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Anthony Stewart
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Sent by Email

Dear Anthony

Letter of Issues - Thales' Proposed Acquisition of Gemalto

1. We refer to the Commission's Letter of Issues dated 10 September 2018 in relation to Thales' proposed acquisition of Gemalto.

2. Thales and Gemalto welcome the opportunity to provide submissions on the matters raised by the Commission. Both Parties' responses are set out in the **Appendix** to this letter.

3. A confidential and public version of the Appendix has been provided. The information that is shaded in colour (using the same colour coding as that set out on the cover page of the clearance application) is confidential and commercially sensitive to the Parties, and they request that it not be disclosed by the Commission to any third party without their prior written consent. Should the Commission receive a request under the Official Information Act 1982 that relates to that information, then the Parties request that the Commission notify them of that request and give them the opportunity to provide comment before any disclosure takes place.

4. Please let me know if you have any questions.

Yours sincerely

James Craig
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PUBLIC VERSION

APPENDIX

THALES / GEMALTO SUBMISSION ON NZ COMMERCE COMMISSION'S 10 SEPTEMBER 2018 LETTER OF ISSUES

For ease of reference, we have used the Commission's headings and paragraph numbering in the left hand margin. The Parties have not responded to every statement in the Letter of Issues, but rather have focused below on the issues that are key to the competitive assessment of the Transaction. Where the Parties have not specifically addressed a particular point in the Letter of Issues, this should not be taken as an indication they agree with such points.

Summary

Many of the concerns expressed by the Commission have been **[redacted]**.

In relation to New Zealand-specific issues, the Parties note that no reference has been made by the Commission in the Letter of Issues to the existing presence in New Zealand of HSMs supplied by other manufacturers. In particular Micro Focus / Utimaco[1] is a significant existing competitor in New Zealand, **[redacted]**. This competitor presence is significant, especially when placed against the **[redacted]**. The concerns expressed by the Commission regarding the ability of new entrants to come into New Zealand do not take into account of the fact that supply, support and maintenance does not require a local presence in New Zealand – instead support and maintenance can be, and generally is, provided remotely from outside New Zealand. This is expanded on in the response below.

Market Definition

10. It is correct that the relevant functional dimension is that for the supply of the relevant products and services.

However, for the reasons set out in paras. 83-88 and 93-97 of the clearance application, the relevant geographic dimension is global in scope (excluding China). This is consistent with how the European Commission has approached the relevant markets previously (for instance refer to the decisions cited in para. 83 of the clearance application where the European Commission approached the issues on a worldwide or at least EEA-wide geographic basis). The European Commission is approaching market

[1] As noted in para. 139 of the clearance application, in May 2018 it was announced that Utimaco is to acquire Micro Focus' Atalla portfolio, which would make the combined entity the third largest Payment HSMs provider worldwide. The Parties understand that this acquisition is expected to complete shortly, but is not yet closed. For that reason we refer to "Micro Focus / Utimaco's" Atalla HSMs in this response.

definition in an equivalent way in the present case (as noted in the Commission's press release dated 23 July 2018[2]).

A wider geographic dimension is also consistent with the fact that the Parties do not sell enterprise key management products directly in New Zealand themselves. Support and maintenance is also dealt with from outside New Zealand. For instance, in the case of Thales, **[redacted**

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Relevant Product Dimension - HSMs

11. The Parties agree that no competition issues arise in relation to the supply of enterprise encryption software. As the Commission notes, there are a large number of alternative suppliers available to customers. In addition, the Parties' New Zealand revenues for enterprise encryption software are **[redacted** **]**.

12-18. In relation to enterprise key management products, the Commission has expressed a preliminary view that it is appropriate to assess HSMs separately from the other types of enterprise key management products (para. 13), and has indicated it is also considering whether it is appropriate to assess general purpose HSMs and payment HSMs separately (para. 18).

For its part, **[redacted**

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16-17. The Parties maintain that other key management products (such as software with key management capabilities, and Cloud-based HSMs aaS) form part of the same enterprise key management product dimension as HSMs and should be considered as a constraint in that market rather than an out of market constraint. **[redacted**

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19 & 22. The Commission has referred to its consideration of whether "encryption software that can be used alongside an HSM" should be included as part of any assessment in the supply of HSMs, or whether it is appropriate to consider them separately. We understand the Commission is referring here to what the Parties have designated as "encryption software/hardware containing key management capabilities" (eg para. 73.1 of the clearance application). The Parties note that encryption software or hardware

[2] http://europa.eu/rapid/press-release_IP-18-4602_en.htm .

containing key management capabilities are defined as "hybrid solutions" and are not used alongside an HSM, but rather are sold primarily or in part for other purposes (e.g. encryption software or cloud-based encryption). **[redacted**

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That said, there is no existing overlap in New Zealand between Thales' Vormetric Data Security Manager and Gemalto's KeySecure products. This is based on the fact that **[redacted**

] (as set out at para. 183 of the clearance application). **[redacted**

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In addition, the Parties note that Thales' Vormetric Data Security Manager and Gemalto's KeySecure products are not purchased by customers seeking an HSM. They are, in the case of Vormetric, a policy manager and key store specifically for the purpose of managing encryption software.

Competition Assessment – Supply of HSMs

20. We deal separately with each of the four concerns expressed by the Commission.

"Thales and Gemalto both have an established presence and reputation in New Zealand and appear to be each other's closest competitors for both payment and general purpose HSMs" (paras. 20.1, 23, 25 & 28 of the LOI)

The Parties' direct presence in New Zealand for enterprise key management is small and they primarily operate in this country through resellers (eg refer to para. 9 of the clearance application).

Moreover the Parties are not unique competitive constraints on one another, whether for payment HSMs or general purpose HSMs. **[redacted**

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"The other overseas-based HSM manufacturers suggested by Thales in the Application appear to have little, if any, existing presence in New Zealand" (paras. 20.2, 27 of the LOI)

This is not consistent with the Parties' understanding of the presence of other HSM manufacturers in New Zealand. In particular, the Parties are aware of Micro Focus / Utimaco having an existing presence in New Zealand already through its Atalla HSM product. **[redacted**

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The Parties understand that Micro Focus / Utimaco support New Zealand customers remotely – likely by telephone or email support depending on the support/maintenance arrangement entered into by the end user. In the event that an urgent HSM replacement is needed by these customers, then an urgent replacement HSM could likely be provided within around 24 hours. Alternatively, the customer would purchase a spare backup HSM and store it on their premises.

[redacted

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It is important that the Commission investigate further the existing presence of Micro Focus / Utimaco, and other HSM manufacturers in New Zealand. **[redacted**

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<u>“Given the importance of security to businesses and the need for on-going maintenance services, customers may be reluctant to switch to an alternative HSM manufacturer who does not have a reputation and/or presence (either directly or via an authorised distributor/reseller) in New Zealand” (also referred to in paras. 20.3, 25.2, 25.3, 27.2 & 29.1 of the LOI)</u>

While reputation is a relevant factor, it is important to bear in mind that the major competitors to the merged entity referred to in the clearance application (for instance at para. 132 onwards) are significant companies with strong reputations themselves. Companies like Microsoft, Amazon Web Services, IBM, Oracle, and Google do not lack name recognition, reputation or presence, in New Zealand or anywhere else. Similarly Micro Focus / Utimaco have good reputations, and the New Zealand customers they are supplying HSMs to (**[redacted]**, as noted above) would provide a good indication of their quality to other potential New Zealand customers.

In addition, it is not necessary for customers to switch fully from one HSM manufacturer to another. It remains possible for customers to use more than one HSM manufacturer. **[redacted**

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There is no need for an HSM manufacturer to have a presence in New Zealand directly. For instance:

- **Resellers:** Thales through TeS sells into New Zealand **[redacted**

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- Gemalto’s New Zealand resellers/distributors **[redacted**

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- **Support: [redacted**

  ]

[redacted

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- **[redacted**

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- As noted above the Parties understand that Micro Focus / Utimaco support New Zealand customers remotely by telephone/email etc.

"Given the limited number of sales of HSMs in New Zealand, competing manufacturers might have limited opportunities and incentive to enter, and expand, into New Zealand" (also at paras. 20.4 and 29.3 of the LOI)

It is important to bear in mind that the HSM purchase cost is only a part of the overall general IT Security spend the customer budgets for within each financial budgeting cycle. So, even if there are limited numbers of sales of HSMs in New Zealand, the wider general IT security spend by New Zealand customers (which can include the acquisition of HSMs) still provides an incentive for other manufacturers to enter.

In any event, there is little or no disincentive to Cloud services providers entering and expanding into New Zealand. They will be rolling out their Cloud services in New Zealand anyway and do not need to incur extra costs to offer HSM aaS. Indeed, there will be a positive incentive on Cloud service providers to offer HSM aaS to customers to enhance the security of their Cloud offering. Cloud service providers would likely face higher customer resistance to their Cloud offerings if they could not also offer HSM aaS due to the security benefits it provides.

21. While the Commission has noted that the competitive conditions for the supply of each of payment HSMs and general purpose HSMs in New Zealand appear to be relatively similar, it is important to bear in mind the Parties' different revenue profiles for payment and GP HSMs in New Zealand. In particular, Gemalto had **[redacted**

]. The Parties also note that at the global level competitive conditions are different for each of payment and GP HSMs, and also that each of these products have different functionalities. **[redacted**

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Competition for the supply of HSMs without the proposed acquisition

24. The Parties agree that, once an HSM is installed within a customer's IT security infrastructure, many customers may be reluctant to switch out that supplier's HSM for a different manufacturer's HSM. But this will remain the case for HSMs that have already been installed with and without the proposed acquisition taking place – so there would

be no competitive effect from the acquisition on such HSMs which have already been purchased.

The more important issue for analysing the competitive effect of the transaction should instead be on contestable sales relating to new applications. **[redacted**

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25. Both Parties' experience in practice is that typically customers do not go out to tender for their HSM requirements. As a result, the Parties are not seeing in practice the head to head competition between them that the Commission refers to in this paragraph. Instead, New Zealand end customers appear to be well versed with HSM technology and know what the budget expectations should be without needing to go out for tender. The HSM purchase cost, while important to the customer, is not high when compared to the general IT Security spend the customer budgets for within each financial budgeting cycle, and this will be the more major concern for the customer.

Examples of the above points in New Zealand include:

- **[redacted**

  ];

- In another recent case in 2018, the end customer chose to procure HSMs via its overseas parent company to provide the services to its local NZ entity, so again there was no competitive process in New Zealand;

- Thales has also recently seen New Zealand customers deciding to outsource their security requirements and therefore choose not to buy HSM technology themselves.

Entry and expansion with the proposed acquisition

27. We refer back to the discussion of Micro Focus / Utimaco's existing presence in New Zealand already as suppliers of HSMs to large New Zealand organisations. Micro Focus / Utimaco offer support/maintenance services to their customers in New Zealand. However, the Parties stress again that support / maintenance does not need to (and is not in practice) provided directly in New Zealand – instead it can and is provided to New Zealand customers remotely from outside New Zealand.

28. **[redacted**

]. We have also referred above to the competition already being offered by Micro Focus / Utimaco in New Zealand for HSMs.

29. We refer to the comments above regarding the relevance of reputation.

As regards whether there are barriers to New Zealand distributors starting to stock a different manufacturer's products due to the need to familiarise themselves with the new product and be in a position to provide sufficient technical support in the event of any issues with the HSM, the Parties do not consider this to be the case.

It is typically not difficult for a distributor to start distributing an HSM product. **[redacted**

]. Usually the supplier of HSM products will expand distribution of their products in a territory when they believe a new distributor will expand sales in that territory. If a new distributor comes to an HSM manufacturer and claims to have access to a customer contemplating a significant HSM purchase, and that purchase is not known to the HSM manufacturer and/or is significant incremental business, the HSM supplier is likely to facilitate the transaction using the new distributor. Often an HSM manufacturer will enable a new distributor for a 'one off' transaction. This to 'test' the potential new relationship between the distributor and HSM manufacturer before signing an outright long-standing resale agreement.

TeS considers that presenting alternative HSM or Key Management Solutions would be feasible for these distributors as the technology is quite standard and most distributors' expertise is more to do with the IT Security landscape versus being a HSM expert. For instance, distributors in New Zealand such as SSS in Wellington and ICT Security in Auckland supply more than one manufacturer's products.

The distributors can rely on the HSM provider such as TeS to answer technical questions that the end user may have for the chosen HSM or Key Management Solution technology. As noted above support/maintenance can be done remotely from outside New Zealand by the manufacturer in any event (this is the case for **[redacted]** and, as far as the Parties are aware, Micro Focus / Utimaco).

The Commission has expressed a concern that, if a customer were to be the only user of a particular supplier's HSM in New Zealand, this could represent a risk if there were not enough technical support or if they were reliant on a single "point of failure" for this support, which might create a security risk for that customer. However the Parties do not consider this concern is realistic. Given that support/maintenance can be (and is in fact) provided from outside New Zealand for these products (as noted above), the New Zealand customer in this situation would be receiving technical support remotely alongside that being provided to other global customers. So there is no issue in practice with there needing to be a certain scale of support/maintenance provided in New Zealand in order for such support to be effective.

Other competitive constraints

31-33. Suppliers of alternative products and services to HSMs (including in particular Cloud-based HSMs aaS) would provide a significant, and not limited, constraint on the merged entity. HSM aaS offerings offer comparable security to an on-premise solution. In some cases, due to the investment made by the service provider, the HSM aaS offering can have superior security. A Cloud service provider can have much greater scale of security operations and investment than can a single customer. As such, having HSM aaS can have significant security benefits when compared to what a single customer can do on-premise. **[redacted**

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[redacted].

Importantly, the Commission's analysis here appears to be focused on customers having to make a choice between using HSMs or other types of key management products, when the reality is that customers can in fact use both HSMs and other types of key management products at the same time. In other words, applying the Commission's example above, even for customers who prefer to have an HSM on their premises, they can do so while still using HSMs aaS as well for other use cases or depending on the workload.

34. The Parties do not agree that the constraint posed by HSMs aaS would be dampened by HSM aaS providers purchasing HSMs from the HSM manufacturers. **[redacted].**

35. The Parties continue to maintain that customers have the ability to sponsor new entry. **[redacted]**. In any event, it is not necessary for every customer to be able to sponsor a new entrant - if one or a few do, the resulting new entrant will increase competition for the benefit of all.