BUDDLE FINDLAY
NEW ZEALAND LAWYERS

21 June 2018

To
David Shaharudin, Nicola Hulley, and Gavin McNeill
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.mcneill@comcom.govt.nz

Dear David, Nicola, and Gavin

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

1. We are making this submission on behalf of Verifone.

2. In this submission, we respond to various points made by Ingenico Group SA, the Vendor Banks,[1] and Paymark in their cross-submissions on the Commerce Commission's statement of preliminary issues in respect of Ingenico's application for clearance to acquire Paymark. We have focused this submission on the key contentions in the cross-submissions, as well as comments in the cross-submission that respond to Verifone's initial submission on the statement of preliminary issues. However, there may be other aspects of the cross-submissions that we do not address, but with which Verifone also disagrees.

3. We submit that the cross-submissions do not sufficiently address the concerns Verifone and other submitters have expressed that the proposed transaction would be likely to substantially lessen competition.

4. Verifone's initial submission explained how the merged entity would have the ability and incentive to leverage Paymark's market power in the switching market to foreclose competition in the terminals markets and the digital payments markets. The proposed transaction would substantially lessen competition because, as a vertically integrated entity with market power in the switching market that also competes in downstream markets, the merged entity would have incentives to foreclose

[1] ASB Bank Limited, ANZ Bank New Zealand Limited, Westpac NZ Operations Limited, and BNZ Investments Limited.

competition in downstream markets. Paymark currently has no such incentives.[2] In addition, the proposed transaction would substantially lessen competition by strengthening the incentives Paymark already has to limit competition in the switching markets, so as to ensure the success of any foreclosure strategy pursued in downstream markets. Verifone's initial submission pointed to examples of Paymark's current and previous conduct to demonstrate Paymark's market power in the switching markets, and our and Payment Express's limited ability to constrain Paymark.

5. In this submission, we outline why:

   (a) cross-submissions about the counterfactual do not change the outcome of the competition analysis (ie, that the proposed transaction would be likely to substantially lessen competition);

   (b) like the clearance application, cross-submissions about the degree of Paymark's market power in the switching markets significantly overstate the ability of competitors, such as Verifone and Payment Express, and the ability of the Vendor Banks (outside their current roles as shareholders), to constrain the merged entity's conduct;

   (c) cross-submissions about competition in the terminals markets focus on conditions of entry that have no bearing on the means by which Verifone has submitted the merged entity could foreclose competition. They also overstate the availability and popularity of alternatives to terminals that require access to Paymark's switch, and overstate the ability of terminal providers to rely on aggregation arrangements to bypass any restrictions the merged entity might place on connection to Paymark's switch.

6. The result of the above is that the merged entity will clearly have both the ability and incentive to engage in foreclosure strategies that substantially lessen competition in downstream markets.

Cross-submissions on the counterfactual do not change the outcome of the competition analysis

7. In Verifone's initial submission, Verifone submitted that a counterfactual under which the Vendor Banks sell Paymark to an alternative purchaser with no presence in the downstream markets (such as Cuscal), is the most competitive counterfactual. In the counterfactual, the sale and purchase agreement would not grant the Vendor Banks any entitlement to financial rewards for meeting volume commitments that the Vendor Banks do not already receive from Paymark. Verifone submitted that, as the most competitive counterfactual, that is the counterfactual upon which the Commission should base its competition analysis.

8. The Vendor Banks have responded by submitting that Paymark continuing in the Vendor Banks' ownership is the more likely counterfactual.[3]

9. The Commission will be better placed than we are to assess whether ownership by an alternative purchaser such as Cuscal, or ownership by the Vendor Banks, is the more likely counterfactual.

10. However, as Verifone referred to in paragraph 14 of its initial submission, the question is not which counterfactual is most likely. Rather, the question is, of all the counterfactuals that have a real chance of occurring, which is the most competitive?

[2] Paymark does, however, already have the ability to foreclose competition in downstream markets.
[3] Cross-submission by the Vendor Banks, paragraphs 5-10 and 14.

11. We maintain that the counterfactual put forward in Verifone's initial submission is the most competitive counterfactual. However, in any event, the proposed transaction would be likely to substantially lessen competition compared with either counterfactual.

12. As Verifone has already submitted, under either of the two counterfactuals:

    (a) Paymark would not be part of a vertically integrated entity, and would therefore lack the incentives the merged entity would have to foreclose competition in downstream markets. No matter which counterfactual is adopted, this is the most important difference from the factual; and

    (b) the Vendor Banks will not be subject to the volume commitments and associated financial services that we understand are provided for in the sale and purchase agreement with Ingenico.

13. The Vendor Banks also submit that Ingenico will be a "significantly better owner" of Paymark than the Vendor Banks (Ingenico's and the Vendor Banks' preferred counterfactual). They submit that, under Ingenico's ownership, Paymark is likely to improve its services. The Vendor Banks claim that Verifone's opposition to the proposed transaction is based on a fear that Paymark will become a more dynamic and effective competitor under Ingenico's ownership.[4]

14. The Vendor Banks' suggestion is essentially that Ingenico will choose to extract profit from Paymark by investing in the quality of Paymark's offerings, rather than pursuing a much cheaper foreclosure strategy that is almost certain to succeed. That suggestion appears far more "speculative" than Verifone's submission that Paymark could be sold to one of the other purchasers shortlisted by the Vendor Banks during their sales process.

15. Currently, Paymark's "effectiveness" as a competitor is actually expressed through the use of its market power to restrict competition, as discussed in Verifone's initial submission. The Commission should be concerned that Paymark's increased "effectiveness" would simply be greater predatory use of that market power, driven off the merged entity's incentive to foreclose downstream markets.

16. In summary, we agree with the Vendor Banks's submission that "the competition analysis of such an alternative counterfactual [of a sale to Cuscal]" may not "differ materially from using the status quo as the relevant counterfactual".[5] No matter which counterfactual is adopted, the most important difference with and without the transaction is that, with the transaction, Paymark will be part of vertically integrated entity with incentives to leverage its market power in the switching market to foreclose competition in downstream markets. Accordingly, the key elements of the competition analysis under either counterfactual lead to the same conclusion - the proposed transaction is likely to substantially lessen competition.

[4] Cross-submission by the Vendor Banks, paragraph 12.
[5] Cross-submission by the Vendor Banks, paragraphs 13-14.

BUDDLE FINDLAY
NEW ZEALAND LAWYERS

Response to cross-submissions about the degree of Paymark's market power in the switching market

17. The cross-submissions claim that Verifone and Payment Express are able to constrain Paymark in the switching market, and that the merged entity would therefore have no market power to leverage into downstream markets. They make those claims on the basis that:

    (a) Verifone and Payment Express could build issuer links to be able to process S2I transactions independently of Paymark, in the same way that Eftpos New Zealand has links with ANZ, and Payment Express has links with various acquirers.[6] The cross-submissions claim that Verifone and Payment Express have made a choice not to build those links, but could do so relatively quickly and cheaply;[7] and

    (b) Verifone and Payment Express can negotiate commercial terms with Paymark to access Paymark's switch for S2I transactions;[8]

    (c) the volume commitments the Vendor Banks have made to Ingenico, and the associated financial incentives to meet those commitments, would not diminish the Verifone's and Payment Express's ability to compete with Paymark.[9]

18. The cross-submissions also claim that the Vendor Banks, and presumably other banks, are able to constrain Paymark, and will be able to constrain the merged entity, by seeking out the lowest cost switching option and demanding that Paymark provide better or more affordable services.[10]

19. We address each of those submissions further below. In summary, Verifone and Payment Express cannot constrain Paymark in the switching market, and will therefore not be able to prevent the merged entity from pursuing a foreclosure strategy targeted at downstream markets. Banks would also be unable to constrain the merged entity, and may even have incentives not to act.

20. The Vendor Banks also claim in paragraph 22 of their submission that Verifone's arrangements with Paymark enable Verifone to provide switching services to non-ANZ acquired merchants. That is incorrect:

    (a) **[**

    REDACTED

    ]; and

    (b) the aggregation agreement allows Verifone to provide a terminal solution to non-ANZ acquired merchants – not switching services. Under the aggregation agreement, Verifone connects a Verifone terminal to the Verifone switch, and then passes on all the transactions to the Paymark switch for processing. Merchants are subject to Paymark's Switching terms

[6] Cross-submission by Ingenico, paragraph 2.3; cross-submission by Paymark, paragraphs 3-6; cross-submission by the Vendor Banks, paragraphs 3(b), 15, 18, and 25.
[7] Cross-submission by Ingenico, paragraphs 2.3, 14-16 and 18; cross-submission by Paymark, paragraphs 4 and 6; cross-submission by the Vendor Banks, paragraph 16.
[8] Cross-submission by Paymark, paragraph 4; cross-submission by the Vendor Banks, paragraph 25.
[9] Cross-submission by Ingenico, paragraph 2.5
[10] Cross-submission by Ingenico, paragraphs 2.2 and 2.4; cross-submission by Paymark; paragraphs 7-8.

and conditions, Paymark remains the switch of record, and earns a wholesale connection fee and all of the switching fees for those transactions.

Ability of Verifone and Payment Express to constrain the merged entity: the suggestion that Verifone or Payment Express could build new links to provide a full-service switch independent of Paymark is untenable

21. To characterise the reason Verifone has not built its own S2I capability as simply a "choice" Verifone has made, ignores commercial reality:

    (a) although Verifone has discussed building links with each of the Vendor Banks in the past, that will not be sufficient to provide a competing full-service switch. Merchants need to be able to process S2I transactions for customers of any issuer. It would be unacceptable to merchants for Verifone to offer them a switching service that allowed them to process payments from customers of ANZ, ASB, BNZ, and Westpac, but not any of the other issuers in New Zealand. In order to provide a truly competitive service, a switch would need to be built to all issuers in New Zealand;

    (b) building that many links would require the agreement and cooperation of at least 24 counterparties. Unlike in other jurisdictions, financial institutions in New Zealand are not required by regulation to allow new links to be built. The counterparties may have limited resources and competing priorities that make them unwilling or unable to provide the necessary support to enable new links to be built or at least to be built at reasonable cost. The counterparties are also likely to include a number of smaller issuers that have a strong interest in limiting their own infrastructure and support costs, making them less likely to agree to or facilitate the build of new links. **[**

    REDACTED

    ];

    (c) coordinating the build of that many links would be an extremely significant undertaking, and unlikely to occur in a sufficiently timely manner to allow Verifone to respond to a foreclosure strategy on the part of the merged entity;

    (d) the cost of building links (including completing development, testing, reconciliation, and settlement processes) is high, as Verifone outlined in its initial submission; and

    (e) any attempt to build a competing S2I switching service would be extremely high risk. If any of the top 24 issuers refused to allow links to be built, or if there were any difficulties during the build that prevented links from being built, any investment in building the other links risks being wasted.

22. Those factors mean that the prospect of building a sufficient number of issuer links to be able to offer merchants who do not acquire with ANZ an acceptable alternative to Paymark's S2I switching service is extremely unlikely. This is supported by the fact that Verifone (and possibly others) has explored the option of building a competing S2I switching service, yet Paymark remains the only switch with full S2I capability in New Zealand.

BUDDLE FINDLAY
NEW ZEALAND LAWYERS

23. **[**
REDACTED **]**[11]**[**
REDACTED
].

24. Finally:

(a) in paragraph 11 of its cross-submission, Ingenico appears to suggest that the quality of Verifone's terminal offerings means that Verifone is in a position to constrain Paymark's conduct in the switching market. We do not see how Verifone's current terminal offerings are evidence of constraints on Paymark in the switching market. Paymark does not currently participate in the terminals markets and therefore does not currently have any incentive to foreclose competition in the terminals markets; and

(b) in paragraph 25 of their cross-submission, the Vendor Banks suggest that the fact that Paymark has its own links "cannot itself be a barrier on the Vendor Banks being able to sell Paymark". That is not Verifone's submission. Verifone's concerns relate to the vertical integration that will result from the proposed transaction, and the effect of that integration on competition in the relevant markets.

Ability of Verifone and Payment Express to constrain the merged entity: the merged entity could, and Paymark already does, exert its market power to provide access to Paymark's switch on terms that limit the ability to compete

25. We agree with Paymark's suggestion in paragraph 4 of its cross-submission that Paymark's commercial dealings with Verifone reflect a common understanding of Verifone's ability to build a credible bypass alternative. **[**
REDACTED
].

26. The Commission is already aware of the status of Verifone's negotiations with Paymark to renew Verifone's wholesale switching and aggregation agreements with Paymark. In summary, **[**
REDACTED
].

27. **[**
REDACTED

[11] Cross-submission by Paymark, paragraph 15.

BUDDLE FINDLAY
NEW ZEALAND LAWYERS

].

Ability of Verifone and Payment Express to constrain the merged entity: volume commitments and associated financial incentives

28. As we have not seen the volume commitments and associated financial incentives provided for in the service agreements ancillary to the proposed transaction, we cannot comment on the exact impact they will have on Verifone's ability to compete with and constrain the merged entity in the switching market. The Commission is in a better position to carry out that assessment **[**

REDACTED

].

The Vendor Banks will not constrain the merged entity following the proposed transaction

29. The cross-submissions suggest that the Vendor Banks will have the ability and incentive to ensure that Paymark keeps its prices down, by threatening to divert transactions to another switch. Paymark even suggests that banks could contribute to the costs of building new links if the merged entity increases its prices for switching services.

30. Those submissions fail to distinguish between banks' costs, and their customers' costs. Merchants and consumers, rather than the banks themselves, would bear the brunt of any price increases by the merged entities. Banks' costs are likely to increase if they need to provide underlying support and infrastructure for two switching networks, rather than one. Accordingly, banks' incentives to support the build of an alternative full-service switch are likely to be limited.

31. This is consistent with the view held by many issuers that they benefit from Verifone's wholesale switching agreement with Paymark because, without it, their technical needs would be more complex. Rather than needing to maintain and operate multiple links and settlement files, the wholesale switching agreement ensures that they only need to maintain and operate a single inbound link. Verifone expects that the banks would need a very strong financial incentive to change that situation.

32. **[**

REDACTED

].

33. **[**

REDACTED

].

Response to cross-submissions about the likely impact of the proposed transaction in the terminals markets

34. The cross-submissions make a number of statements about competition in the terminals markets, and suggest that the current levels of competition mean that there is no prospect of the merged entity targeting those markets with a foreclosure strategy.

35. In the following paragraphs, we address:

(a) why the conditions of entry for the terminals markets discussed in the cross-submissions have no bearing on the merged entity's ability to pursue the potential foreclosure strategies outlined in Verifone's initial submission;

(b) statements in the cross-submissions that overstate the availability and popularity of emerging technologies and alternatives to terminals that do not require access to Paymark's switch;

(c) statements in the cross-submissions that overstate the ability of terminal providers to rely on aggregation arrangements to bypass any restrictions the merged entity might place on connection to Paymark's switch; and

(d) why claims in the cross-submissions that the merged entity will have no incentive to engage in a foreclosure strategy are incorrect.

The conditions of entry discussed in the cross-submissions have no bearing on the merged entity's ability to pursue a foreclosure strategy

36. The cross-submissions include detailed discussions about why the merged entity could not engage in a foreclosure strategy in the terminals markets, because terminal specifications are set in accordance with international standards. The cross-submissions contend that this means that any of the multiple large international terminal providers could enter the terminals markets in New Zealand, and prevent the merged entity from engaging in a foreclosure strategy.[12]

37. However, those terminal specifications have no bearing on the merged entity's ability to engage in foreclosure strategies of the types described in Verifone's initial submission. As Ingenico seems to implicitly recognise in paragraphs 7 and 8 of its cross-submission, there is a distinction between:

[12] Cross-submission by Ingenico, paragraphs 5, 7, and 8; cross-submission by the Vendor Banks, paragraphs 27 and 28.

(a) on the one hand, the international payment technology standards that set the baseline requirements for terminals around the world, and the hardware certification requirements set by Payments New Zealand; and

(b) on the other hand, the standards for connecting to Paymark's switch that Paymark sets itself, and the associated certification services.

38. Even though Paymark's standards for connecting to Paymark's switch are currently based on international standards, the concern is that there is nothing to prevent the merged entity from setting those standards on some other basis. The merged entity could set more onerous requirements for Ingenico's competitors to connect to Paymark's switch, and then grant Ingenico exemptions from those standards for its terminals. Even if the merged entity kept standards equal, it could manipulate access to Paymark's testing and certification services to disadvantage competitors. As Verifone stated in its initial submission, Verifone is already aware of at least one recent example of Paymark having granted an extension to meet the requirement to comply with Paymark's standards that Verifone understands was prompted by delays a local Ingenico distributor was experiencing in meeting these requirements.

39. By manipulating the standards for connecting to Paymark's switch or manipulating access to certification services in this way, the merged entity could foreclose competition in the terminals markets. Verifone would not be able to prevent the merged entity from successfully engaging in a foreclosure strategy of this type, **[**

REDACTED

]. In addition, although Paymark submits that Verifone could constrain the merged entity from preventing terminal providers from connecting to Paymark's switch by offering terminals and switching services to merchants who acquire, or are willing to acquire, with ANZ,[13] that constraint would be weak at best. If the merged entity manipulated the standards imposed by Paymark under the aggregation agreement, a response where Verifone offered to connect merchants to its switch would only be effective if Verifone could persuade the bulk of merchants to change their acquiring provider to ANZ (as Verifone is only able to connect ANZ-acquired merchants to its switch). This presents a significant barrier to Verifone's ability to respond to a foreclosure strategy.[14]

40. The merged entity could also foreclose competition in the terminals markets by increasing Paymark's switching fees across the board, and then using that increased switching revenue to cross-subsidise its fees for using Ingenico terminals down to a level with which other terminal providers cannot compete. Verifone would not be able to prevent the merged entity from successfully engaging in a foreclosure strategy of this type either. This is because (as previously outlined) **[**

REDACTED

].

---

[13] Cross-submission by Paymark, paragraph 19.
[14] For example, large customers may enter into long-term contracts for banking services, and smaller merchants may be less willing to switch banking providers if they procure both their business and personal banking services from a single bank.

The cross-submissions overstate the availability and popularity of emerging technologies and alternatives to terminals that do not require access to Paymark's switch

41. Ingenico claims that that a number of alternatives to terminals exist that do not require access to Paymark's switch, and that this would prevent the merged entity from engaging in a foreclosure strategy. Ingenico points to Payclip and Fastpay as popular examples of such alternatives.[15]

42. However, Payclip and Fastpay are not alternatives to terminals. They are cheaper versions of terminals, and their use still relies on access to a switch. In practice, this means their use still relies on access to Paymark's switch, as use of Paymark's switch is the only way to process S2I transactions.

43. Paymark also submits that it expects the number and variety of payment solutions that do not require access to conventional switching services to increase over time.[16] However, that will not remove the need for terminal providers to be able to connect to Paymark's switch. As long as a not-insignificant portion of the general population continues to want to pay for goods and services using eftpos/debit cards, merchants will continue to require their payment solutions to be able to process S2I transactions. Verifone expects that not only will the uptake of alternative solutions be slower than the cross-submissions suggest, but that merchants will treat those solutions as complements to, and not substitutes for, traditional payment solutions. Accordingly, the availability of alternative payment solutions that do not require access to conventional switching services will not prevent the merged entity from engaging in a foreclosure strategy directed at the terminals markets.

44. Finally, the Vendor Banks submit that merchants' decision-making in terminals markets is largely driven by terminal preferences, including the technological capabilities of a terminal, rather than the switch to which the terminal will connect.[17]

45. That submission is incorrect. Verifone's experience as a terminal provider is that while certain merchants have requirements for bespoke functionality and capabilities such as POS integration, in general merchants' decision-making is primarily driven by price. So, if the merged entity chose to engage in a foreclosure strategy under which it increased switching fees across the board, but used that revenue to subsidise its prices for using an Ingenico terminal connected to Paymark's switch, the merged entity would be likely to win a significant number of merchants in the terminals markets.

The cross-submissions overstate the ability of terminal providers to rely on aggregation arrangements to bypass any restrictions the merged entity might place on connection to Paymark's switch

46. Paymark's cross-submission makes a number of references to its "aggregation model" providing terminal providers with the ability to avoid any restrictions the merged entity might place on connection to Paymark's switch. Paymark also refers to the minimum standards it has imposed under its aggregation agreement with us as being based on international standards, and directed at ensuring a minimum level of security and technical capability required to connect to Paymark's switch.[18]

[15] Cross-submission by Ingenico, paragraph 5.4.
[16] Cross-submission by Paymark, paragraph 11.
[17] Cross-submission by the Vendor Banks, paragraph 27.
[18] Cross-submission by Paymark, paragraphs 8, 21, and 25-26.

BUDDLEFINDLAY
NEW ZEALAND LAWYERS

47. First, that submission suggests that it is easy to enter into and implement an aggregation agreement with Paymark. As the Commission is already aware, that is entirely inconsistent with Verifone's experience. **[**

REDACTED

].

48. **[**

REDACTED

].

49. There is no evidence to suggest that the merged entity will have any better incentives to allow take-up of the aggregation model. Rather, because of its presence in the terminals markets, we submit that the merged entity is likely to make it more difficult to establish an aggregation agreement with Paymark.

50. Second, because Paymark is able to unilaterally change the standards that apply under the aggregation agreement, the merged entity would be able to completely remove Verifone's ability to rely on the aggregation agreement to bypass any overly onerous requirements the merged entity might impose for connecting a terminal to Paymark's switch – the merged entity could simply change the requirements under the aggregation agreement as well. Although we very much doubt that the merged entity would enter into any new aggregation agreements with other terminal providers, we imagine that similar provisions would be included in those.

51. In any case, meeting Paymark's requirements is not the only cost of providing terminals that connect under an aggregation model. The main cost is the cost of running a switch or terminal handler. The low penetration of terminals that connect under an aggregation model is indicative of the costs and challenges associated with relying on an aggregation model in the terminals markets.

Claims that the merged entity would not have an incentive to engage in a foreclosure strategy are incorrect

52. Finally, paragraphs 29 and 30 of the Vendor Banks' submission suggest that "limiting terminal access is a highly risky and unprofitable strategy", and Ingenico would be incentivised to maximise the switching volumes across its network, by maximising the number of terminals and merchants connected to its network. Similarly, Paymark submits that it would not want to encourage merchants to take up any new technologies that could limit the volume of transactions processed through Paymark's switch, which Paymark would expect them to do if it was in their commercial interests.[19]

53. However, for the reasons outlined above, there are no constraints that would operate to prevent the merged entity from engaging in a foreclosure strategy. As long as a not-insignificant proportion of consumers continue to choose to pay for goods or services using eftpos/debit cards, merchants will

[19] Cross-submission by Paymark, paragraphs 20 and 28-29.

BUDDLEFINDLAY
NEW ZEALAND LAWYERS

still require access to Paymark's switch to process S2I transactions. As a result, the merged entity could be confident of the success and profitability of a foreclosure strategy.

54. All that limits Paymark's foreclosure strategy now is its limited incentives to foreclose competition in downstream markets. As a vertically integrated entity, the merged entity can be expected to use Paymark's substantial degree of market power in the switching market to lessen the competition it faces in downstream markets.

Confidentiality

55. 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.

56. 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.

57. 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