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Commerce Commission
BY EMAIL

INGENICO: APPLICATION FOR CLEARANCE TO ACQUIRE PAYMARK – RESPONSE TO LETTER OF ISSUES DATED 11 JULY 2018

1. We act for Payment Express (**PE**).

Introduction

2. This letter is written on PE's behalf in response to the following, interrelated, issues raised in the Commission's "Letter of Issues" to Ingenico's solicitors dated 11 July 2018 (**LoI**):
 - (a) Ingenico's submission that merchants and banks are in a position to mitigate any lessening of competition by steering customers from S2I to S2A transactions (LoI, para 23).
 - (b) The challenges facing PE (and Verifone) in establishing sufficient direct issuer links to effectively compete with Paymark in the S2I sphere, and the number of issuer links required to do so (LoI, para 48).
 - (c) The merged entity's ability and incentives to foreclose rivals (LoI, paras 63 and 67).
3. This letter is supplementary to, and should be read together with, PE's earlier submissions in relation to the application, including as set out in the letter from Matthew Dunning QC dated 11 May 2018.
4. As this letter includes references to confidential information it is not for publication. Passages containing information confidential to PE are highlighted in **blue**. Information confidential to other parties is highlighted in **purple**. A public version, in which these passages have been redacted, is **enclosed**.

Electronic payment services must include traditional EFTPOS (S2I) switching to be competitive

5. At para 18 of the LoI, the Commission raises the possibility that Verifone and PE may effectively compete with the merged entity for switching services through offering S2A switching (in essence, scheme card payments) only. By necessity, that rests on the proposition that there are enough merchants who will be willing either: (a) to have two separate terminals for S2A

- (scheme) and S2I (EFTPOS); or to *refuse* to accept S2I payments while accepting S2A payments. That is not realistic.
6. First, consumers do not view payment options based on the switching method used. Instead, consumer behaviour is largely driven by expectations relating to the acceptance of one or more types of payment cards they hold, being: (a) traditional EFTPOS cards; (b) scheme cards (credit or debit); and (c) contactless scheme cards.
 7. Importantly, consumers and merchants generally do not consider acceptance of those different types of payment strictly as equally acceptable *alternatives* in card present transactions. Instead, they are considered cumulative and complementary. There is a general expectation that all merchants that accept card payments will accept traditional EFTPOS transactions (irrespective of the identity of the card issuer – a matter discussed further below). A subset of those merchants will also accept scheme cards, and a further subset will also accept contactless scheme card payments. In short, from a merchant perspective, S2I acceptance is a “must have” feature and at the core minimum of a card payment offering that a merchant will accept.
 8. As a result, a putative merchant using S2A only services provided by Verifone or PE would also, in the first permutation, be required to carry separate S2I terminals connected to the network provided by the proposed merged entity (assuming it maintains Paymark’s current position as the only switching provider with a virtually complete set of issuer links). The duplication of costs and inconvenience involved in that arrangement would put Verifone and PE at a significant competitive disadvantage vis-à-vis the merged entity, which would be capable of offering a bundled service. Similar duplication issues would arise in respect of attempts to compete in respect of online S2A transactions only: it is inherently unattractive to a merchant to use separate providers for terminal and online payments where a bundled alternative exists. PE considers that there is no sufficient group of merchants willing to do that, and for the reasons of ubiquity discussed above, similarly no such group willing simply to refuse EFTPOS, while accepting scheme payments.
 9. Second, scheme only cards are not direct alternatives to cards with traditional EFTPOS functionality. EFTPOS cards are generally issued to all bank customers without additional costs. Scheme cards, on the other hand, often carry annual fees, and are therefore not available to a certain subset of consumers. Accordingly, by choosing not to accept S2I payments, merchants would exclude a section of their potential customer base based on their card payment preference. That is not an attractive option for any merchant.
 10. Third, and for completeness, it is noted that unlike S2I transactions (presently at least), S2A switches carry per-transaction/value costs to the merchant through merchant service fees covering scheme fees, interchange fees and the like. Therefore, merchants will on the pure transaction cost dimension, have an incentive to steer customers to EFTPOS rather than scheme transactions. The proposition that an S2A only service would overcome that position in the near term is difficult to understand.
 11. Banks are in a different position. First, they are, as issuers, able to incentivise the use S2A payment types by offering scheme cards to consumers on favourable terms. Second, it is accepted that they have an incentive to do so, including to earn revenue from credit card balances and various fees.
 12. However, no evidence has been provided to support any suggestion that such steps by banks are driving changes to consumer behaviour (to the detriment of EFTPOS) sufficiently rapidly to offset the anti-competitive effects of the proposed merger. On the contrary, consumers appear

to have been relatively slow to move away from a high degree of reliance on traditional EFTPOS payments. This is reflected in the continuing high prevalence of S2I transactions – currently approximately 70%.¹

Expanding issuer links to bypass Paymark

13. At para 10 of its cross-submissions, Paymark asserts that:

Payment Express... is in a position to invest in switching assets in order to bypass Paymark entirely. To date it has chosen not to do so.

14. PE does not accept this submission.

15. First, PE agrees with Verifone's submission that in order to compete with effectively with Paymark in the S2I sphere, PE would need to establish issuer links with virtually all New Zealand issuers.² This view is supported in the submission of Woolworths New Zealand Limited dated 19 July 2018 which includes the following passage:

[C]ustomers expect retailers to be able to offer them a seamless and frictionless payment experience – one that does not discriminate between issuers.

We doubt any retailer would support a proposition that allows them to (under normal circumstances i.e. not during an outage or adverse event) only accept 88% of transactions.

16. With its ability to switch direct to scheme operators in S2A transactions, PE estimates that it would require *at least* 9 direct issuer links in order to support a service offering independently of Paymark capable of processing approximately 99% of S2I transactions.
17. However, significant uncertainties regarding the viability of such a service remain, even if such a level over link building could be achieved in reasonable time. Even with 99% coverage, a number of payment cards would remain unsupported by the service. This may be unacceptable to merchants whose customers (as Woolworths notes) expect ubiquity in terms of EFTPOS acceptance. In that case, PE considers that it is likely that a further five links would be required in order to provide a service acceptable to merchants.
18. Second, PE rejects the suggestion that it has "*chosen*" not to expand its direct issuer links. On the contrary, PE has engaged constructively with a number of issuers. However, it has faced, and continues to face, significant challenges in establishing links.

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¹ Lol, para 18. More detail that is not repeated here can be found in the MBIE Issues Paper on Retail Payment Systems (<http://www.mbie.govt.nz/info-services/business/competition-policy/retail-payment-systems/issues-paper/retail-payment-systems-issues-paper.pdf>).

² Ingenico/Paymark: Response on behalf of Verifone to cross-submissions by Ingenico, Paymark, and the Vendor Banks on the Commission's Statement of Preliminary Issues dated 21 June 2018, para 21(a).

(a)

(b)

(c)

(d)

(e)

(f)

(g)

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(a)

(b)

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The merged entity has the ability and incentive to foreclose rivals, including PE

23. As a result of the combination of the commercial necessity to offer ubiquitous S2I payment services and the challenges facing PE in establishing sufficient direct issuer links to compete directly with Paymark in that sphere, PE's only option to compete in the terminal and switching markets is by accessing Paymark's S2I network. This is currently done indirectly through Verifone.
24. A merged entity will have significant opportunities to further limit PE's ability to effectively compete in this way, including by:
 - (a)
 - (b) raising fees payable under the Paymark/Verifone wholesale and aggregation agreements;
 - (c) degrading the quality of services provided under the Paymark/Verifone wholesale and aggregation agreements; and
 - (d) requiring merchants to use Ingenico terminals if the wish to use Paymark switching services (or providing significant incentives to do so).
25. There is nothing to suggest that these options are not all available to the proposed merged entity. In addition, there are incentives to do so, as discussed at para 66 of the Lol. These incentives are unmitigated in the current market environment, due to Paymark's monopoly position in respect of ubiquitous S2I switching, as noted at paras 66.2.1-2 of the Lol.
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27. The merged entity's ability, and incentives, to foreclose rivals by any of the means discussed above would be mitigated if competitors were guaranteed access to Paymark's switch on standard and non-discriminatory terms. Comparable systems overseas offer standard access terms. By way of example, in Australia, the Paymark equivalent, eftpos Payments Australia Limited, offers access to its S2I switch to members of the "eftpos Payments Systems". Membership is granted to all applicants who comply with standard conditions. A similar system is operated in Canada under the name "Interac".
28. However, no access guarantee exists in New Zealand.

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31. Please do not hesitate to contact us if you wish to discuss any aspect of this submission further with us or our client's representatives.

Yours faithfully

[sgd:Tim Mullins/Daniel Nilsson]

Tim Mullins / Daniel Nilsson
Partner / Associate

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