Matthew Dunning QC | BARRISTER

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Commerce Commission

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INGENICO: APPLICATION FOR CLEARANCE TO ACQUIRE PAYMARK

Introduction

1 Further to our discussion on 2 May 2017, I confirm that I act for Payment Express (**PE**). PE has seen the public version of the application for clearance dated 20 April 2018 filed by Ingenico Group SA (**Ingenico**) to acquire Paymark Limited (**Paymark**) (**the Application**). That application rests in significant part on matters within PE's knowledge, including PE's own competitive position, and I understand that the Commission would like to speak to PE about that. As agreed, Andy Cullen (CEO of PE) and I will meet you at your Auckland offices on Thursday 17 May at 9.30 am for that purpose. The following is to provide a precis of what PE will address at that meeting.

2 Matters which are confidential and commercially sensitive are marked in square brackets. I also attach a public version of this submission with those passages marked and redacted.

3 While there are various matters of detail that should be corrected in Ingenico's submission[1], it seems to PE that there are three key matters where PE can assist with the Commission's understanding. In summary:

(a) Payment Express is significantly constrained from competing for transaction switching in ways not described in the application (contrary to the impression it creates of PE being a substantial competitor to Paymark);

(b) New Zealand's banks are understood to also face significant constraints by virtue of the agreements that they have signed with Paymark to take effect once it has sold. In short they have guaranteed minimum volumes that will in practice mean PE can move little traffic away from Paymark;

(c) Ingenico acquiring Paymark would allow the merged entity significant opportunities for anti-competitive bundling. Paymark already distorts competition by doing so but its ability to do so would be enhanced after the

[1] For example, the Application refers to Paymark's business Paypr but does not record it was recently closed.

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acquisition by allowing its market power to be leveraged into other markets where competition exists.

4 I address each issue in turn below, and Andy Cullen will provide an update at the meeting on approaches PE has made to Paymark for commercial terms to address the situation.

Payment Express's position

5 The Application describes PE as one of "the two largest competing switch providers."[2] It goes on to define switching as two separate markets (STI and STA switching[3]), apparently to deal with the fact that PE is not and cannot be a genuine competitor to Paymark for the latter, as it does not have the ability to switch a large proportion of transactions.

6 The defining feature of the payments industry is that you can only add payment methods, not remove them. In New Zealand, a large proportion (approximately [ ]%) of payments are made by EFTPOS. Merchants and customers alike will not accept a payment solution that excludes EFTPOS. Despite the rapid development of other payment methods it will be many years before they do (as was the case with cheques, for example).

7 There is only one provider of EFTPOS switching in New Zealand, Paymark. VeriFone buys access through Paymark and onsells it to PE. Both VeriFone and PE have some ability to switch EFTPOS transactions by virtue of links they themselves have between banks, but that ability is limited, as they do not have links between all the major banks, despite PE working hard for some years to build them. As such Verifone and PE cannot switch transactions that PE estimates comprise just under [ ]% of all EFTPOS transactions. And being able to switch only between certain banks is not a commercially viable proposition: no merchant or customer will accept a payment solution that only allows transfers between certain major banks and not all of them. Ubiquity is key.

8 As such, the Application's assertion that there are separate markets for STA and STI switching because they are substitutable for each other is not the case. Both are part of an overall market. Moreover, STA cards are inherently more expensive for transactions than STI and many individuals only have the latter. Many merchants will not accept credit cards for that reason too. As such the assertion in the Application that a SSNIP could not profitably be imposed is incorrect.[4]

9 But even if STI and STA were in the same market, Paymark would still have market power. It offers a service that is essential to a commercial payments offering and has a monopoly over it. As such, even if there were a shift to STA, Paymark could simply increase prices for STI to make up any lost revenue: and its customers would have no choice but to accept.

10 As such, the Application significantly overstates the constraint that PE can exercise. It simply cannot constrain Paymark's market power over STI transactions. And there is no commercially viable payments solution without STI transactions.

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[2] Executive Summary, paragraph L.

[3] See footnote 15. The more commonly accepted nomenclature in the market is between "Scheme Transactions" (essentially credit cards, and more recently debit cards run through the same "rails"), and EFTPOS.

[4] Ibid

11 The Application suggests that Paymark's market power is vulnerable to new entry, including from PE.[5] [

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The position of the major banks

12 The Application also asserts that the banks have significant countervailing power,[6] by virtue of the very high proportion of transactions that they control.

13 However, PE understands that the banks have recently signed new terms of access to apply once the acquisition completes. That is confirmed in paragraph 47 of the Application.

14 PE has not seen the new terms of access, but understands that they include a volume based pricing structure. That structure is understood to involve pricing that is dramatically different if certain specified volumes are not met. And that the volumes that are specified are for the vast majority of the bank's current EFTPOS volumes (in a market where transaction volumes for EFTPOS are falling).

15 As noted above, the banks must use Paymark for a significant proportion of their transactions, as there is no alternative. As such, it is understood that PE is in effect foreclosed from competing for the bank's switching business, because even if PE undercuts the prices Paymark offers, any significant switching of business will result in dramatic price increases for the proportion of transactions that must be switched through Paymark, such that banks are not better off overall.

16 The commercial rationale for the banks tying their hands in this way is of course obvious. The banks are the current owners of Paymark. The price they get for it will be dramatically undercut if they do not give prospective purchasers sufficient assurance that Paymark's business will remain unaffected by the sale of their stake. As such they can be assumed to have taken steps to ensure volumes do not decline (though no doubt they are anxious to make it appear otherwise, so that clearance is given and this transaction proceeds).

17 I note that the Commission has been provided with the revised terms of service, and as such the Commission will be in a position to test the true situation (by obtaining data on current transactions volumes and modelling the total cost to banks under the new agreement were transactions that PE could switch were in fact switched by it).

Bundling

18 Last but not least, the acquisition will significantly increase the risk of anti-competitive bundling.

[5] At 153

[6] At 126

19 The Application notes that bundling is common in the industry, recording that PE "generally offers its merchants a bundled service including both terminal provision and switching/processing services".[7] It appears to be conceded that after the acquisition, Ingenico will bundle the services it competes with PE for (terminals, STA switching) with those it does not.

20 Bundling per se is, of course, not anti-competitive. But what will change after the acquisition is that Ingenico will be a vertically integrated entity with the ability and incentive to foreclose competition for terminals by bundling to include a service where there is no competition (STI switching). That is the source of PE's concerns in this case. It will be forced to deal with Ingenico as a supplier, competitor, and monopolist. Ingenico will have the ability to exert leverage in the latter capacity to its advantage in either two.

21 PE already deals with Verifone both as a competitor and as a supplier. But Verifone does not have a monopoly position and (no doubt as a result) does not bundle the services it offers to PE. It allows PE to use its switching network for those transactions where it has no alternative, without compelling it to also switch those transactions where PE does.

22 By contrast, Paymark does not. PE has repeatedly sought access to the Paymark switch on the basis that it can switch only those transactions it must route through Paymark, and bypass it for the rest. Paymark has consistently and repeatedly refused to grant access on those terms. That has moved from an outright refusal in past years (PE has been trying to address this since 2011) to now allowing access on the basis of minimum volumes that can only be satisfied by PE passing through all or nearly all of its volume, including that which might otherwise bypass it. The net effect is the same.

23 This is a position unprecedented in payment systems in Western nations. In every one of the dozens of overseas markets PE competes in, it has been able to obtain access to the EFTPOS switch on an unbundled basis. Only in New Zealand it cannot.

24 If Paymark were to grant PE unbundled switching access then Ingenico could be taken at face value when it says Paymark will not act anti-competitively by leveraging its monopoly position in one market against Ingenico's competitors in others. The fact it repeatedly refuses to do so, as recently as a few months ago, is why in PE's view it cannot.

25 It should go without saying that the ability to leverage such market power, obtained by virtue of the acquisition, is a real anti-competitive effect. It will stifle, or at least considerably delay, innovation in payment terminals and keep switching prices up. It will allow the merged entity to foreclose competition where it exists now (for terminals, for example).

[7] At Appendix 2, 11(f)(ii)(B)

Conclusion

26 I trust that the forgoing assists the Commission's thinking ahead of our meeting. Mr Cullen and I look forward to answering your questions and providing any further information you require when we meet.

Yours faithfully

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