ ]. Hon Kris Faafoi, in his role as the Minister of Commerce, has directed banks to have "in-store" versions of their electronic bill payments systems using industry API's within the next 12 months.[23]

(ii) Most e-commerce business already bypasses Paymark's switch. Payment Express is the giant in the e-commerce switching world.

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[19] See [35] – [40].

[20] See [4] of the NERA report.

[21] https://go.trademe.co.nz/Ping

[22] https://www.paymark.co.nz/products/online-eftpos/consumer/

[23] Hon Kris Faafoi speech to Payments NZ Conference (26 June 2018). Accessible at: https://www.beehive.govt.nz/speech/speech-payments-nz-conference-26-june.

(c) Some of these new technologies, such as API technology, will make it significantly cheaper to create links. [ ].

Efficiencies

The disbenefits of bank ownership

71. As has already been discussed with the Commission:

(a) [ ];

(b) [ ];

(c) [ ]; and

(d) [ ].