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Confidential version

Determination

Ingenico Group SA and Paymark Limited [2018] NZCC 18

The Commission:	Dr Mark Berry Dr Stephen Gale Anna Rawlings
Summary of application:	An application from Ingenico Group SA to acquire 100% of the shares in Paymark Limited.
Determination:	Under section 66(3)(a) of the Commerce Act 1986, the Commerce Commission determines to give clearance to the acquisition
Date of determination:	02 November 2018

Confidential material in this report has been removed. Its location in the document is denoted by [ ].

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Executive summary

X1. The Commerce Commission determines to give clearance to Ingenico Group SA (Ingenico) to acquire 100% of the shares in Paymark Limited (Paymark) (the acquisition) on the basis the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market.

The parties

X2. Ingenico and Paymark provide services that allow merchants to accept electronic payments.

X2.1 Ingenico supplies physical payment terminals (which allow merchants to accept payments instore) and digital payment services (which allow merchants to accept payments online).

X2.2 Paymark's primary business is to provide a "switch" that routes transactions from terminals or online payments to the relevant financial institution (we refer to this as providing "switching services").

X3. Ingenico competes against other suppliers of terminals and digital payment services. The transaction would make Ingenico a provider of switching services to those suppliers. Ingenico would therefore be both a direct competitor against suppliers of terminals and digital payment services, while also providing switching services to those rivals.

Main concern from the acquisition

X4. Our primary concern was whether the acquisition would be likely to give Ingenico the ability and incentive to inhibit rivals that supply terminals from competing by raising the cost of switching services to those suppliers.[1] (We commonly refer to the act of inhibiting rivals from competing as "foreclosing rivals".) We assessed whether:

X4.1 the merged entity would have the ability to inhibit rivals from competing through having market power over switching services and a mechanism to raise rivals' costs;

X4.2 the merged entity would have the incentive to inhibit rivals from competing because it would gain more profits in the terminal market[2] as a result of this conduct compared with the profits it would lose for switching services; and

X4.3 any competition lost from the merged entity's conduct would result in a substantial lessening of competition in a market.[3]

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1 We also considered whether the acquisition would: give Ingenico the ability and incentive to inhibit rivals of digital gateway services competing; eliminate competition between Ingenico and Paymark for the supply of digital gateway services; and eliminate competition between Ingenico and Paymark for the supply of terminals. The Commission was satisfied that the acquisition would not be likely to cause a substantial lessening of competition due to any of these effects.

2 The merged entity might also gain profits from digital payment services from merchants that switched to it from rival terminal providers.

Ability to inhibit rival terminal providers from competing

X5. Paymark is the leading provider of switching services in New Zealand and is the only switch that can process certain types of card transactions. Paymark processes transactions for over [ ]% of terminals in New Zealand (we refer to these terminals as being "directly connected to Paymark's switch"). Terminals that connect directly to Paymark's switch must be "certified", which means they meet Paymark's requirements for security and functionality.

X6. Paymark's main rival for switching services is Verifone, which processes transactions for around [ ]% of terminals in New Zealand. However, Verifone's switch cannot process all types of transactions. Verifone has an agreement with Paymark to process those transactions it cannot, known as the "wholesale switching agreement" (we refer to it below as the "wholesale agreement"). The wholesale agreement gives Verifone access to Paymark's switch.[4]

X7. We considered whether Paymark's position as the only switch provider that can process certain transactions would give the merged entity the ability to inhibit rival terminal providers from competing.[5] This may be the case if rival terminal providers had no good alternatives to Paymark for switching services.

Incentive to inhibit rival terminal providers from competing

X8. At present, Paymark is not involved in supplying terminals. Paymark sets its terms for switching services taking into account only its profits from supplying switching services. It has no incentive to favour one terminal provider over another. Following the acquisition, Ingenico will earn profits from its terminal business and profits from switching services. We considered whether this would create the incentive for the merged entity to favour its own terminals business by inhibiting rival terminal providers from competing. There are two main ways in which the merged entity could achieve this.[6]

X8.1 First, the merged entity could increase the price for Verifone to access Paymark's switch under the wholesale agreement, or degrade the quality of the switching service (for example, by slowing the speed at which transactions are processed). An increase in the price Verifone pays to access

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3 Our concern is whether the acquisition would be likely to substantially lessen competition in the market. It is possible as a result of the acquisition Ingenico is able to reduce its own costs to supply terminals. Although this may harm rivals, it would only be a concern if it resulted in a price increase (and/or quality reduction) in the market.

4 Paymark and Verifone also have an agreement called the "aggregation agreement". This agreement allows Verifone to deploy terminals connected to its switch to non-ANZ acquired merchants, however all traffic is routed to Paymark's network.

5 The main steps in the supply of terminals in New Zealand are: importing and adapting terminals ready for use in New Zealand (known as "terminal vendors"); supplying these terminals to merchants (known as "terminal resellers"). The conduct we are concerned about may affect both terminal vendors and resellers. We refer to both groups together as "terminal providers".

6 The examples below consider ways in which the merged entity could raise rivals' costs. An extreme version of this is that the merged entity denies rivals access to its switch altogether.

Paymark's switch may adversely affect Verifone's ability to compete to supply terminals.

X8.2 Second, the merged entity would supply switching services to suppliers of rival terminals (such as those that supply Verifone, PAX and other brands of terminals). The merged entity could raise the costs of these competitors that connect to Paymark's switch by:

X8.2.1 making it harder to gain certification to connect to Paymark's switch;

X8.2.2 increasing the price to connect to Paymark's switch or to have transactions processed; and/or

X8.2.3 degrading the quality of the switching services.

X9. To assess whether the merged entity might be incentivised to engage in such conduct, we weighed the potential economic benefits to the merged entity of engaging in the conduct against the risks. The main consideration was whether the potential gain in profits from terminals would outweigh the potential loss in profits from switching services.

X9.1 The main benefit of foreclosing competing terminal providers is that the merged entity could gain profits from its terminal supply business. By raising the costs of switching services, competing terminal providers may be forced to increase the price for use of their terminals (or reduce quality). This would benefit Ingenico because it would be able to increase prices for its own terminals (or reduce quality) or it would be able to convince merchants to switch from rivals to its own terminals diminishing the competitiveness of those rivals over time so that merchants face higher prices or degraded quality.

X9.2 The main risk of raising the costs of competing terminal providers is that the merged entity might lose transactions altogether. This could occur in several ways. For example, if the merged entity raised the costs of rival terminal providers: rivals might create or augment a switch that competes more directly with Paymark; and, if the rivals pass on the increase in costs, merchants and/or consumers might switch to services that do not use Paymark's switch. These reactions would result in the merged entity losing profits from its switching service.

Balancing the potential benefits and risks of foreclosure

X10. It was a complex exercise to balance the potential benefits and risk to Ingenico of engaging in conduct that may inhibit competition from rival terminal providers. We had to consider how rivals, merchants, consumers and banks would react if terminals became less attractive. We concluded that the cumulative impact of constraints that the merged entity would face meant that it would be unlikely to engage in such conduct to the point where it would result in a substantial lessening of competition.

X11. The constraints include:

X11.1 Raising the costs of competing terminal providers would likely increase the incentive for Verifone or other rivals to build a switch that would compete more directly with Paymark. There are barriers to building a switch. However, the evidence we have viewed suggests the merged entity is likely to view the prospect of rivals building a switch as a threat. This threat in turn would drive Ingenico to offer terms on the wholesale agreement that Verifone will likely find acceptable.

X11.1.1 Our estimates of the cost of building a switch suggest they are not high relative to the revenues that would be at risk for Verifone (including revenues from terminal sales and from its own switching revenues) if Paymark increased its price for switching services. We considered Verifone would find it profitable to build a switch so it was no longer reliant on Paymark if those revenues were at risk.

X11.1.2 The main barrier to building a switch is gaining the cooperation of the banks. There is evidence that firms providing switching services have struggled to engage the banks in the past. However, we considered the banks will be more motivated to cooperate post-merger since they will no longer own Paymark and will have only their own incentives to pursue. These incentives include the desire to ensure competition for the supply of terminals is maintained and to maintain leverage in negotiating agreements with the merged entity.

X11.2 Raising the costs of rivals such that merchants face higher prices and/or degraded quality is likely to encourage the take up of alternative payment types that do not require Paymark's switch. It is hard to predict the speed at which such technologies will be introduced and taken up. However, we considered the evidence indicates that the merged entity will view alternative payment technologies as a threat. We considered that this threat increases the merged entity's incentive to keep the terminal market attractive to discourage the adoption of rival technologies.[7]

Conclusion on impact of merger

X12. We cannot predict with certainty how banks may behave or what alternative technology may be introduced and its impact on the relevant markets. Our analysis was based on evidence, submissions and our assessment of how a rational actor

[7] The threat of new technologies that do not use S2I processing may also reduce the incentive for firms such as Verifone to build an alternative network. Banks may also be more reluctant to engage if they expect links to become redundant. However, it is not necessary that both constraints apply simultaneously to avoid a substantial lessening of competition. We consider that the merged entity is likely to view both the building of a rival switch and alternative technologies as significant risks, with the former a more immediate risk and the latter likely to become stronger over time. As the need for S2I transactions is likely to endure for some time to come, the future emergence of alternative technologies may only reduce the incentive to build links but not eliminate it.

would be likely to behave. On this basis we considered that Ingenico is likely to view the risk of a competitor building an alternative switch and the introduction of new technology as genuine threats, either of which would have the potential to significantly and permanently reduce the volumes of transactions that Paymark processes. We considered these threats mean that the merged entity is unlikely to discriminate against other terminal providers to such a degree that competition is substantially lessened. As such, we were satisfied that the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition.

The acquisition

1. On 20 April 2018 the Commerce Commission registered an application (the application) under section 66(1) of the Commerce Act 1986 (the Act) from Ingenico Group SA (Ingenico) seeking clearance to acquire 100% of the shares in Paymark Limited (Paymark).[8]

2. Ingenico and Paymark are active in the provision of payment services in New Zealand.

The applicant's rationale for the acquisition

3. Ingenico submitted that the rationale for the acquisition is to expand its customer offering in New Zealand.[9] Ingenico sees the purchase of Paymark as assisting in two ways:

   3.1 enriching Ingenico's current product and service offering to merchants to include transaction-based solutions; and

   3.2 providing "end-to-end" solutions to the New Zealand payments system, in partnership with resellers, banks and other parties covering all aspects of the payments value chain.

Our decision

4. The Commission gives clearance to the acquisition as it is satisfied that the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.

Our framework

5. Our approach to analysing the competition effects of the acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines (our guidelines).[10]

The substantial lessening of competition test

6. As required by the Act, we assess mergers and acquisitions using the substantial lessening of competition test.

7. We determine whether a merger is likely to substantially lessen competition in a market by comparing the likely state of competition if the merger proceeds (the scenario with the merger, often referred to as the factual), with the likely state of competition if the merger does not proceed (the scenario without the merger, often referred to as the counterfactual).[11]

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[8] Ingenico has not decided whether it will continue to use the brand "Paymark" post-merger. We refer to Paymark in some post-merger scenarios although Ingenico may later choose a different name. This does not affect our analysis.

[9] The Application at [38].

[10] Commerce Commission "Mergers and Acquisitions Guidelines" (July 2013).

[11] *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

8. A lessening of competition is generally the same as an increase in market power. Market power is the ability to raise price above the price that would exist in a competitive market (the 'competitive price'),[12] or reduce non-price factors such as quality or service below competitive levels.

When a lessening of competition is substantial

9. Only a lessening of competition that is substantial is prohibited. A lessening of competition will be substantial if it is real, of substance, or more than nominal.[13] The High Court has used the word 'material' to describe a lessening of competition that is substantial.[14]

10. As set out in our guidelines, there is no bright line that separates a lessening of competition that is substantial from one which is not. What is substantial is a matter of judgment and depends on the facts of each case.[15]

11. While we commonly assess competition effects over the short term (up to two years), the relevant timeframe for assessment depends on the circumstances. A longer timeframe will be appropriate if, on the evidence, competition effects are likely to arise in later years.[16]

When a substantial lessening of competition is likely

12. A substantial lessening of competition is 'likely' if there is a real and substantial risk, or a real chance, that it will occur. This requires that a substantial lessening of competition is more than a possibility, but does not mean that the effect needs to be more likely than not to occur.[17]

The clearance test

13. We must clear a merger if we are satisfied that the merger would not be likely to substantially lessen competition in any market.[18] If we are not satisfied – including if we are left in doubt – we must decline to clear the merger.

The parties

The Applicant – Ingenico

14. Ingenico Group SA (Ingenico) is a member of Ingenico Group, based in France. Ingenico is a supplier of electronic payment services including payment terminals, transaction routing, and digital payment services.

15. In New Zealand, Ingenico wholesales its terminals via a network of resellers. Ingenico estimates that it supplies around [ ]% of terminals in New Zealand.[19] In addition to

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12 Or below competitive levels in a merger between buyers.
13 *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [127].
14 *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [129].
15 Our guidelines at [2.23].
16 *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [131].
17 *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) at [111].
18 Section 66(3)(a).
19 The Application at [104(a)].

its terminal business, Ingenico also provides digital payment services to merchants through its subsidiary Bambora.[20] For the financial year 2017, Ingenico's revenues from terminals and repairs was $[ ] and Bambora's revenues from digital payment services was $[ ].[21]

The Target – Paymark

16. Paymark Ltd (Paymark) is a New Zealand company and its primary business is to operate a "switch" that routes electronic payment transactions from terminals to the relevant financial institutions (we refer to this function as providing "switching services"). Paymark estimates that it processes around [ ]% of New Zealand's in-store card transactions.[22]

17. Paymark also provides related payment services, including software tools for analysing and tracking payment data, terminal certification and compliance, and services which enable merchants to use cards to run loyalty programs.[23] Paymark also operates a digital payment business called Click and provides an online debit payment service called Online Eftpos.

18. Paymark is jointly owned by ANZ Bank New Zealand Ltd (ANZ), ASB Bank Ltd (ASB), BNZ Investments Ltd (BNZ), and Westpac NZ Operations Ltd (Westpac) (collectively, the 'vendor banks'). Each of the four vendor banks has a 25% shareholding. Paymark's board comprises a director from each shareholder bank and two independent directors. Decisions regarding Paymark's pricing and terms of supply are made by an independent pricing committee comprising the Chief Executive and the two independent directors on the Board.

19. In the year ended March 2017, Paymark reported total New Zealand revenue of [ ].[24]

Other interested parties

Verifone

20. Verifone New Zealand (Verifone) is a wholly-owned subsidiary of Verifone Systems Inc., a global payments company based in the United States. According to its website, Verifone is the world's largest point of sale (POS) terminal provider and a leading provider of payment and commerce solutions.[25]

21. Verifone's presence in the New Zealand payments market is as a result of two acquisitions in 2013:[26]

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20 Bambora is a digital payment service based in Sweden, and operates in New Zealand, Australia, Canada, and other countries in northern Europe.

21 The Application, Appendix 10B.

22 The Application at [18].

23 The Application at [26].

24 Paymark "Financial Statements: For the year ending 31 March 2017".

25 Verifone "About us" <www.verifone.com>.

26 Submission from Verifone on the statement of preliminary issues (4 May 2018) at 10.

21.1 The purchase of EFTPOS New Zealand Ltd (ENZ) from ANZ. ENZ's main business was operating a switch for merchants that used ANZ as their bank. ENZ also supplied terminals to retailers under the "EFTPOS New Zealand" brand.

21.2 The purchase of Sektor Payments Limited, which had the distribution rights for Verifone terminals in New Zealand.

22. As a result of these purchases, Verifone operates a vertically-integrated payments business in New Zealand. Verifone continues to wholesale terminals to resellers and also supplies terminals directly to retailers under the "EFTPOS New Zealand" brand.

23. For the financial year 2018, Verifone generated [ ] from switching services and [ ] from terminal sales.[27]

Payment Express

24. Payment Express Ltd (Payment Express) is a New Zealand payments company that also has operations in Australia, US, UK, Ireland, Canada and Europe. Payment Express describes itself as a "high growth, innovative global leader in payment technology".[28] In New Zealand, Payment Express is a supplier of digital payment services that enable merchants to accept online payments and also supplies terminals to merchants.

25. Payment Express was previously called Direct Payment Solutions Limited (DPS) but changed its name in September 2015.[29]

Industry background[30]

Types of electronic payments

26. Consumers in New Zealand can choose to purchase goods and services using electronic or non-electronic methods. Non-electronic payments include cash or cheques, while electronic payments include cards and online banking.

27. There are three main types of cards that consumers can use:

27.1 *Proprietary EFTPOS* – Information from EFTPOS cards is transmitted through a magnetic strip, which is swiped through the terminal. EFTPOS cards can only be used when the customer makes a payment in person (known as a "card-present transaction"). EFTPOS cards cannot be used for online payments (known as card-not-present transactions). EFTPOS cards take an immediate payment from the customer's bank account.

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27 [ ] attached to an email from Buddle Findlay (on behalf of Verifone) to the Commerce Commission (5 June 2018). [ ]

28 Payment Express "About" <www.paymentexpress.com>

29 Payment Express "Company name change – Payment Express" (24 November 2015) <www.paymentexpress.com>

30 Much of the following is drawn from MBIE "Retail payment systems in New Zealand" (Issues Paper, October 2016).

27.2 *Scheme debit cards* – Debit cards are issued by a bank using the technology and standards of either Visa or Mastercard. These cards are operated using a chip which is inserted into the terminal and may also have contactless technology that allows customers to pay by tapping the card against the terminal. Debit cards can be used for both card-present and card-not-present transactions. Debit cards take an immediate payment from the customer's bank account.

27.3 *Scheme credit cards* –These cards provide similar functionality as debit cards except they provide the consumer the ability to pay on credit. It is the issuers of the cards that guarantee payment to the merchant.

28. In recent years new payment technologies have been developed. Many of these are new ways to make use of existing payment types, whereas others involve entirely new ways to make payments. Some examples include:

28.1 Mobile applications that use "near field communication" technology such as Apple Pay and Android Pay. These applications allow the use of a smart phone to make payments using contactless technology. The application is linked to a scheme card. The customer makes a payment by holding the mobile device near the terminal. The transaction is processed as if the transaction was made using a scheme card.

28.2 Mobile applications that use QR codes like Alipay and We Chat Pay.[31] The consumer scans a QR code with a mobile, which enables an account-to-account transaction.

28.3 Development of open banking. Open banking will enable third party developers to access banks' systems and develop money management and payment applications. This has the potential to create new payment systems that allow account-to-account transactions.

How electronic payments are processed

29. When a cardholder seeks to make a payment at a merchant, the payment system needs to perform the necessary steps to confirm with the issuer of the card that the cardholder has sufficient funds or credit available and then send an approval or decline message to the terminal.

30. There are two ways in which transactions may be processed:

30.1 Switch-to-issuer ("S2I") is triggered when a cardholder uses an EFTPOS card, or swipes or inserts a scheme debit card, and then selects either 'cheque' or 'savings' on the terminal.

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[31] A QR (or Quick Response) code is a machine-readable code consisting of black and white squares which is capable of storing information to facilitate contactless payments.

30.1.1 The transaction is sent via the switch to the issuer of the card, to check whether the customer has sufficient funds in their bank account to complete the purchase.

30.1.2 The transaction then returns to the terminal via the switch and appears as approved or declined.

30.1.3 The funds are then settled between the cardholder's and merchant's banks via the interbank settlement process.

30.2 Switch-to-acquirer ("S2A") is triggered whenever a cardholder uses a credit card (either in-store or online), uses a scheme debit card for card-not-present purchases, or taps their contactless debit card.

30.2.1 Transactions are sent via the switch to the bank that the merchant has chosen to process its transactions (known as an 'acquiring' bank).[32]

30.2.2 The acquiring bank will then send the transaction to the card scheme (such as Visa or Mastercard).

30.2.3 The card scheme sends the transaction to the issuer or the card to check whether the cardholder has sufficient funds or credit.

30.2.4 The transaction then returns to the terminal via the switch and appears as approved or declined.

30.2.5 Funds are deposited with the merchant and debited with the customer according to the card scheme rules.

31. The routes that the different types of card transactions take is summarised in the table below.

[32] The merchant's acquiring bank will normally be the bank that it has its transaction business with.

Table 1: Transaction routes

Type of card	Type of transaction	Method of switch
Loyalty cards	All	S2I
Proprietary EFTPOS	Swiped	
Scheme debit	Inserted/swiped	
	Contactless/card-not-present	S2A
Open or closed credit	All	

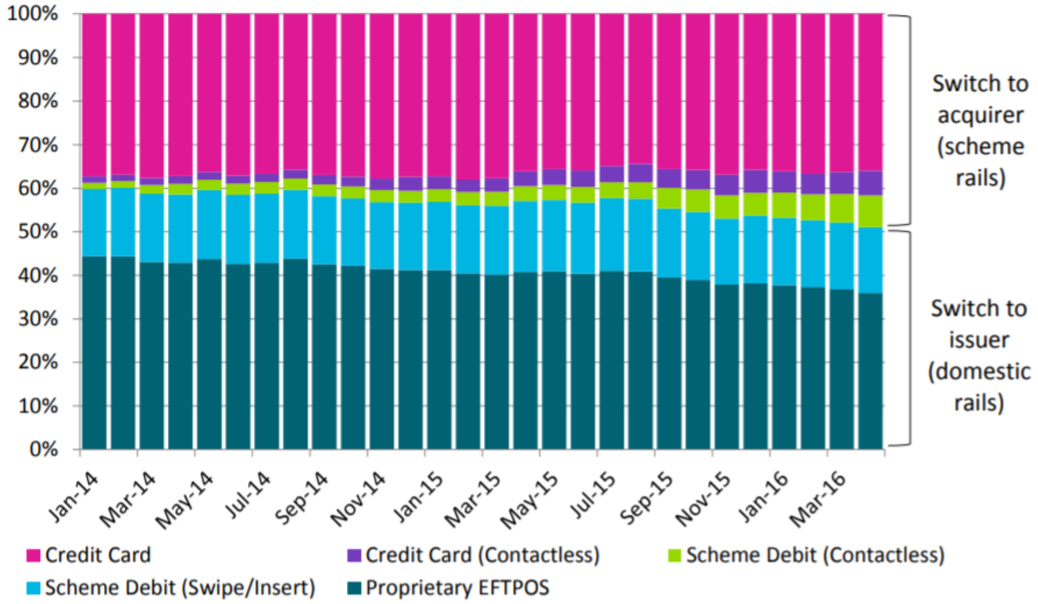
Source: MBIE "Retail payment systems in New Zealand" (Issues Paper, October 2016) Figure 3

Transaction data

32. In 2017 New Zealand consumers made 1.7 billion electronic card transactions with a total value of $83 billion.[33] The use of electronic payments has been rising over time. Data shows that since 2009, the number of transactions per capita has risen from 233 to 339 per annum.[34]

33. The chart below shows that electronic transactions by value is currently split almost evenly between transactions that use S2I processing and S2A processing. The chart, however, shows that the proportion of transaction value using proprietary EFTPOS has been in slow decline, while the use of contactless debit and credit cards has been increasing.

Figure 1: Value of electronic card transactions by card type



[33] Stats NZ "Electronic card transactions: April 2018" (12 April 2018) <www.stats.govt.nz>

[34] Stats NZ "Electronic card transactions: April 2018" (12 April 2018) <www.stats.govt.nz>

Source: MBIE "Retail payment systems in New Zealand" (Issues Paper, October 2016) Figure 3

Industry participants

34. The merging parties provide products and services that enable merchants to receive payments. The main participants in this process relevant to our analysis are:

    34.1 merchants that wish to accept electronic payments from customers using point of sale (POS) terminals for in-person (card-present) sales and/or digital payment gateways for online (card-not-present) sales;

    34.2 terminal providers that supply terminals to merchants and providers of digital gateways;

    34.3 switch operators that enable the transactions from the terminal or digital gateway to be routed to the relevant financial institution; and

    34.4 banks that issue cards and act as "acquirers" for merchants to process S2A transactions.

35. We provide more information about these industry participants below.

Merchants

36. Merchants need a terminal to accept card-present transactions and a digital payment gateway to accept card-not-present transactions. The merchants that use terminals and digital gateways vary in size.

    36.1 The smallest merchants are those that have only one site and one terminal. These merchants include standalone retail stores, vending machines, and unattended carparks.

    36.2 Small to medium enterprises (SMEs) include hotels, fast-food restaurants, and small retail chain stores.

    36.3 The largest merchants include supermarkets, service stations, and department stores. These merchants may have several thousand terminals and tens of millions of transactions per year. Large merchants account for a relatively large share of transactions, reflecting the high volume of transactions that pass through those merchants. For example, Paymark's largest ten merchants account for [ ]% of its total transactions.[35] Verifone's largest ten merchants account for [ ]% of its total transactions.[36]

37. The requirements of merchants differ according to size.

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35 [ ] attached to an email from Chapman Tripp (on behalf of Paymark) to the Commerce Commission (5 June 2018).

36 [ ] attached to an email from Buddle Findlay (on behalf of Verifone) to the Commerce Commission (19 July 2018).

37.1 Smaller merchants tend to have the most basic requirements for their payment solutions. These will often be standalone terminals, which are not integrated with their point of sale systems or other parts of their businesses. Small merchants often have just one store and no online presence, and so often do not require a digital payment gateway. Price, brand reputation, and the appearance of the terminal hardware may influence smaller merchants' choices of terminal.[37]

37.2 Larger merchants tend to have more complex electronic payment solutions because they have more locations and terminals, and may have both an online and physical presence. Their terminals and digital payment gateway may be integrated with their accounting systems and cash registers. These merchants may seek specific functionalities to suit their business and therefore require a bespoke payment solution developed for them. These merchants may have a greater interest in the choice of switch that the terminal uses due to the different functionality switches offer and the opportunity to get a discount through dealing directly with the switch.

Terminal providers[38]

38. Terminals are typically imported into New Zealand and then adapted for the local market. The main brands that are imported are Ingenico, Verifone and PAX. Table 2 below sets out the number of terminals connected to the main switches.

Table 2: Terminal brands on each switch

Terminal	Paymark		Verifone		Payment Express		Total	
	No.	%	No.	%	No.	%	No.	%
Ingenico	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%
Verifone	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%
PAX	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%
Other	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%
Total	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%

Notes: Staff calculations based on data provided by each party. Verifone numbers do not include those terminals connecting via Payment Express. Source: [ ], attached to an email from Chapman Tripp (on behalf of Paymark) to the Commerce Commission (5 June 2018); [ ], attached to an email from Buddle Findlay (on behalf of Verifone) to the Commerce Commission (19 July 2018); [ ], attached to an email from Lee Salmon Long (on behalf of Payment Express) to the Commerce Commission (19 October 2018).

39. Terminals must meet security specifications set by global standards, the card schemes and the switch that they will operate on. Terminals manufactured overseas

37 Commerce Commission interview with [ ] (24 May 2018).

38 As noted earlier, the term "terminal provider" includes both "terminal vendor" and "terminal reseller" which are described in this section.

will normally already have hardware and software to meet global standards and those of the card schemes. However, terminal importers must also meet the additional security and connectivity requirements in New Zealand that the switch sets to allow connection to its network. Firms that import and adapt terminals for use in New Zealand are referred to as “terminal vendors”.

40. As an example, a terminal vendor wishing to supply a terminal that connects to the Paymark network must meet Paymark’s specifications.[39] Paymark issues new hardware and software specifications and updates regularly. These changes may reflect new security requirements or introduce new functionality. Each new software version will have a set lifespan, after which Paymark requires that it is removed from the market. For example, terminals operating on software version 2014 are to be removed from the market in January 2019.[40] The terminal vendor will produce software that is compatible with that specification and send a model to Paymark for certification. Once a given model has been certified, terminals of that type can be sold to merchants and connected to the switch.

41. The terminal vendors then compete to supply merchants directly or via a reseller. The main terminal suppliers in New Zealand use different strategies to supply customers.

    41.1 Verifone imports its own terminals into New Zealand. Verifone competes directly for customers under the EFTPOS New Zealand brand offering an integrated terminal and switch solution, and also supplies via resellers. Verifone terminals are available on both Paymark’s switch and its own switch.

    41.2 Skyzer supplies Ingenico terminals with its own software through a network of resellers, using Paymark to switch its transactions.[41] According to the Application, Skyzer is a strong competitor for SMEs.[42]

    41.3 Smartpay supplies PAX terminals running its own software.[43] Smartpay sells direct to market rather than via resellers.[44] Smartpay uses Paymark to switch its transactions.

    41.4 Payment Express supplies Ingenico terminals. Payment Express also produces terminals for unattended operations such as carparks.[45] Payment Express sells directly to merchants. It supplies terminals that use Paymark’s switch but also provides solutions to merchants using its own switch.

42. The size of the merchant affects how the terminal providers compete.

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39 See Paymark “Terminals and technology” <www.paymark.co.nz>.
40 See Paymark “Terminals and technology” <www.paymark.co.nz>.
41 Skyzer “About us” <www.skyzerpayments.co.nz>
42 The Application at 64.
43 The Application at [107(c)].
44 The Application at 64.
45 Payment Express “Secure payment processing in unattended environments” <www.paymentexpress.com>

42.1 For smaller merchants, the merchant's bank may assist the merchant in finding a terminal provider when the business is being set up. Alternatively, the terminal reseller may approach an existing merchant to offer its services.

42.2 Larger merchants have more complex requirements and may run formal tender processes. As these merchants account for a large share of transactions, they are more likely to obtain discounts compared to smaller customers. As part of its service to its customers, the merchant's bank may assist the merchant in finding a payment solution.

43. The primary purpose of terminals is to allow merchants to accept payments. At a basic level, terminals of different brands have similar functionality. However, terminal providers can differentiate their terminal offers through software innovation.[46] Terminal providers can tailor products to specific industries. For example, for taxi drivers, Smartpay's terminals have functionality to assist fleet management and reporting.[47] Verifone's terminals allow pre-authorisation of payments that can be completed on a different terminal.[48] This functionality is useful for merchants in the hospitality sector, such as car rental companies and hotels.

Digital payment gateway providers

44. A digital payment gateway service (also known as an "ecommerce service") is a software application that is integrated with a merchant's online store. These allow the merchant to take payments for goods and services online. Digital payment services can enable a range of different payment types. These include:

44.1 Scheme debit or credit card payments where the customers enter details into an online interface. These are processed via the S2A route.

44.2 Direct entry payments (such as Poli) which are a direct transfer of funds from one bank account to another. These do not require a switch as they are directly processed by the customer's bank.

45. Payment Express is one of the main providers of these services. Its switch processes around [ ]% of digital payment services transactions in New Zealand.[49] Other suppliers of digital payment services include Click (a Paymark business), Bambora (an Ingenico business), Paystation and eWay.

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46 [ ] attached to an email from Chapman Tripp (on behalf of Ingenico) to the Commerce Commission (18 May 2018) at [8.2]. Commerce Commission interview with [ ] (18 May 2018).

47 Smartpay "Industry Tailored EFTPOS Solutions" <www.smartpay.co.nz>.

48 Eftpos New Zealand Limited "Pre-authorisation and competition" <www.eftpos.co.nz>.

49 Staff calculations based on data provided by Paymark, Verifone and Payment Express. [ ], attached to an email from Chapman Tripp (on behalf of Paymark) to the Commerce Commission (5 June 2018); [ ], attached to an email from Buddle Findlay (on behalf of Verifone) to the Commerce Commission (12 October 2018); [ ], attached to an email from Lee Salmon Long (on behalf of Payment Express) to the Commerce Commission (19 October 2018).

Switches

46. Switches are systems that route transaction data between merchants on one end, and those financial institutions that issue and process card payments for consumers on the other end. The benefit of a centralised switch is that it reduces the number of bilateral links required. Without a centralised switch, there would need to be bilateral links between all parties involved in the payment system: merchants, issuers, and acquirers. A centralised switch means all those parties can be linked to each other with just a single link to the switch.

47. The major operators of switches in New Zealand are: Paymark, Verifone, and Payment Express. Of the three, Paymark has the most links to issuers and acquirers in the payment system.

48. To build links, switch operators must agree commercial terms with the relevant issuer or acquirer and then build and test the links. The type of transactions that a switch provider wishes to process determines which parties it builds a link with.

    48.1 S2A transactions travel from the terminal or digital payment gateway to the switch and then to the merchant's acquirer for processing. Building a link to that acquirer bank would enable the switch to process all S2A transactions for merchants of that bank. For example, Verifone has a link to ANZ, which enables it to process S2A transactions for ANZ-acquired merchants.

    48.2 S2I transactions travel from the terminal to the switch and then to the issuer of that card. For the switch to process an EFTPOS transaction it would need to have a link to the issuer of the card that the consumer used. For example, if Westpac issued the card, the switch would need a link to Westpac to process the transaction. As such, a terminal can only accept payments from cards if the switch it is connected to has links to those issuers.

49. A switch only needs a single link to the relevant acquiring bank to process a merchant's S2A transactions. This means it is less costly for a switch to build the capability to process S2A transactions for the merchants of an acquirer bank than to build the capability to process all S2I transactions for those same merchants.

<u>Paymark</u>

50. Paymark has agreements with around 50 card issuers and merchant acquirers.[50] Paymark is the only switch that has links with all significant acquirers and issuers. Paymark processes around [ ]% of New Zealand's card-present transactions, and around [ ]% of New Zealand's card-not-present transactions.[51]

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[50] [ ], attached as confidential Appendix 5 to the Application at 7.

[51] Staff calculations based on data provided by Paymark, Verifone and Payment Express. [ ], attached to an email from Chapman Tripp (on behalf of Paymark) to the Commerce Commission (5 June 2018);); [ ], attached to an email from Buddle Findlay (on behalf of Verifone) to the Commerce Commission (12 October 2018); [ ],

Verifone

51. Verifone became a switch operator when it purchased ENZ from ANZ in 2013. The switch infrastructure was not part of the purchase, however Verifone was permitted to continue using ANZ's switch until it could establish its own links. Instead of building its own links Verifone entered into an agreement with Paymark to use its links with issuers to process S2I transactions ("the wholesale agreement"). Verifone has a link with ANZ and, in conjunction with the wholesale agreement, can offer a "full-service" switch for ANZ-acquired merchants. That is, for ANZ-acquired merchants, Verifone uses:[52]

    51.1 its own link to ANZ to process S2A transactions, and S2I transactions where ANZ is the issuer; and

    51.2 the wholesale link with Paymark for S2I transactions for all other issuers.

52. The wholesale agreement is due to run until 2019. Under the current agreement Verifone pays [ ]. Verifone and Paymark are currently in negotiations to renew the wholesale agreement.

53. Paymark and Verifone also reached an agreement for Verifone to connect non-standard software to Paymark's switch ("the aggregation agreement").[53] This allows Verifone to supply its terminals (with its own software) to non-ANZ-acquired merchants through Paymark. Paymark continues to operate as the switch and processes all Verifone's non-ANZ merchant transactions (S2I and S2A) under this arrangement. Paymark and Verifone are also negotiating to renew this agreement.

54. Verifone's switch processes around [ ]% of New Zealand's card-present transactions and around [ ]% of New Zealand's card-not-present transactions.[54]

Payment Express

55. Payment Express also operates a switch. Payment Express has direct links to the card schemes and can process:

    55.1 card-not-present S2A transactions for all four major acquiring banks; and

    55.2 card-present S2A transactions for [ ] acquired merchants.

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attached to an email from Lee Salmon Long (on behalf of Payment Express) to the Commerce Commission (19 October 2018).

52 Submission from Verifone on the statement of preliminary issues (4 May 2018) at [24]-[25].

53 [ ], attached as confidential Appendix 13 to the Application.

54 Staff calculations based on data provided by Paymark, Verifone and Payment Express. [ ], attached to an email from Chapman Tripp (on behalf of Paymark) to the Commerce Commission (5 June 2018);); [ ], attached to an email from Buddle Findlay (on behalf of Verifone) to the Commerce Commission (12 October 2018); [ ], attached to an email from Lee Salmon Long (on behalf of Payment Express) to the Commerce Commission (19 October 2018).

56. Payment Express does not have S2I links with card issuers [ ]. Payment Express has an arrangement with Verifone to provide capability to process S2I transactions through Verifone's access to the Paymark switch (via the wholesale agreement). In contrast, Payment Express does not rely on Paymark or Verifone for digital payment services.

57. Payment Express' switch processes around [ ]% of New Zealand's card-present transactions and around [ ]% of New Zealand's card-not-present transactions. [55]

The banks

58. Banks play several roles in the payment system. Banks are the main issuer of cards including proprietary EFTPOS cards and scheme debit and credit cards. Other issuers include card schemes that supply direct to consumers, such as American Express, and merchants that issue loyalty cards, reward cards and gift cards.[56]

59. Banks also operate as "acquirers", which are the entities that process electronic payments on behalf of merchants by authorising, clearing, and settling transactions. Merchants that want to receive certain electronic card payments (such as credit card payments) need to have an acquirer. ANZ, ASB, BNZ, Westpac, and Kiwibank are the five largest acquirer banks in New Zealand. The banks earn revenues from providing those services.

60. A merchant's choice of acquiring bank affects its options for payment solutions. Paymark is the only switch that has links with all acquirers. In contrast Verifone only has an S2A link with ANZ. This means that, at present:

    60.1 a merchant that uses ANZ as its acquirer has the choice of using either Paymark or Verifone as its switch operator; but

    60.2 a merchant that uses any other bank as its acquirer can only use Paymark as its switch operator.

61. Verifone offers terminals for use on both the Paymark switch and its own switch. A merchant that uses an acquirer bank other than ANZ is still able to use a Verifone terminal even if it uses Paymark as its switch operator. However, these terminals may have different functionality as a terminal on the Verifone switch. The aggregation agreement provides another means for non-ANZ acquired merchants to use Verifone terminals. In this case the terminal is connected to Verifone's switch but the transactions are routed to Paymark for processing.

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[55] Staff calculations based on data provided by Paymark, Verifone and Payment Express. [ ], attached to an email from Chapman Tripp (on behalf of Paymark) to the Commerce Commission (5 June 2018);); [ ], attached to an email from Buddle Findlay (on behalf of Verifone) to the Commerce Commission (12 October 2018); [ ], attached to an email from Lee Salmon Long (on behalf of Payment Express) to the Commerce Commission (19 October 2018).

[56] MBIE "Retail payment systems in New Zealand" (Issues Paper, October 2016) at 5. The Application at [11].

62. Banks are sometimes involved in the merchant's choice of payment system. Banks may assist a merchant in their payment solution as part of the service as an acquirer. For smaller merchants this may involve making merchants aware of the options available. For larger merchants, the banks may be more involved in facilitating a payment solution that is attractive to a merchant, as it may create the opportunity to win the merchant. [ ].[57] Banks may also support new payment systems to attract new merchants. For example, BNZ offers PayClip which is a terminal that pairs with a smartphone or tablet, enabling processing without an internet connection.[58] This may be useful for mobile traders.

Payment flows

63. The different participants in the electronic payments system have different incentives, partly because they incur costs and receive revenues from different parts of the payment process. We set out below some of the main payment flows.

Merchants

64. To accept card payments in-store, merchants must pay for:

    64.1 Terminals: Merchants rent or purchase terminals from terminal providers, with rental being the most common.[59] Merchants must also pay for repairs, upgrades and other maintenance for their terminals.

    64.2 Access to the switch: The merchant pays a monthly fee to the switch provider for access to the switch. This is referred to as the Merchant Administration Fee ("MAF").

    64.3 Acquiring fees: Merchants pay a merchant service fee ("MSF") to their acquiring bank in exchange for the bank processing card transactions. The MSF is an aggregation of several different charges.[60] For example, merchants will typically pay a base monthly administration fee, but will also pay a percentage of the value of each purchase made with a scheme card.

65. The cost to merchants differs depending on the type of transactions. Merchants are not charged by the issuing bank for S2I transactions. However, S2A transactions attract interchange fees. Interchange fees are set by the card scheme and are charged to the acquiring banks. The acquiring banks then recoup those costs from merchants. Merchants are charged on average 1.2% of the value of the purchase for contactless debit cards and 1.6% for credit cards.[61] This varies among merchants, with larger merchants able to negotiate discounts. For some merchants, the additional cost of accepting S2A payments means that they do not offer credit or contactless payment options (or offer them with restrictions such as a minimum

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57 Commerce Commission interview with [ ] (19 July 2018).
58 BNZ "Payments: PayClip" <www.bnz.co.nz>.
59 Commerce Commission interview with [ ] (31 May 2018).
60 BNZ "Merchant Service Fees" <www.bnz.co.nz>.
61 Retail NZ "Payments Survey Report" (19 April 2018) at 1.

transaction amount) to customers. Other merchants are more likely willing to absorb the costs of S2A transactions because they want to be able to provide the full suite of payment options (and they may pay a lower rate).

Banks

Switching payments

66. Banks are direct customers of Paymark and Verifone for switching services. For each transaction processed via their switch involving the bank (either as an issuer or acquirer), the bank will pay Paymark or Verifone for switching that transaction.

67. For example, if the acquisition was to proceed, the vendor banks would enter into a services agreement with Paymark that will set charges for transactions for [ ] (the 'services agreement').[62] Paymark's expected per transaction switching fees under the services agreement would be as follows:

Table 3: [

]

68. [
]

69. The proposed services agreement would also
[
]

[62] [ ] attached as confidential Appendix 8 to the Application.

Table 4: [

]

70. [

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Interchange revenues

71. S2A transactions also generate other payment flows for banks. For example, banks receive interchange fees on S2A transactions from the card schemes, but banks also pay rewards to card holders.

Market definition

Our approach to market definition

72. Market definition is a tool that helps identify and assess the competitive constraints that the merging party would face. Determining the relevant market requires us to judge whether, for example, two products or services are sufficiently close substitutes in demand and/or supply as a matter of fact and commercial common sense to fall within the same market.

73. We define markets in the way that best isolates the key competition issues that arise from an acquisition.[63] In many cases this may not require us to precisely define the boundaries of a market. What matters is that we consider all relevant competitive constraints, and the extent of those constraints. For that reason, we also considered products and services that fall outside the market but that still impose some degree of competitive constraint.

74. We identify a relevant market by considering demand-side and supply-side substitutes to the product in question. In considering demand-side substitution, we ask, if a hypothetical monopolist of the product in question increased prices by a small but significant non-transitory amount (a SSNIP), whether sufficient customers of the product in question would switch to other types of products to defeat the

[63] Our guidelines at [3.10]-[3.12].

SSNIP. In considering supply-side substitution, we ask, if prices increased,[64] whether competing firms could easily, profitably, and quickly (generally within one year) switch sufficient production to compete with the products or locations in question.[65]

Summary

75. We considered that, for the purposes of the analysis, the relevant markets affected by the proposed merger are national markets for:

75.1 S2I switching services;

75.2 S2A switching services;

75.3 terminal wholesaling;

75.4 terminal retailing; and

75.5 digital payment gateway services.

76. We have defined a separate market for S2I switching services. However, we have taken into account all constraints, including from S2A switching, in assessing whether the merged entity is likely to have the ability and incentive to inhibit rivals from competing to supply terminals and digital payment gate services.

Switching services

Submissions

77. The key area of contention among submitters is whether there are separate markets for S2I and S2A switching services. The reason this is of particular interest is because Paymark is the only switch that has a full set of S2I links. Verifone and Payment Express have some S2A links or could build these more easily than S2I links. If S2A processing is not a close substitute for S2I processing, it makes it more likely that Paymark would have market power in a market.

78. Ingenico, Paymark and the vendor banks submitted that S2I and S2A switch transactions should be analysed as a single national switching services market because:

78.1 S2I and S2A transactions are substitutes because banks and merchants could steer customers from payment types that use S2I to those that use S2A.[66] S2I will only be important to merchants so long as it is cost effective.[67] An increase in price would lead merchants and banks to steer customers to payment types that do not use S2I.

78.2 Payment types that use S2I processing are in decline. Innovation in S2A payment methods is increasing demand for those products in place of

64 By at least a SSNIP.
65 Our guidelines at [3.16].
66 The Application at [63] FN 15. Submission from Paymark on letter of issues (3 August 2018) at [2]-[6]
67 Submission from Paymark on letter of issues (3 August 2018) at [3].

payment types that use S2I processing.[68] This trend would hasten if payment types that use S2I processing became less attractive.

79. Verifone and Payment Express submitted that S2A is not a substitute for S2I for merchants because:

79.1 There is a difference in costs, with S2I being largely free and S2A incurring charges.[69] Alternatively, if there is any degree of substitutability between S2I and S2A switching, it is one sided: merchants may view S2I as an acceptable substitute for S2A, but not vice-versa.[70]

79.2 As a terminal provider they must be able to switch both types of transaction to be acceptable to merchants.[71]

Commission's view of the relevant market

80. Switch operators transact and recover revenue from two sets of customers; merchants and financial institutions.[72] To assess the relevant market we have considered the likely reaction of both sets of customers to a SSNIP.[73][74]

81. We considered it unlikely that a significant number of merchants would switch away from S2I transactions in response to a SSNIP, at least in the short term. This is because:

81.1 Although S2I transactions have declined in recent years, S2I transactions still account for a significant amount of transactions in New Zealand. As of April 2018, S2I made up around [ ] of all transactions by volume for Paymark.[75]

81.2 Some internal documents of Paymark suggest a lack of substitutability:

68 Submission from NERA on letter of issues (3 August 2018) at [19]-[27].
69 Submission from Verifone on letter of issues (1 August 2018) at [8].
70 Submission from Verifone on letter of issues (1 August 2018) at [7].
71 Submission from Matthew Dunning QC (on behalf of Payment Express) on statement of preliminary issues (11 May 2018) at [7]-[8].
72 The Application at [59].
73 When analysing two-sided markets it may be appropriate to define one market encompassing both sets of customers or two separate interrelated markets for each set of customers. The former may be more appropriate when products are consumed in a fixed 1:1 proportion (this is known as a "transaction" platform). In this particular case, we have proceeded on this basis. See OECD "Rethinking Antitrust Tools for Multi-Sided Platforms" (2018) at 38 and 42.
74 For a two-sided market, the SSNIP is applied to the overall price level, rather than to individual price on a side of the market.
75 Figures derived from [ ], attached to an email from Chapman Tripp (on behalf of Paymark) to the Commerce Commission (26 July 2018).

81.2.1 One document suggested [ ].[76]

81.2.2 A report considered [ ].[77]

81.3 [ ].

82. It is unclear whether a significant number of banks would switch away from S2I transactions in response to a SSNIP in the short term. Banks are motivated to steer customers towards payment types that use S2A due to the interchange revenue that banks can earn on transactions using those cards. However, competition to issue EFTPOS or scheme debit cards (that use S2I processing) can be seen as part of banks' broader offerings for personal banking customers. Such cards are tied to a customer's current account, with the customer usually having their current account with the bank that provides the remainder of their more significant banking services, such as their mortgage. This contrasts with credit cards, where it might be common for consumers to have a credit card with a bank that is different to the one they get banking services from.[78] [79]

83. Over the medium to long term, merchants and banks are likely to have greater alternatives to payment types that use S2I. We discuss in more detail on pages 64-66 how this may affect the incentive to inhibit rivals from competing.

84. For the purposes of our analysis, we have defined a separate market for S2I switching services. We take into account the various constraints, including from S2A

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76 [ ].

77 [ ].

78 MBIE "Retail payment systems in New Zealand" (Issues Paper, October 2016) at [99].

79 We do not consider supply side substitution is likely to be strong between S2A and S2I transactions. A switch requires significantly more links to process S2I transactions than to process S2A transactions. As such a switch that can process S2A transactions could not easily substitute to process S2I in response to SSNIP.

switching, in assessing whether the merged entity is likely to have the ability and incentive to inhibit rivals from competing.

Terminals

Submissions

85. Ingenico submitted that the acquisition would affect:[80]

85.1 the national market for the wholesale supply of payment terminals and terminal connectivity to resellers; and

85.2 the various regional markets for the resale supply of payment terminals and terminal connectivity to merchants.

86. There were few other submissions on market definition for terminals.

Previous decisions

87. We last considered terminal markets in 2008 during the application for the merger of Cadmus Technology Limited and Provenco Group Limited.[81] We considered that the relevant markets for that merger were:[82]

87.1 the national market for the wholesale supply of standalone EFTPOS technology and services;

87.2 the national market for the wholesale supply of integrated EFTPOS technology and services;

87.3 various regional markets for the resale supply of standalone EFTPOS technology and services; and

87.4 various regional markets for the resale supply of integrated EFTPOS technology and services.

Commission's view

88. It appears that since 2008, all major terminal manufacturers and resellers in New Zealand have started offering both integrated and standalone terminal solutions.[83] If so, this may suggest broader wholesale and resale markets for terminal solutions due to supply-side substitutability. As such, for the purposes of our analysis we used the product markets that Ingenico has submitted. However, our assessment does not turn on the precise boundaries of these product markets. Our concerns over terminals could affect suppliers at both the wholesale and retail level.

80 The Application at [56(a)] and [56(b)].
81 Decision No 632 *Provenco Group Limited and Cadmus Technology Limited* (2008).
82 Decision No 632 *Provenco Group Limited and Cadmus Technology Limited* (2008) at [8].
83 The Application at [76].

89. We have not assessed whether the geographic markets should be changed. However, our assessment does not turn on the precise boundaries of these geographic markets.

90. As noted earlier, some merchants may not have quite the same options for terminal providers as others. Merchants that use ANZ as their acquirer have a greater range of options than merchants that use other banks as their acquirer. We considered whether this might justify different markets. However, rather than define separate markets, we took into account the different options for merchants in our analysis below.

Digital payments services

91. Ingenico submitted that the relevant market is the national market for the provision of digital payment services ("the digital payment market"). There were few other submissions on market definition for digital payment services. We have used Ingenico's market definition for the purposes of our analysis. However, our assessment does not turn on the precise boundaries of this market as any reasonable definition would not result in a finding of substantial lessening of competition in this market.

The with and without the merger scenarios

92. To assess whether a merger is likely to substantially lessen competition in a market, we compare the likely state of competition if the merger proceeds (the scenario with the merger, often referred to as the factual), with the likely state of competition if the merger does not proceed (the scenario without the merger, often referred to as the counterfactual).[84]

With the merger

93. With the acquisition, Ingenico would acquire Paymark. The acquisition would create a single firm that provides switching services, terminals and digital payment services. Ingenico has not yet decided on whether it will change the way it or Paymark operates in New Zealand. We considered that the merged entity would likely continue to offer its terminals through Ingenico's existing reseller model, [ ].[85]

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84 Our guidelines at [2.29].

85 [ ] [ ] attached to an email from Chapman Tripp (on behalf of Ingenico) to the Commerce Commission (20 April 2018) at 2 and 8.
[ ] Ingenico response to 4 May 2018 request for information (18 May 2018) at [3.1].

94. The transaction documents include the proposed services agreement for the supply of payment switching services to the vendor banks.[86] This agreement includes:

  94.1 [ ]

  94.2 [ ]

95. Ingenico advised that [ ].[87] We considered the terms of this agreement form part of the transaction.

Without the merger

96. We consider that there are two potential without the merger scenarios, both of which involve Paymark being owned by a party independent of Ingenico and without a terminal business:

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

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

97. We consider there is a real chance Paymark will continue under its current ownership. The vendor banks have informed us that [ ].[88] The vendor banks stated that the sales process was [ ]. The vendor banks also noted that [ ].[89] [90]

98. Under the status quo scenario, we consider the shareholding and governance arrangements of Paymark would be similar to that which exist now. That is, the four vendor banks each maintaining their existing 25% stake and an independent pricing committee.

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86 [ ] attached as confidential Appendix 8 to the Application

87 [ ], attached to an email from Chapman Tripp (on behalf of Ingenico) to the Commerce Commission (26 July 2018) at [1].

88 See: [ ], attached to an email from Russell McVeagh (8 June 2018) at 55; Commerce Commission Interview with [ ] (22 May 2018); and Commerce Commission interview with [ ] (17 May 2018).

89 Commerce Commission interview with [ ](16 May 2018).

90 Commerce Commission interview with [ ] (22 May 2018).

99. However, we also consider there is a real chance of Paymark being sold to an alternative purchaser without the merger. This is because
[
].[91]
[
].[92]

100. In this alternative purchaser scenario, we consider it likely that the bidder would have sought
[
].[93]
There are [ ] in the status quo scenario; however, the vendor banks are likely to prefer the Paymark switch due to their ownership interests.

101. We consider that there is little material difference between these two 'without the merger' scenarios. In either scenario, we consider that Paymark would remain an independent provider of switching services, and would not be vertically integrated into the supply of terminals.

102. We therefore conclude that the appropriate 'without the merger' scenario against which to assess the competition effects of the acquisition is the status quo.

How the acquisition could substantially lessen competition

Introduction

103. We considered whether the acquisition would be likely to have the effect of substantially lessening competition due to:

 103.1 the loss of direct competition for the supply of digital payment services between the digital payment businesses of Paymark (Click) with Ingenico's Bambora;

 103.2 loss of direct competition for the supply of terminal services between Ingenico and Paymark;

 103.3 the ability and incentive of the merged entity to foreclose rivals for the supply of digital payment services; and,

 103.4 the ability and incentive of the merged entity to foreclose rivals for the supply of terminals.

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91 See, for example, Commerce Commission interview with [ ] (22 May 2018).
92 The successful Ingenico bid for Paymark was $190 million [ ] Interview with [ ] (12 June 2018) at [49.5].
93 Commerce Commission interview with [ ] (8 June and 12 June).

104. The first three of these did not raise significant concerns to the Commission and we have addressed these briefly in the section below. The fourth raised significant concerns for the Commission and the remainder of the report is focused on our assessment of that issue.

Issues that did not raise significant concerns

105. The Commission is satisfied the acquisition would not be likely to cause a substantial lessening of competition due to horizontal effects in the digital gateway services market. The evidence we received suggested Click and Bambora each compete for small and medium-sized customers.[94] Despite this competition, we were satisfied that the acquisition would be unlikely to substantially lessen competition. This is because:

    105.1 The merged entity will continue to face competition from Payment Express, which can operate independently from Paymark using its own card-not-present S2A links;[95]

    105.2 [ ]; and,

    105.3 internal documents suggest [ ].[96]

106. The Commission is satisfied that the merged entity would not have the ability to foreclose rivals of digital gateway services because these services are processed using S2A. We consider that Paymark is unlikely to have sufficient market power over S2A switching services to significantly inhibit rival providers of digital gateway services.

107. The Commission is satisfied there would not be a substantial loss of competition for the supply of terminals. There was insufficient evidence that Paymark was a likely entrant into the terminal market or that the threat of Paymark entering the market was an important constraint on existing players.

108. We do not address the issues above any further in this report.

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[94] [ ]; [ ], attached to an email from Chapman Tripp (on behalf of Ingenico) to the Commerce Commission (18 May 2018) at 15.

[95] [ ], attached to an email from Chapman Tripp (on behalf of Ingenico) to the Commerce Commission (20 April 2018) at 9. [ ] [ ];
[ ]
[ ]

[96]
[ ][
]

Foreclosing rivals in the terminal market

109. Our primary concern was whether the transaction would be likely to give Ingenico the ability and incentive to inhibit rivals that supply terminals from competing by raising the cost of switching services (foreclosing rivals).

110. We considered two ways in which the merged entity could attempt to foreclose rivals, reflecting the two main ways in which it supplies switching services. These are discussed below. In summary:

110.1 increasing the price for Verifone to access Paymark's switch under the wholesale agreement or degrading the quality of the switching service for Verifone (we refer to this as "foreclosing rivals connected via the wholesale agreement"); and

110.2 raising the costs of rivals whose terminals are directly connected to Paymark's switch (we refer to this as "foreclosing rivals directly connected") by, for example:

110.2.1 making it harder to gain certification;

110.2.2 increasing the price to connect to Paymark's switch or to have transactions processed; and/or

110.2.3 degrading the quality of the switching services.

111. We also considered whether the merged entity might tie or bundle switching services, terminals and digital payment services together. We considered this is unlikely to have a significant effect on competition for terminals and/or digital payment services. This is because there appears to be limited demand for such bundles and most payment solution providers focus on the supply of terminals or ecommerce but not both (with Payment Express an exception).[97] We did not consider this theory of harm further. We considered bundling and tying of S2I switching services with terminals as another means to raise rivals' costs and therefore considered it part of our assessment of the potential foreclosure of rival terminal providers.

Rivals connected via the wholesale agreement

112. Paymark provides access to its network via the wholesale agreement to Verifone. Verifone and Payment Express can process S2A transactions themselves for merchants of the acquirer banks they serve. However, Verifone and Payment Express do not have the ability to process all S2I transactions themselves. Verifone uses the

[97] For example, [ ] identified that firms that are starting up may purchase a complete payment solution but firms that are mid-cycle tend to have a set ecommerce solution. [ ] Commerce Commission interview with [ ] (15 June 2018). Bambora (a supplier of ecommerce solutions) identified that it only sometimes gets requests for a bundled terminal and ecommerce solution and refers those requests for terminals to Skyzer (a terminal reseller). Commerce Commission interview with Bambora (24 May 2018).

wholesale agreement to process those S2I transactions that it cannot. Payment Express has an arrangement with Verifone to process S2I transactions, which Verifone satisfies using the wholesale agreement. That is, Verifone and Payment Express both use the wholesale agreement to compete for merchants against terminal providers that use terminals on the Paymark switch.

113. We considered whether the acquisition would be likely to give the merged entity the ability and incentive to foreclose rivals (including Verifone and Payment Express) by raising the cost of accessing Paymark's switch via the wholesale agreement. The concerns that we assessed were whether:

113.1 the merged entity would have the ability to foreclose rivals because it held market power for the supply of S2I switching services;

113.2 the merged entity would have a mechanism to foreclose rivals;

113.3 the acquisition creates an incentive for the merged entity to foreclose rivals via the wholesale agreements; and

113.4 the conduct would make Verifone and Payment Express less effective competitors, resulting in a reduction of competition in the terminal market.

114. The merged entity could have the ability to foreclose rivals via the wholesale agreement if those rivals did not have a good alternative to using Paymark's switching services. Paymark is the only switch that can process all S2I transactions. As part of our analysis of the merger, we assessed whether rivals that use the wholesale agreement to compete (including Verifone and Payment Express) would have other good alternatives if the merged entity was to raise their costs of obtaining switching services.

115. To have the ability to foreclose rivals, the merged entity would also need a mechanism to raise the costs of rivals. We considered that the merged entity would likely have mechanisms available to carry out such foreclosure if other necessary conditions of foreclosure were found to be satisfied.[98] The merged entity could raise rivals' costs by:[99][100]

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98 Paymark submitted that clause 7.2 of the services agreement would oblige Paymark to treat rivals fairly. Cross submission from Paymark on statement of preliminary issues at [9]. [ ] We recognise that this may impose some limits on the types of conduct the merged entity could engage in. However, the merged entity may be able to find subtle ways to disadvantage rivals that may be difficult to prove are in breach of those clauses. We do not need to conclude on this point as we are satisfied for other reasons the merged is unlikely to cause a substantial lessening of competition.

99 The examples below consider scenarios in which the merged entity raises the costs of those rivals that rely on the wholesale agreement. In the extreme case, this conduct could amount to refusing supply of switching services altogether. Our analysis takes into account this possibility.

100 We also considered whether the merged entity might also raise Payment Express' costs by refusing to supply Ingenico terminals. We consider that it is unlikely that the merged entity would choose this mechanism because Ingenico would likely perceive a risk of losing the profits that it gains from those terminal sales. The evidence we received is that terminals of different brands have only basic

115.1 refusing to renew the wholesale agreement that is due to expire at the end of 2019;

115.2 worsening the terms (compared to that which would have occurred in the status quo) by raising the price or adding other conditions; and/or

115.3 degrading the quality of the link between Verifone and Paymark that enables the transactions to be processed.

116. We also considered whether the merged entity would have the incentive to foreclose rivals via the wholesale agreement.

117. At present, Paymark is not involved in supplying terminals. Paymark sets its terms for switching services taking into account only its profits from switching services. It has no incentive to favour one terminal provider over another. Following the acquisition, Ingenico will earn profits from its terminal business and profits from switching services. We considered whether this would create the incentive for the merged entity to foreclose rival terminal providers from competing. This assessment involved weighing the potential economic benefits to the merged entity in doing so against the risks.

117.1 The main benefit of foreclosing rivals via the wholesale agreement is that the merged entity could gain profits from its terminal supply business. By raising the costs of access via the wholesale agreement, competing terminal providers such as Verifone and Payment Express may be forced to increase the price for use of their terminals (or reduce quality). This would benefit Ingenico because it would be able to increase prices for its own terminals (or reduce quality) or it would be able to convince merchants to switch from rivals to its own terminals.

117.2 The potential risk of foreclosing rivals via the wholesale agreement is that the merged entity might lose the merchant altogether. Raising rivals' costs in this manner might result in the merged entity losing the merger to a payment solution that does not require Paymark's switch, in which case the merged entity would lose profits from the switching service. For example:

117.2.1 rivals might create or augment a switch that competes directly with Paymark; and,

117.2.2 if the rivals pass on the increase in costs, merchants and/or consumers might switch to services that do not use Paymark's switch (such as alternative technologies that do not use switches).

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functionality and resellers add their own software to add functionality. Payment Express advised that [ ]. Commerce Commission interview with [ ] (17 May 2018). Increasing the cost of those terminals to Payment Express may result in Payment Express eventually switching to another brand of terminal or Payment Express' customers switching to Verifone. As such we consider it unlikely that this is the mechanism that the merged entity would use to attempt to foreclose rivals.

118. Verifone uses the wholesale agreement for merchants that have ANZ as their acquirer. If Ingenico's conduct post-merger raised their costs, it would be those merchants that would be most directly impacted. The conduct could also impact on merchants that do not have ANZ as their acquirer, if those merchants could switch to ANZ to take up the offers of Verifone and Payment Express. The nature of the harm that the conduct causes could be higher prices, reduced quality of terminals or a reduction of variety if it led to a rival exiting the market.

119. Our assessment is focused on harm to competition rather than particular competitors. It is possible that the transaction gives the merged entity advantages in competing for merchants. Although rivals may lose customers to the merged entity, harm to competition would only occur if prices were to rise (and/or quality were to fall) relative to the counterfactual. We assessed whether the acquisition is likely to have such an effect.

Rivals directly connected to the Paymark network

120. Paymark provides switching services to terminal providers. As a result of the transaction, the merged entity would supply switching services to suppliers of rival terminals (such as those that supply Verifone, PAX and other brands of terminals). We considered whether the acquisition would be likely to give the merged entity the ability and incentive to foreclose rivals that connect directly to Paymark's switch by raising the cost of access.

121. The concern that we assessed is the same as described for rivals connected via the wholesale agreement. That is, whether:

121.1 the merged entity would have the ability to foreclose rivals and have a mechanism to do so;

121.2 the acquisition creates an incentive to raise the costs of rivals or engage in conduct that would foreclose rivals; and

121.3 the conduct makes Ingenico's terminal rivals less effective, resulting in a reduction of competition in the terminal market.

122. In this case we considered that potential mechanisms that the merged entity could use to carry out such foreclosure could be:

122.1 making it harder or more costly to gain certification;

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

122.3 increasing the price that it charges to merchants and/or rival terminal resellers to connect to its network.

123. The merged entity could use bundling or tying to foreclose rivals. For example:

123.1 offering switching services in a bundle with terminals and/or digital payment services at a price rivals cannot match; and/or

123.2 requiring merchants and terminal resellers that wish to use its S2I switching services to also purchase Ingenico's terminal.

124. The conduct described above could raise the costs of both terminal vendors and resellers. For example, making certification harder for non-Ingenico terminals would raise the costs of rival terminal vendors. This would in turn make it harder for resellers of rival terminals to compete against the merged entity. Increasing the price to connect to the network would impact the costs of resellers directly.

125. As for our concerns over rivals connected via the wholesale agreement, we assessed whether the merged entity would have the ability and incentive to foreclose rivals directly connected to Paymark.

125.1 The merged entity may have the ability to foreclose rivals directly connected to Paymark's switch if those rivals did not have a good alternative to using Paymark's switching services. We looked at whether those rivals would have other good alternatives if the merged entity was to raise their costs of obtaining switching services.

125.2 We considered whether this would create the incentive for the merged entity to foreclose rival terminal providers from competing. This involved weighing the potential economic benefits to the merged entity against the risks.

126. The overall assessment is whether the acquisition would be likely to have an adverse impact on competition. Such conduct would most directly impact on competition to supply terminals for merchants that do not use ANZ as their acquirer. For these merchants only Paymark has the current capability to process transactions. Conduct that raises the costs to rival terminals providers may reduce competition to supply payment solutions to those merchants. Depending on the nature of the conduct this could result in higher prices or reduced quality of terminals or a reduction of variety if it led to a rival exiting the market.

127. As we note above, our assessment is focused on potential harm to competition rather than particular competitors. It is possible that the transaction gives the merged entity advantages in competing for merchants. Although rivals may lose customers to the merged entity, harm to competition would only occur if prices were to rise (and/or quality were to fall) relative to the counterfactual. We assessed whether the acquisition is likely to have such an effect.

Our approach to testing these concerns

128. We have identified two main ways in which the merged entity might seek to foreclose rivals: rivals connected via the wholesale agreement and those directly connected to Paymark. Many of the factors that are relevant to this assessment

apply to both. Our approach was to consider each of the main factors that will affect whether the merged entity would have the ability and incentive to foreclose rivals.[101]

129. The main factors that will likely affect the ability and/or incentive of the merged entity to foreclose terminal rivals include:

129.1 the threat that rivals (including Verifone and Payment Express) impose from building an alternative network to process S2I transactions;

129.2 the ability and incentive of banks to protect competition in terminal supply;

129.3 the extent to which the wholesale and aggregation agreements will allow Verifone and Payment Express to impose a constraint on the merged entity; and

129.4 the threat that emerging technologies and other technologies that do not use S2I will impose on the merged entity.

130. On the basis of the cumulative constraint from these factors we have assessed whether the merged entity is likely to have the ability and incentive to foreclose rivals and therefore whether the acquisition is likely to cause a substantial lessening of competition.

Constraint from the threat of rivals building an alternative network

Introduction and summary

131. The merged entity would be limited in its ability and incentive to attempt to foreclose rivals if such conduct would be likely to encourage rivals to build an alternative network. If rivals build an alternative network, the merged entity would stand to lose profits from both terminals and switching services as merchants move their volumes to the competing network.[102]

132. We assessed the ability of rivals to build an alternative network. We assessed:

132.1 the number of links likely required;

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101 In mergers that raise concerns from foreclosure it is common to use "vertical arithmetic" to assess whether the acquisition entity would have the incentive to foreclose rivals. These analyses seek to weigh up the potential margins upstream that the merged entity could lose against the downstream margins that it could potentially gain from foreclosing rivals. We attempted to conduct such an analysis in this case but ultimately found it was of limited use to our assessment. The main problem was due to the complexity of the market, which meant there was a wide range of possible ways in which switching could occur. This made it difficult to use the model to identify the precise trade-offs and whether switching would defeat attempts to foreclose. For this reason, we have placed more reliance on other simpler analyses and qualitative evidence.

102 The rival does not need to build the alternative network to impose a constraint, it only needs for such a threat to be credible. The threat of building a network would incentivise the merged entity to offer reasonable terms to access its network. The threat of Verifone and/or Payment Express building a network would be likely to incentivise Paymark to offer reasonable terms on the wholesale and aggregation agreements.

132.2 the cost and risks of building those links;

132.3 any barriers to the links being established on an incremental basis; and

132.4 whether the financial institutions will be incentivised to prioritise the building and activating of links.

The number of links to financial institutions

133. There was disagreement among submitters as to the number of issuer links that would be required to establish a viable switch.[103] This was relevant because a greater number of links would imply greater barriers to building an alternative switch. Ingenico and Paymark submitted that links to the five largest issuer banks would be enough to provide a credible offering to merchants.[104] [105] Ingenico submitted these links would cover over [ ]% of transactions. In contrast, Verifone submitted that it would need to build links to all, or the vast majority, of the 29 issuers to provide a credible constraint because higher volume merchants would not accept a solution that did not cover 100% of transactions.[106] Payment Express submitted that it would need 14 links in total to provide a service acceptable to merchants.[107]

134. We asked merchants about the proportion of transactions that they require their terminals to cover. Our investigation included interviews with major merchants (including [ ]) and questions emailed to some large merchants ([ ]). In general, the merchants contacted identified a desire to be able to process all debit transactions.[108] This suggests that the ability of Paymark to process all transactions would place it at an advantage over other rivals.

135. Internal documents that we viewed were consistent with the argument that having many links provides Paymark an advantage. For example, a Paymark document

[103] In addition to issuer links, a rival network would also need links to the bank acquirers for the merchants the rival network wishes to service. In contrast to S2I transactions, a single S2A link is sufficient to serve all merchants of a given bank acquirer. As such, having built the necessary S2I links, it would be a much easier matter to deal with the S2A transactions. Verifone and Payment Express already have some S2A links. For these reasons we focus on the number of issuer links required to build a competing network.

[104] Submission from Ingenico on letter of issues (3 August 2018) at [32.4].

[105] Submission from Paymark on letter of issues (3 August 2018) at [31].

[106] Submission from Verifone on statement of preliminary issues (4 May 2018) at [41(b)]; Submission from Verifone on letter of issues (1 August 2018) at [24].

[107] Submission from Lee Salmon Long (on behalf of Payment Express) on letter of issues (1 August 2018).

[108] See for example Commerce Commission interview with [ ] (23 July 2018), Commerce Commission interview with [ ] (25 July 2018), email responses of [ ]. An exception was [ ] which did not consider it needed to accept every all cards. Commerce Commission interview with [ ] (24 July 2018).

appears to identify the advantage it possesses from all S2I links, although this also appears to impose costs on Paymark:[109]

> [
>
>]

136. [ ].[110]

> [ ]
> .]

137. We consider that the claim that links to the big five banks would be sufficient to provide a credible offer to merchants is not supported.[111] However, it is unlikely that all 29 links would be necessary to be a credible alternative, given many of those links account for only a small fraction of transactions. Payment Express submitted that it would need 14 links to provide a service acceptable to merchants.[112] According to Verifone data, 16 links would cover [ ]% of transactions.[113]

138. To conclude, we considered that a rival with around 14-16 issuer links is likely to offer a credible alternative. We do not need to conclude on the precise number as it does not affect our overall conclusion as to whether a rival could credibly threaten to build these links.

The cost to build the links

139. We received a wide range of submissions on the cost and difficulty to build links. This was relevant because a higher cost to build a link would imply greater barriers to building an alternative switch.

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109 [ ]

110 [ ], attached as confidential Appendix 5 to the Application at 7-8.

111 Ingenico claimed that once a rival had secured five links then Paymark would agree to process the transactions for the remaining issuers. Submission from Ingenico on letter of issues (3 August 2018) at [32.6]. Although we agree such a rival would be in a better bargaining position (compared to having no links), Paymark would still retain the competitive advantage that its full set of links provides. Paymark may not wish to assist a rival by allowing access to those links at reasonable prices or at all. As such, we do not rely on this argument.

112 Submission from Lee Salmon Long (on behalf of Payment Express) on letter of issues (1 August 2018) at [17].

113 Staff calculations based on data provided by Verifone. [ ], attached to an email from Buddle Findlay (on behalf of Verifone) to the Commerce Commission (19 July 2018.

139.1 Ingenico submitted that to build a link, based on its own experience, requires [ ] person (FTE) days per new connection and a financial cost of [ ].[114]

139.2 Paymark submitted that if a rival was to build a set of links, they would be likely to use API technology.[115] Using this technology, each link would take around [ ] to build and cost around [ ].[116] Paymark submitted that [ ].[117]

139.3 The vendor banks submitted that a conservative estimate for the cost to build links is [ ].[118] The vendor banks also submitted an economics report from NERA that implied a cost of around [ ] per link.[119]

139.4 Verifone submitted that the cost to build each link is $500,000-$1 million and it would take "a number of years" to build a full network.[120] Verifone also submitted that "the small scale of the New Zealand market makes it extremely difficult to achieve scale".[121]

139.5 Payment Express [ ].[122]

140. The evidence we received to back up these estimates was mixed. Although parties have submitted a range of estimates, few provided clear evidence to support their claims. However, a figure of around [ ] seems to be a reasonable estimate:

140.1 Paymark's estimate of [ ] does not appear likely to present the current cost of building a link, as Verifone would have been unlikely to have agreed on the wholesale access terms if it was this cheap to build links.

140.2 Payment Express provided evidence to show that the costs to the participating bank of building a link is around [ ]. Assuming a similar cost on Payment Express' side, it would suggest a total figure in the order of [ ].

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114 Submission from Ingenico on letter of issues (3 August 2018) at [32.7]. The figures have been converted from Ingenico estimates of [ ].

115 [ ], attached to an email from Chapman Tripp (on behalf of Paymark) to the Commerce Commission (26 April 2018) at [4].

116 [ ] attached to an email from Chapman Tripp (on behalf of Paymark) to the Commerce Commission (26 July 2018) at [15.1]-[15.2].

117 Cross submission from Paymark on statement of preliminary issues (7 June 2018) at [15].

118 Submission from vendor banks on letter of issues (3 August 2018) at [52].

119 NERA "Ingenico/Paymark: Expansion model" (14 August 2018).

120 Submission from Verifone on statement of preliminary issues (4 May 2018) at [41]-[42].

121 Submission from Verifone on statement of preliminary issues (4 May 2018) at [41(c)].

122 Submission from Lee Salmon Long (on behalf of Payment Express) on letter of issues (1 August 2018) at [19(a)].

141. Assuming a cost of around [ ] per link and a requirement to build around 15 links implies a total cost of around [ ].[123] We did not consider this total cost is likely to represent a significant barrier to Paymark's main rival Verifone.[124] Payment Express may also be prepared to the meet the cost.

141.1 The analysis that we have conducted suggests the total cost of building links is unlikely to be large compared to Verifone annual revenues in the market, which are around [ ].[125] We considered it likely that Verifone would be prepared to invest in the network if those revenues were at risk. This would also be true for higher estimates of the cost to build links.

141.2 It is unclear that the claim that New Zealand is too small for second network is supported. A second network (ANZ's issuer network) operated in New Zealand until recently. [ ] suggests the main barrier is not necessarily scale, but rather the willingness of banks to engage (which we discuss further below).

Barriers to establishing links incrementally

142. If Verifone had a credible threat of building an alternative network, it would motivate Paymark to offer reasonable terms on the wholesale and aggregation agreement. However, the threat of building the network might be hindered if the terms of the wholesale agreement prevented Verifone from building links.

143. Clause 4.4 of the wholesale agreement with Verifone provides that:

[ ]

[ ]

[

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[123] This assumes that the cost of building does not fall as more are built. However, the rival may become more efficient as more links are built.

[124] We consider that Verifone is likely to carry the greatest threat to Paymark of building an alternative network that can process all S2I transactions. This is because Verifone operates a switch, has recently operated a network with a full set of issuer links (that is, prior to agreeing to the wholesale agreement) and has merchant customers that account for a large proportion of card transactions. Payment Express could also potentially build a network given it has a significant position in the New Zealand payment systems. For these reasons we mainly focus on the ability of Verifone to build an S2I network in this section and, to a lesser extent, Payment Express. There may be other parties that could also build a network. We did not need to test this further to satisfy our concerns over the transaction.

[125] [ ], attached to an email from Buddle Findlay (on behalf of Verifone) to the Commerce Commission (12 October 2018). [ ]

]

144. Paymark submitted that this term would not enable it to impair Verifone's ability to access to the Paymark network in the event that it chooses to rely on the wholesale arrangement for the purposes of supplementing any new links it builds.[126] This means Verifone could start to process some transactions on its own new links as soon as each is built, while relying on its wholesale arrangements for the remainder of the transactions. We accept Paymark's interpretation of the term.

Time and risk of building the links

145. The greater barrier to building a competing network than cost is likely to be the time and risk in building all the links. To build a link requires that the financial institution cooperates with the switch operator to negotiate an agreement and prioritise resources for building and testing the links.

146. The vendor banks submitted that rivals can build links to them if they wish to do so.[127] Despite this, the evidence suggests that building a full set of links is likely to be a complex task. For example:

146.1 [ ] and [ ] stated in interviews that building a network would be complicated.[128]

146.2 Internal documents from [ ] and [ ] suggest that building a network could be difficult.
[ ][129]
[ ][130]

147. An important barrier appears to be simply getting banks to cooperate with building links. [ ].[131]
The next section (in paragraphs 160-167) considers whether the financial institutions are likely to be incentivised to cooperate to build an alternative network. However, in summary, we found that:

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126 [ ], attached to an email from Chapman Tripp (on behalf of Paymark) to the Commerce Commission (11 June 2018) at [7.2].

127 Cross submission from vendor banks on statement of preliminary issues (5 June 2018) at [3(b)].

128 Commerce Commission interview with [ ] (16 May 2018); Commerce Commission interview with [ ] (22 May 2018).

129 [ ]

130 [ ]

131 Submission from Lee Salmon Long (on behalf of Payment Express) on letter of issues (enclosure) (21 August 2018).

147.1 the financial institutions will be more motivated to cooperate post-merger since they will no longer own Paymark and will have only their own incentives to pursue;

147.2 a reduction in competition for terminals and/or loss of potential switch operators is likely to adversely affect the financial institutions; and,

147.3 the provisions of the services agreement are unlikely to materially affect the banks' ability and incentive to consider alternatives to the merged entity.

Conclusion

148. In summary, we considered that the threat of a rival building a network will impose some constraint on the merged entity's attempts to foreclose. Raising the costs of switching S2I transactions for rivals would put at risk their other switching and terminal revenues, which would in turn motivate these rivals to build links.

149. The Commission did not consider that cost is likely to be a significant barrier to building the network (at least for Verifone and potentially Payment Express). The major barrier would be securing cooperation from the financial institutions. We considered that the financial institutions would be likely to have an increased motivation to cooperate if the merged entity was to attempt to foreclose rivals, especially in respect of the most extreme types of conduct.

150. Although building an alternative switch would be difficult, it would significantly and permanently reduce the revenues of the merged entity.[132] As such, we considered the merged entity is likely to view the possibility of this as a significant risk, which would provide some disincentive from engaging in foreclosure conduct.

The constraint from banks

151. We considered whether the banks would have the ability and incentive to prevent the merged entity from engaging in conduct that would reduce competition.

Submissions of interested parties

152. There was disagreement among interested parties over whether banks had the ability and incentive to prevent the merged entity from engaging in foreclosure. A major concern from interested parties was whether the provisions of the service agreement would disincentivise banks from working with rivals to the merged entity.

153. The vendor banks submitted the acquisition would increase their countervailing power. This is because:

[132] We consider the merged entity would view a rival network as putting revenues from all acquirer banks at risk, not just those for which rivals have existing S2A links. If a rival (such as Verifone or Payment Express) was to build the necessary S2I links, it would be a relatively easy matter to then build the few additional S2A links to serve the merchants of other acquirer banks.

153.1 the acquisition would remove a key incentive (ie, their shareholding) to use Paymark;[133]

153.2 dealing with Paymark at arm's length means it will have the ability to demand a higher quality of service and an increased ability to incentivise improvements in Paymark's offering, which it has struggled to do as an owner due to the governance structure;[134] and

153.3 the banks' focus is on ensuring the best customer service to their merchants, and if quality of service was to drop on the Paymark switch, [ ].[135]

154. Verifone submitted that the barriers to entry and expansion mean the vendor banks have little countervailing power.[136] Verifone and Payment Express submitted that the provisions of the services agreement would disincentivise banks from moving traffic away from Paymark.[137] In particular, Verifone and Payment Express raised concerns about the provisions that provide [ ]

Ability of banks to protect competition

155. We considered there are ways in which the banks could protect competition if they had the incentive to do so.

156. First, the banks have the ability to protect competition by prioritising building links. As we identified above, the main barrier to building an alternative set of links is to secure cooperation from the financial institutions. A rival would need many links to be a credible alternative. However, Paymark may view any additional S2I links built as a threat as it will move the rival one step closer to completing that network (especially if the financial institution in question is one of the major banks).

157. Second, the banks could influence merchants and/or customers to use payment systems that do not require Paymark's switch. The evidence we have viewed suggests that banks can influence merchant choice. For example:

157.1 The May 2016 Paymark information memorandum suggests that [ ].[138]

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133 Cross submission from the vendor banks on statement of preliminary issues (5 June 2018) at [3(d)].
134 Cross submission from the vendor banks on statement of preliminary issues (5 June 2018) at [36].
135 Submission from the vendor banks on the letter of issues (3 August 2018) at [56].
136 Submission from Verifone on statement of preliminary issues (4 May 2018) at [6].
137 Submission from Matthew Dunning QC (on behalf of Payment Express) on statement of preliminary issues (11 May 2018) at [14]; Submission from Verifone on statement of preliminary issues (4 May 2018) at [16], [53].
138 [ ], attached as confidential Appendix 5 to the Application at 31. [ ]

157.2 A January 2018 Ingenico internal document suggests [ ][139]

157.3 The major banks in interviews indicated they have the power to influence merchant choice, but now tend to only provide introductions and allow the merchant to choose their preferred supplier.[140]

158. The ability of the banks to influence merchant choice relies on there being a good alternative to the merged entity. As we find in the section on alternative technologies below (at paragraphs 196-198) there are at present few good alternatives to payment methods that use Paymark's switch. There is no clear data on when the new payment technologies that interested parties have identified would be introduced or how quickly they would be taken up. Despite this, the internal documents of banks and Paymark are consistent with the argument that these technologies represent a threat to Paymark over the longer term. The speed at which these technologies emerge will be affected by how well the current payment system meets the needs of banks and merchants. As such, the ability of banks to encourage these technologies has the potential to impose a constraint even if the threat to the merged entity is not imminent.

159. The ability to encourage merchants to choose rival services may be limited to some extent by the services agreement which will come into effect as part of the transaction. Under the services agreement [ ][141] However, we did not consider this is likely to significantly inhibit the banks from influencing merchants to consider alternative payment options. This is because:

159.1 [

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[139] [ ], attached to an email from Chapman Tripp (on behalf of Ingenico) to the Commerce Commission (20 April 2018) at 4.
[ ]

[140] Commerce Commission interview with [ ] (22 May 2018) [ ] Commerce Commission interview with [ ] (22 May 2018).
[ ]; Commerce Commission interview with [ ] (16 May 2018).
[ ]

[141] [ ] attached as confidential Appendix 8 to the Application at [2.2].

159.2

159.3

]

Incentive of banks to protect competition

160. We considered the banks are unlikely to be incentivised to protect competition in the terminal market unless the harm from the foreclosure directly affects them. We considered whether such conduct would be likely to harm the banks.

161. First, if the merged entity was to raise rivals' costs for terminals directly connected to the Paymark network, then merchants using those services would expect to pay more for their payment solutions. We considered that banks are likely to prefer merchants to face lower costs.

    161.1 As a general point, payment solutions that merchants use are complementary to the services that banks offer to merchants. All things equal, an increase in the costs for merchants will reduce demand for bank services. It is, however, difficult to say how strong that effect is.

    161.2 More directly, an increase in the cost of payment solutions may result in merchants using terminals less intensively. This may place some of the revenues that the banks gain from interchange fees on scheme transactions at risk.

162. The harm from raising the costs for merchants using terminals directly connected to Paymark will most affect banks other than ANZ (since ANZ's merchants are mostly served by Verifone). Those banks may fear merchants switching to ANZ to take up Verifone's offer and so may be motivated to ensure their merchants enjoy a competitive market.

163. Second, if the merged entity sought to foreclose Verifone and Payment Express by further increasing the price of the wholesale agreement (for example, increasing the price per transaction or for each terminal on the network), then merchants using those services may be forced to use Paymark's services. This is likely to adversely impact on the banks because:

    163.1 The banks will likely face resistance from those merchants that prefer the different functionality of Verifone and Payment Express services. The value to the banks of gaining or maintaining an acquiring customer exceeds the actual revenue received from the acquiring services alone. Having the acquiring relationship with a merchant means that the banks are more likely to be able to supply other services such as transactional banking, lending, and insurance. For example, BNZ has estimated that for every $[ ] it earns from a customer through acquiring services, it earns around $[ ] from other services.[142] This means that banks are likely to have a financial incentive to act to satisfy the interests of those merchants.

163.2 The loss of Verifone and Payment Express will reduce the banks' leverage against Paymark when the services agreement comes to an end [ ]. The banks would likely wish to retain an option to ensure they are in the best position to negotiate an attractive deal with Paymark for switching fees.

164. Interested parties have raised concerns that the provisions of the services agreement will disincentivise the banks from switching to other providers.[143] In particular, the services agreement includes the following provisions:[144]

164.1 [

164.2

164.3

164.3.1

164.3.2]

165. Our review of the services agreement suggested that [ ] are unlikely to be a strong disincentive to banks from activating links to rival switches. This is because:

165.1 [
]

165.2 [ ][145], [ ][146] [ ][147]

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[142] [ ], attached to an email from Russell McVeagh (on behalf of BNZ) to the Commerce Commission (11 September 2018) at 6.

[143] [ ]; Submission from Verifone on statement of preliminary issues (4 May 2018) at [6], [53].

[144] [ ] attached as confidential Appendix 8 to the Application.

166. Finally, the vendor banks would no longer have an ownership interest in Paymark following the transaction. This would likely reduce the incentive to favour Paymark over other rivals compared to the status quo.

Conclusion

167. We cannot be certain about the behaviour of the banks post-merger. However, the evidence we have received and our analysis led us to conclude that the banks are likely to have the ability and incentive to protect competition if the merged entity engaged in conduct that materially reduced competition for the supply of terminals.

The constraint from the wholesale and aggregation agreements

Introduction and summary

168. Verifone has two agreements with Paymark for access to its network: the wholesale agreement and the aggregation agreement. We have considered whether these agreements would constrain the merged entity from engaging in foreclosure. In the case that these agreements enable Verifone to continue to operate, it would make foreclosure less likely, given that:

    168.1 acceptable terms on the wholesale agreement would allow Verifone to continue to provide services to merchants on its own switch; and

    168.2 acceptable terms on the aggregation agreement would provide a way for Verifone to offer its functionality to non-ANZ acquired merchants.

169. We considered it likely that the proposed new terms of the wholesale and aggregation agreement will be accepted by the parties. We considered that these terms would likely be sufficient to allow at least Verifone to continue to operate and serve its existing customers.

Ability to compete under the current terms

170. The wholesale agreement allows Verifone to offer full switching capability to ANZ-acquired merchants. We considered that the current terms of the wholesale agreement are likely attractive enough to enable Verifone to act as a credible alternative to Paymark for ANZ-acquired merchants. [ ].[148] [ ]

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145 [ ]

146 [ ]

147 [ ]

148 [ ] [ ], attached as confidential Appendix 5 to the Application at 41; [ ], attached as confidential Appendix 12 to the Application, Schedule 3.

170.1 A November 2017 Paymark document identifies that the [ ][149]

170.2 A November 2017 Ingenico internal document states: [ ][150]

171. The aggregation agreement enables Verifone to process non-ANZ merchant transactions over the Paymark switch. The aggregation agreement allows Verifone to use terminals with its own specification rather than that of Paymark. Verifone has completed the technical ability to do aggregation [ ] For the purposes of our analysis, we do not place weight on the aggregation agreement as a constraint on the merged entity.

Ability to compete under the proposed new terms

172. The parties are currently in negotiations for new terms but these have not yet been finalised.

173. The new terms that Paymark offered on the wholesale agreement:[151]

173.1 [

173.2

173.3]

174. [ ][152]

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149 [ ].

150 [ ], attached to an email from Chapman Tripp (on behalf of Ingenico) to the Commerce Commission (20 April 2018) at 3.

151 See for example [ ], attached to an email from Buddle Findlay (on behalf of Verifone) to the Commerce Commission (8 June 2018); Commerce Commission interview with [ ] (18 May 2018).

175. The Commission considered that the proposed terms, if accepted, would be likely to allow Verifone to continue to operate and serve its existing customers. We reached this view because:

175.1 [[153] [154]]

175.2 As noted earlier, we considered it likely that Paymark would view at least some risk of Verifone building its own network. Therefore, we considered, it would offer terms that would at least allow Verifone to continue to operate.

176. [ ]

177. We cannot say whether the proposed new terms are [ ].[155] This means that:

177.1 The wholesale agreement [ ]. We do not rely on the ability of merchants to switch to payment solutions that use Verifone's switch in reaching our conclusion on the acquisition.

177.2 The new terms of the wholesale agreement may allow Paymark to increase prices for switching services to non-ANZ merchants (as [ ]). However, we considered this is likely to have occurred in the counterfactual as well, since [ ].[156] We have assessed whether the acquisition would likely cause a substantial lessening of competition that increased prices (or reduced quality) relative to the counterfactual.

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152 [ ].

153 [ ]

154 [ ]

155 [ ]

156 As the transaction is mainly vertical in nature we do not consider it will likely create any additional incentive for Paymark to raise prices that occurs due to [ ].

Whether the proposed new terms will be accepted

178. The proposed new terms have been negotiated but at the time of the decision had not yet been signed off. Verifone has raised the concern that the terms [ ].[157] However, the Commission considers that [ ].

179. First, [ ]. Paymark's pricing committee approved the proposed new terms in March 2018.[158] [ ].[159] [ ][160]

180. Second, we considered it likely that any further increases in price (or worsening of the conditions under the contract) would increase Verifone's incentive to build a network. NERA provided a model to the Commission that compares the prices under the wholesale agreement against the cost of building links.[161] NERA's model suggests that a small increase in prices under the wholesale agreement would make it economic for Verifone to build its own network. We have reviewed this model and considered that its estimates are plausible.

181. Internal documents of Paymark and Ingenico are consistent with the risk that Verifone could build a rival network. For example:

181.1 A Paymark internal document states:[162]

[ ]

181.2 An Ingenico internal document states:[163]

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157 Cross submission from Buddle Findlay (on behalf of Verifone) on statement of preliminary issues (21 June 2018) at [27].

158 [ ] provided as Annex A to cross submission from Paymark on the statement of preliminary issues (7 June 2018) at 3.

159 [ ], attached to email from Chapman Tripp (on behalf of Ingenico) to the Commerce Commission (26 July 2018).

160 [ ].

161 NERA "Ingenico/Paymark: expansion model" (14 August 2018).

162 [ ] provided as Annex A to Paymark's cross submission on the statement of preliminary issues (7 June 2018) at 1.

163 [ ], attached to an email from Chapman Tripp (on behalf of Ingenico) to the Commerce Commission (20 April 2018) at 9.

[ ]

182. The threat of Verifone building an alternative network would likely persist if the merged entity did not fulfil expectations under the wholesale agreement. As noted above, we considered it likely any significant worsening of terms would likely create an incentive for Verifone to build a network. For example, if the merged entity degraded the quality of processing under the wholesale agreement (by slowing the speed of transactions), it may push Verifone to build its own network.

Conclusion

183. We considered it likely that the proposed new terms of the wholesale agreement would be accepted by the parties. We considered that these terms would likely be sufficient to allow Verifone and Payment Express to continue to operate and serve their existing customers.

184. We cannot say whether the wholesale and aggregation agreement terms will [ ]. We do not rely on this constraint in our assessment of whether the acquisition was likely to cause a substantial lessening of competition.

Constraint from alternative payment technologies

Introduction

185. We have considered the extent to which the growth of competing payment technologies that do not use S2I processing, including new technologies and innovation in existing technologies, will affect the merged entity's ability and incentive to foreclose terminal providers. The main concern with the acquisition that we tested is that the merged entity will use market power for S2I switching services to harm competition for terminals. Where the threat from other technologies that do not use S2I processing is strong, it will increase the risk to the merged entity of engaging in such conduct. Engaging in this foreclosure conduct would risk merchants and banks moving to these other technologies and, depending on what technologies they move to, place at risk the merged entity's profits on both terminals and switching services.

186. As such we analysed:

    186.1 whether other technologies act, or will act, as an alternative to payment systems that use S2I processing;

    186.2 the speed at which these technologies will be taken up by merchants; and

    186.3 the impact that these technologies will have on the merged entity's incentives in the short term.

Submissions

187. Submitters disagreed about the constraint from new and alternative payment technologies. This was relevant because the greater the threat of those alternatives, the less likely that the merged entity would have the ability and incentive to engage in foreclosure. Or, putting it another way, to the extent that these alternatives are a threat, the greater will be the merged entity's incentive to ensure that the S2I payment system is competitive, including terminals that process S2I transactions.

188. Ingenico, the vendor banks and Paymark submitted that the ability and incentive of the merged entity to foreclose would be constrained by disruption from emerging technologies.[164] [165] [166] Ingenico submitted that the payments industry is changing quickly. The threat of disruption means its primary incentive is to retain transaction volume on Paymark for as long as possible.[167] Ingenico submitted that it is best able to achieve this by "encouraging the largest possible number of terminals and transaction volumes on its switch to make the POS offering as attractive as possible, rather than by hindering or impeding certain types of terminals from connecting". The vendor banks acknowledged that market participants have different views about how this disruption will play out,[168] but submitted that Paymark will be "rapidly overtaken by new technologies" if it remains under bank ownership.[169]

189. Ingenico and the vendor banks submitted that the following technologies are a threat:[170]

189.1 Mobile wallet applications that use NFC, such as Apple Pay, Google Pay, and similar applications provided by the vendor banks (such as ASB Virtual).

189.2 Mobile applications that use QR code payments, such as Alipay and We Chat Pay. These applications enable account-to-account payments between retailers and customers, bypassing the switch. Terminal vendors in New Zealand (such as EFTPOS New Zealand and Smartpay) are enabling Alipay and We Chat Pay on their terminals but QR code payments can also be used without a terminal.[171]

189.3 The development of industry standard API (Application Programming Interface) pilots.[172] Although the API pilot is in its early stages, this process

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164 The Application at [155-163].
165 Submission from vendor banks on letter of issues (3 August 2018) at [3].
166 Cross submission from Paymark on statement of preliminary issues (7 June 2018) at [11].
167 Submission from Ingenico on letter of issues (3 August 2018) at [42].
168 Submission from vendor banks on letter of issues (3 August 2018) at [3].
169 Submission from vendor banks on letter of issues (3 August 2018) at [7].
170 Submission from Ingenico on letter of issues (3 August 2018) at [42]. Submission from vendor banks on letter of issues (3 August 2018) at [68]-[70].
171 EFTPOS New Zealand "Value added solutions" <www.eftpos.co.nz>; Smartpay "Alipay We Chat" <www.smartpay.co.nz>.
172 APIs define the ways in which applications and software components communicate with each other. Digital Government "Application programming interfaces (APIs)" <www.digital.govt.nz>

could lead to the development of an account-to-account in-store payment method that ultimately replaces debit transactions in NZ.[173]

190. NERA (on behalf of the vendor banks) also submitted that mobile payment applications such as Apple Pay are familiarising consumers with mobile payments. NERA suggested that, should mobile wallet applications grow as a payment method in New Zealand, there will be "little change in behaviour required" for consumers to adopt new payment methods, such as those that might arise from the development of industry APIs.[174] The vendor banks and NERA submitted that Paymark is highly sensitive to volume loss, and that the merged entity will be incentivised to foster innovation and competition in the terminals market to maintain demand for its switch, rather than engage in conduct which might encourage use of alternative payment options.[175]

191. Verifone submitted that new entry by emerging payment methods will not be sufficient to effectively constraint the merged entity.[176] Verifone submitted that:

191.1 New Zealand merchants are slow to adopt new payment methods.[177]

191.2 S2A growth in recent years is due to the uptake of contactless cards,[178] and that this growth is likely to plateau in the years to come.[179] New technologies like Google Pay and Apple Pay simply allow consumers to pay with phones in place of cards, and that these transactions account for a very small proportion of payments.[180]

191.3 The use of APIs is uncertain. Industry API development is a voluntary program in its early stages, and it is not clear if, when, or under what commercial conditions, APIs will be made available to developers.[181] It is unlikely that API-based payment methods will be adopted by merchants as an alternative payment method at their physical POS. There are no examples of new API payment methods impacting the use of card payments in other countries where similar developments have been, such as Australia or the United Kingdom.[182]

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173 Submission from Ingenico on letter of issues (3 August 2018) at [43]; "Ingenico additional information and RFI response for Commerce Commission", attached to an email from Chapman Tripp (on behalf of Ingenico) to the Commerce Commission (7 September 2018) at [36].

174 Submission from NERA on letter of issues (3 August 2018) at [64].

175 Cross submission from the vendor banks on letter of issues (14 August 2018) at 4-5; Submission from NERA on letter of issues (3 August 2018) at [74].

176 Submission from Verifone on statement of preliminary issues (4 May 2018) at [75].

177 Submission from Verifone on statement of preliminary issues (4 May 2018) at [75].

178 Submission from Verifone on statement of preliminary issues (4 May 2018) at [75(b)].

179 Cross submission from Verifone on letter of issues (13 August 2018) at [20].

180 Cross submission from Verifone on letter of issues (13 August 2018) at [21(c)].

181 Cross submission from Verifone on letter of issues (13 August 2018) at [23].

182 Cross submission from Verifone on letter of issues (13 August 2018) at [24].

The extent to which other technologies will be an alternative to the merged entity

192. We considered that emerging technologies could affect the position of the merged entity in two ways.

193. First, mobile applications that make use of NFC technology, such as Apple Pay and other mobile wallets, are processed using S2A. A shift to these technologies would result in a decline of S2I transactions. Paymark may continue to process those S2A transactions. However, S2A transactions require fewer links (one link to an acquiring bank allows a switch to process all S2A transactions for that bank's merchants). A switch from S2I to S2A will weaken Paymark's competitive advantage in S2I. As S2I transactions decline, Verifone and Payment Express would impose a greater competitive threat to Paymark.[183]

194. The same effect applies more generally to any other developments that lead to a shift to payment solutions that use S2A processing. For example, innovations on scheme credit card or contactless debit cards may shift more consumers away from payment solutions that use S2I processing.

195. Second, new technologies that bypass the switch altogether could reduce transaction volumes on all switches, including Paymark's. This includes applications like Alipay and We Chat Pay which use a QR code to make a payment directly from a consumers account. Developments in New Zealand of open banking APIs may also lead to the development of applications that allow for direct to account payments. It is unclear that these technologies will entirely replace the need for S2I and S2A transactions. However, the introduction of such technologies could displace some portion of card payments and decrease transaction volumes on the merged entity's network.

Speed of take up

196. We have sought evidence on whether new technologies are likely to be introduced and/or taken up by merchants. There is limited evidence available. The evidence that we viewed did not indicate that emerging technologies are likely to be a significant part of the market in the short term.

    196.1 QR code payment applications like Alipay and We Chat Pay are mainstream payment methods in China. While New Zealand merchants have access to terminals that can accept Alipay and We Chat Pay payments, New Zealand domestic consumers do not appear to be able to use either application as an alternative to card payments. It appears that the main driver for QR code payment acceptance in New Zealand is to allow merchants to receive payments from Chinese visitors.[184] QR code payment applications have grown rapidly in China. We have, however, received limited evidence to suggest

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183 Verifone and Payment Express do not have S2A links to all acquiring banks. However, as few links (those to the acquiring banks) are required to cover all merchants, the barriers for Verifone and Payment Express to process S2A transactions are lower than to process S2I transactions.

184 See, for example, EFTPOS New Zealand "Value added solutions" <www.eftpos.co.nz>; Payplus "Alipay and We Chat Pay" <www.payplus.co.nz>.

these types of payment will enjoy the same success in New Zealand, in the near future.

196.2 Mobile applications that emulate cards to make contactless payments are becoming available in New Zealand. However, there is little evidence showing the extent of uptake in New Zealand.

196.2.1 MBIE's 2016 Issues Paper on retail payments suggests that these payment types are in their infancy.[185] Despite the introduction of these products, MBIE's data suggests S2I transactions are only declining at a slow rate and suggests S2I transactions will continue to endure for some time.

196.2.2 There is evidence that these kinds of payments are growing in other countries, however it is from a low base. For example, a 2016 Reserve Bank of Australia payments survey found that mobile card payments accounted for 1% of all in-person payments at a merchant's POS, and 2% of all in-person card payments.[186] ANZ data has since shown that Australian mobile payments in December 2017 by Australian ANZ customers increased by 140% from December 2016 figures. It is suggested that this growth is partly driven by the popularity of NFC payment applications on smartwatches and wearable technology.[187]

196.3 The development of industry APIs could provide a platform for new payment technologies to enter the New Zealand market. However, there is no clear evidence on when these will be introduced or the extent to which they will displace S2I transactions.

197. Other evidence was also consistent with the claim that payments that use S2I transactions will continue to be important in the immediate future. For example, both BNZ and ASB accepted that [ ].[188] [189] A BNZ internal document states:

> [ ][190]

198. Despite the lack of evidence of an immediate threat, internal documents show that market participants recognise a threat from technologies that do not use S2I

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[185] MBIE "Retail payments in New Zealand: Issues Paper" (October 2016) at [236].

[186] Reserve Bank of Australia "How Australians Pay: Evidence from the 2016 Consumer Payments Survey" (Research discussion paper, July 2017) at 12.

[187] BlueNotes "Mobile wallet spending surges over holiday period" (19 January 2018) <www.bluenotes.anz.com>.

[188] Commerce Commission interview with [ ] (17 May 2018).

[189] Commerce Commission interview with [ ] (22 May 2018).

[190] [ ], attached to an email from Russell McVeagh (on behalf of BNZ) to the Commerce Commission (13 June 2018) at 5-13.

processing over the longer term. This includes threats both from new technologies and innovations by the scheme cards.

198.1 An Ingenico presentation (dated 23 March 2016) describes a changing payment landscape in which there is an increasing number of physical devices that can be used to make payments and an increasing number of software applications for making and accepting payments. The document predicted high growth in mobile retail payments with smartphones and wearables (eg, smartwatches and Fitbits) by 2020.[191]

198.2 ASB internal documents [ ]:

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][192] [ ]

198.3 BNZ internal documents
[ ].

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][193] [ ]

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][194] [ ]

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][195] [ ]

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[191] [ ], attached to an email from Chapman Tripp (on behalf of Ingenico) to the Commerce Commission (20 April 2018) at [16]-[17].

[192] [ ], attached to an email from Russell McVeagh (on behalf of ASB) to the Commerce Commission (12 June 2018) at 2.

[193] [ ], attached to an email from Russell McVeagh (on behalf of BNZ) to the Commerce Commission (13 June 2018) at 5-13.

[194] [ ], attached to an email from Russell McVeagh (on behalf of BNZ) to the Commerce Commission (13 June 2018) at 5-13.

198.4 Westpac internal documents [ ]:

[ ][196]

[ ][197]

198.5 ANZ internal documents [ ]:[198]

[ ]

[ ]

[ ]

198.6 Paymark internal documents recognise the threat from other technologies, including those that use S2A processing and others (such as [ ]) that do not require S2I switch processing:

[ ][199] [ ]

195 [ ], attached to an email from Russell McVeagh (on behalf of BNZ) to the Commerce Commission (13 June 2018) at 7.

196 [ ], attached to an email from Russell McVeagh (on behalf of Westpac) to the Commerce Commission (12 June 2018) at 2.

197 [ ], attached to an email from Russell McVeagh (on behalf of Westpac) to the Commerce Commission (12 June 2018) at 3.

198 [ ], attached to an email from Russell McVeagh (on behalf of ANZ) to the Commerce Commission (8 June 2018) at 12, 16, 21.

199 [ ], provided in response to 24 April 2018 request for information (4 May 2018) at 5.

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][200] [ ]

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][201] [ ]

199. The threats referred to in the documents in particular identified those posed by shifts to scheme cards and new NFC technologies such as ApplePay and GooglePay that use S2A processing. There are also some references to technologies that have the potential to bypass the need for switches entirely. The documents suggest the threat is likely to materialise over the medium to long term.

200. Although the threat may not be immediate, it may nevertheless affect the merged entity's conduct now. The merged entity may perceive a risk to engaging in conduct that makes terminals unattractive, as it could encourage banks and merchants to look to other technologies, hastening the speed at which alternative technologies are taken up. We considered the perceived threat of these alternatives evidenced in the internal documents quoted above is likely to impose some constraint on the ability and incentive of the merged entity to pursue a foreclosure strategy in the terminals market.

Conclusion

201. We considered alternative technologies could reduce the reliance on the merged entity's network either because:

    201.1 transactions will shift to S2A (which require fewer links to process); or

    201.2 bypass the switch altogether.

202. There is limited evidence on the speed at which these technologies will be taken up. It is unlikely these technologies will be strong alternatives in the short term. The evidence suggests that S2I transactions will endure for the coming years. However, the internal documents support the claims that these alternative technologies represent a threat to the merged entity's future revenues in the medium to long term. The uptake of such technologies has the potential to significantly and permanently reduce the merged entity's revenues.

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[200] [ ], provided in response to 24 April 2018 request for information (4 May 2018) at 1.

[201] [ ], provided in response to 24 April 2018 request for information (4 May 2018) at 3.

203. We considered that the threat from alternative technologies is likely to impose some constraint on the ability and incentive of the merged entity to engage in foreclosure in the terminal market. We considered that the merged entity is likely to see those alternative technologies as a threat and be motivated to keep the terminal market attractive to discourage banks and merchants from adopting rival technologies.

204. The threat of new technologies that do not use S2I processing may also reduce the incentive for rivals to build an alternative network. Banks may also be more reluctant to engage if they expect links to become redundant. However, it is not necessary that both constraints apply simultaneously to avoid a substantial lessening of competition. We considered that the merged entity is likely to view both the building of a rival switch and alternative technologies as significant risks, with the former a more immediate risk and the latter likely to become stronger over time. As the need for S2I transactions is likely to endure for some time to come, the future emergence of alternative technologies may only reduce the incentive to build links but not eliminate it.

Whether there will likely be sufficient constraints on the merged entity to prevent foreclosure

205. In the sections above, we have considered the constraints to the merged entity engaging in foreclosure conduct. This section has our assessment of whether those constraints on the merged entity would be likely to prevent it engaging in conduct that forecloses rivals.

Submissions from interested parties

206. Ingenico submitted that it would not have the incentive to prevent its terminal rivals from accessing Paymark's switch or to favour Ingenico terminals:[202]

> Paymark's revenue and gross margin in the upstream switching market would necessarily suffer from lost transaction revenue that it current receives via remaining terminal agnostic. The combined entity could never make up that lost gross margin through any increased Ingenico margin in the terminal market.

207. In support of this view, the vendor banks submitted that their focus is on ensuring the best customer service to their merchants, and if quality of service was to drop on the Paymark switch, [ ].[203]

208. However, against these views, Verifone submitted that Paymark already has the ability and incentive to restrict competition in the switching market but the acquisition will create a new incentive due to the revenue it will gain from terminals

[202] The Application at [129].
[203] Submission from the vendor banks on the letter of issues (3 August 2018) at [56].

and digital payments.[204] Payment Express also considered the merged entity would have the incentive to foreclose.[205]

Foreclosing rivals that connect via the wholesale agreement

209. We considered whether the acquisition would be likely to give the merged entity the ability and incentive to foreclose rivals (including Verifone and Payment Express) by raising the cost of accessing Paymark's switch via the wholesale agreement.

210. This was a complex assessment. We had to consider the extent to which rivals connected via the wholesale agreement had alternative options if Ingenico engaged in behaviour to reduce their competitiveness and how merchants and banks would react if terminals became less attractive. This was in the context of uncertainty over new and alternative technologies.

211. However, on balance, we concluded that the cumulative impact of the constraints that the merged entity faced meant it would be unlikely to engage in such conduct.

211.1 First, we considered that raising the costs of connecting via the wholesale agreement would likely incentivise rivals to build a switch that would compete more directly with Paymark. There are barriers to building a switch. However, the evidence we have viewed suggests the merged entity is likely to view this as a threat:

211.1.1 Our assessment indicated that the cost itself was unlikely to be a major impediment for Verifone (and potentially Payment Express) to building a rival network given the revenues that were at stake and benefits that could be derived from that network. We did not consider scale was likely to be an issue given a second network had so recently been in operation.

211.1.2 The greater barrier to building a competing switch is likely to be the time and risk in building all the links. To build a link requires that the financial institution cooperates with the switch operator to negotiate an agreement and prioritise resources for building and testing the links. We viewed evidence indicating [ ]. However, the evidence we received and our analysis led us to conclude that the banks are likely to be incentivised to cooperate if the merged entity engaged in conduct that materially reduced competition for the supply of terminals. The banks will be further motivated to assist rivals to ensure they have an alternative to the merged entity when the services agreement is due for renegotiation.

204 Submission from Verifone on statement of preliminary issues (4 May 2018) at [54]-[59].

205 Submission from Matthew Dunning QC (on behalf of Payment Express) on statement of preliminary issues (11 May 2018) at 4.

211.2 Second, we considered that the potential threat of Verifone building a rival switch would drive the merged entity to offer terms on the wholesale agreement that Verifone will find acceptable. We considered that these terms would likely be sufficient to allow Verifone to continue to operate and serve its existing customers.

211.3 Third, raising the costs of rivals is likely to encourage the take up of alternative payment types that do not require Paymark's switch. This includes: shifting transactions to S2A (which require fewer links to process); or bypassing switching altogether. The shifts to other technologies would put at risk the merged entity's profits from both terminals and its switch. The evidence we viewed was unclear about when these alternative technologies will be introduced and taken up. However, we considered the internal documents provide evidence that the merged entity will nevertheless still see alternative payment technologies as a threat. We considered the merged entity will be motivated to keep the terminal market attractive to discourage banks and merchants from adopting those rival technologies.

212. The threat of new technologies that do not use S2I processing may reduce the incentive for firms such as Verifone to build an alternative network. However, it is not necessary that both constraints apply simultaneously to avoid a substantial lessening of competition. We considered that the merged entity is likely to view both the building of a rival switch and alternative technologies as significant risks, with the former a more immediate risk and the latter likely to become stronger over time.

213. We cannot predict aspects such as bank behaviour and the introduction of new technology with certainty. Our analysis was based on evidence, submissions and our assessment of how a rational actor would be likely to behave. On this basis we considered that the merged entity is likely to view the risk of a competitor building an alternative switch and the introduction of new technology, assisted with the support of the banks, as genuine threats. Either of these would have the potential to significantly and permanently reduce the volumes of transactions that Paymark processes and potentially the terminals Ingenico sells. We considered this will motivate the merged entity to ensure the terminal market remains competitive.

214. As such, we were satisfied the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition due to foreclosure of rivals connected to Paymark's switch via the wholesale agreement.

Foreclosing rivals that connect directly

215. We considered whether the acquisition would be likely to give the merged entity the ability and incentive to foreclose rivals connected directly to Paymark's switch including those terminal providers supplying Verifone, PAX and other rival terminals.

216. This was similarly a complex assessment. We considered whether those rivals directly connected to Paymark had alternative options if Ingenico engaged in behaviour to reduce their competitiveness and how merchants and banks would

react if terminals became less attractive. This was in the context of uncertainty over new and alternative technologies.

217. However, on balance, we concluded that the cumulative impact of constraints that the merged entity faced meant it would be unlikely to engage in such conduct.

217.1 First, we considered that raising the costs of rivals could result in a rival building an alternative network. This is unlikely to be an option for all terminal suppliers as some are relatively small. However, it may be viable for Verifone whose terminal sales would be at risk. As above, we considered the banks are likely to be incentivised to cooperate with rivals if competition was threatened.

217.2 Second, as above, raising the costs of rivals in a manner that raises prices and/or degrades quality for merchants is likely to encourage the take up of alternative payment types that do not require Paymark's switch. We considered that the merged entity is likely to see those alternative technologies as a threat and be motivated to keep the terminal market attractive to discourage banks and merchants from adopting those rival technologies.

218. As noted earlier, we cannot predict aspects such as bank behaviour and the introduction of new technology with certainty. Our analysis was based on evidence, submissions and our assessment of how a rational actor would be likely to behave. We considered that the cumulative effect of the risks that the merged entity faces would be likely to motivate the merged entity to ensure the terminal market is not subject to a substantial lessening of competition.

219. As such, we were satisfied the acquisition will not have, or would not be likely to have, the effect of substantially lessen competition due to foreclosure of rivals connected directly to Paymark's switch.

Overall conclusion

220. To conclude, we were satisfied that the acquisition will not have, or will not be likely to have, the effect of substantially lessen competition in the terminal market due to vertical and/or conglomerate effects.

Determination on notice of clearance

221. We are satisfied that the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.

222. Pursuant to section 66(3)(a) of the Act, the Commerce Commission determines to give clearance to Ingenico Group SA to acquire 100% of the shares in Paymark Limited.

Dated this 2nd day of November 2018

Dr Mark Berry
Chairman