PAYMARK – CROSS SUBMISSION ON ISSUES RAISED IN SUBMISSIONS ON THE COMMISSION'S 23 APRIL 2018 STATEMENT OF PRELIMINARY ISSUES

1 We refer to the submissions received by the Commerce Commission in response to its Statement of Preliminary Issues. In this cross-submission Paymark wishes to comment on key themes regarding Paymark's ability to foreclose terminal providers from its switching services (whether by refusing access to its switch or increasing the price or difficulty of access). Corrections to and comments on the specific points made in the submissions are set out in the Appendix.

Verifone would prevent Paymark being able to foreclose terminal rivals

2 Paymark considers that it does not have the market power necessary to be in a position to foreclose terminal providers in relation to its switching services. If it sought to do so, those terminal providers could use Verifone.

3 Verifone is in a position to act as a full service competitor to Paymark, now and in the future. First, it has a credible bypass option and as such is able to extract competitive terms from Paymark in order to compete effectively using Paymark's assets. Secondly, its bypass option of course means it could readily alter its strategy to compete using its own assets.

4 Paymark's commercial dealings with Verifone, including in the context of the wholesale and aggregation agreements, are premised on, and reflect, both parties' view that Verifone has a credible bypass alternative, in other words that Verifone could relatively quickly and cheaply build out links to issuing banks. As a result, the commercial terms of their relationship are and can be expected to remain such that Verifone is able to compete vigorously without actually exercising its bypass alternative. [

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5 If for some reason that changed, it is Paymark's view (and operating assumption) that Verifone could exercise its bypass option and would be in a position to continue to exercise a material competitive constraint on Paymark, but on a standalone basis.

6 If Verifone did decide to exercise its bypass option because of a worsening of terms between it and Paymark (or for any other reason), Paymark expects that could occur relatively quickly. In circumstances where Verifone were exercising its option because of a perceived worsening of terms or service quality by Paymark, issuing banks would likely facilitate the process. That is because card-issuing banks wish to keep their own transaction costs down and ensure their merchants have access to compliant solutions and a reliable switch that are fit for purpose for their businesses.

Banks would continue to have the ability and incentive to constrain Paymark

7 In Paymark's view, the acquiring banks have the incentive and ability to prevent Paymark from foreclosing terminal providers. The acquiring banks have an incentive to ensure the electronic payments industry remains attractive for merchants and fit for their merchants' purpose; in other words, they have an incentive to ensure that Paymark allows competitive payment solutions. Since those banks are the key constituents of any switch, they have bargaining power to use to influence Paymark's conduct.

8 In Paymark's experience, the banks genuinely seek to ensure they are able to support payment solutions for their merchants that are fit for their merchants' purpose. The origin of Paymark's aggregation model is in part an example of this in

action. Before the aggregation model existed, certain innovative terminal solutions (such as Payclip, BNZ's Payclip device and certain Verifone terminals) did not meet Paymark's full specification and therefore could not connect to the Paymark switch. The acquiring banks, as key customers of Paymark, wanted to be able to offer those terminal solutions to their merchants. Paymark considered it needed to respond to the banks' wishes and did so by developing the aggregation model, which allows terminal solutions to connect to its switch on meeting certain minimum standards (and taking on some additional transaction risks). This model has allowed Paymark to facilitate the innovative terminal solutions sought by the acquiring banks.

9 Also consistent with this incentive, [

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Payment Express and terminal alternatives also constrain Paymark

10 It is worth noting that Payment Express, in addition to Verifone, is in a position to invest in switching assets in order to bypass Paymark entirely. To date it has chosen not to do so, presumably because market conditions do not provide an incentive. However, Paymark understands Payment Express has commenced building links to smaller issuers, so this position may be changing.

11 Separately, there are increasing numbers and variety of payment solutions that do not require access to any conventional switching services. Paymark expects this to increase, further reinforcing the availability of terminal alternatives to Paymark's switch.

APPENDIX: COMMENTS ON SUBMISSIONS

Verifone's submission

31. *We understand that DPS Payment Express approached Paymark to attempt to negotiate an aggregation agreement (similar to our agreement with Paymark), to enable DPS Payment Express to provide services to those merchants. Paymark refused.*

12 Paymark has not refused to negotiate with Payment Express.

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41. *In our view, the cost to either a new entrant or an existing participant of building a complete connectivity network would be prohibitive, making such entry or expansion extremely unlikely:*

(a) *we estimate that it would cost from $500,000 to $1 million to build each bilateral link required;*

14 The cost of building links would not, as Verifone claims, be prohibitive. Further, as the Commission is aware, Verifone's estimated costs of building links to issuers at paragraph 41 of its submission is inconsistent with its previously stated views.

15 As the Commission is aware, for Verifone, bypassing Paymark completely would not involve building a switch but only re-directing the existing ANZ issuer links, which would involve technical configuration changes at both ends. [

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45. *The clearance application overstates the ability of the banks to constrain Paymark. As the Commission states in its* Merger and Acquisitions Guidelines, *a customer's size and commercial importance is not sufficient in itself to amount to countervailing power.*

16 The banks are able to build out links and divert to another switch. Paymark considers that the acquiring banks would be likely to do so if prices were to increase beyond a competitive level. If they were motivated to enable Paymark to be bypassed in this way, the banks could contribute to the cost of the links and help ensure issuer links could be built to Verifone relatively quickly either by re-directing the old ANZ links to Verifone or building new links.

17 [

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59. *Paymark is already in a position to influence competition in the terminal markets. For example, one potential terminal provider, Adyen, was recently unable to enter the terminal markets in New Zealand, because it could not get access to Paymark's switch to process S2I transactions. Because Ingenico is a competitor in the terminal* *markets, the proposed transaction will give Paymark, as part of the merged entity, an incentive to foreclose competition in the terminals markets.*[1]

18 This statement is incorrect. [ ]

19 Verifone would constrain Paymark from preventing terminal providers from connecting to its switch. If Paymark sought to do so, terminal providers could connect to Verifone (for merchants who bank, or are willing to bank, with ANZ) and have their transactions processed using the wholesale agreement with Paymark. As set out above, Verifone is also in a position to bypass Paymark sufficiently quickly and cheaply to constrain Paymark from this type of conduct.

20 Further, Paymark would be reluctant to send any signal (including restricting access to innovative terminal solutions) that might encourage merchants to take up alternative technologies that do not require switching services. The significantly stronger growth in STA volumes relative to STI volumes is a material and present constraint on Paymark.

67. However, the aggregation agreement will not provide any real constraint on the merged entity's ability to manipulate terminal requirements to lessen competition in the terminal markets:

(c) terminals we connect under the aggregation agreement must comply with minimum standards set unilaterally by Paymark. The merged entity could manipulate those requirements in a similar fashion to the terminal specification and certification processes described above.[2]

21 Paymark notes that the minimum standards required for its aggregation model are aimed at ensuring a minimum level of security and technical capability required to connect to the switch. They are international standards, which means that terminal providers participating in payments markets in many other countries are likely to meet, or be readily able to meet, the standards.

22 Furthermore, in the context of establishing a relationship with Paymark the minimum standards are [ ]. As noted above, Paymark's goals with the minimum standards are ensuring a minimum level of security and technical capability and it is primarily concerned to ensure any terminal provider is able to meet those goals.

70. Although we agree that the barriers to entry in the retail terminal markets are low, the barriers to entry in the wholesale terminal market are high. This is the result of the high cost of meeting terminal specifications and obtaining certification, the time it takes to complete those processes, and the ongoing cost of maintaining the hardware and software compliance of deployed solutions (Paymark passes the compliance obligations to the terminal vendors). Those factors limit the timeliness with which new entrants can enter the terminal markets or existing competitors can expand, and create costs that are potentially prohibitive given limited scale in the market. We estimate that:

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[1] PED NZ Ltd and Perception Technologies Ltd also discuss this in their submission at page 1.

[2] PED NZ Ltd and Perception Technologies Ltd raise similar issues in their submission at page 1.

(a) *the cost of developing a new terminal that meets Paymark's specifications would be at least $250,000 to $500,000;*

(b) *obtaining certification from Paymark costs around $50,000, and would take at least 12 months;*

23 There is no horizontal overlap between Paymark and Ingenico in terminals markets, so concentration in those markets would not be altered by the proposed transaction.

24 Regardless, it is important to note that the estimate of $250,000 to $500,000 is the cost of developing a terminal *from scratch* to meet Paymark's specification or any other specification in New Zealand. That cost is not the incremental cost for any existing supplier of terminals, whether internationally or using the Payment Express or Verifone specification in New Zealand, to bring their terminals to the Paymark specification because there would be a certain amount of code that could be re-used.

25 Further, as noted above, Paymark offers its aggregation model as an alternative for terminal providers that would prefer not to use Paymark's terminal specification. Given the link to international standards, the minimum standards are typically similar to those any terminal supplier would need to meet in other countries.

26 For an existing terminal manufacturer to be an aggregator, meeting the "minimum standards" in the contract would cost very little, although if it were not already present in New Zealand it would incur the cost of developing software for the New Zealand market in accordance with one of the specifications (which Paymark estimates to be approximately $200,000).

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75. A large proportion of New Zealand merchants are extremely slow to adopt new technologies, meaning that new entry by emerging payment methods will not be sufficient in extent or sufficiently timely to effectively constrain the merged entity.

28 To the extent New Zealand merchants are perceived to be slow to adopt new technologies, this suggests only that they are well- and cost-effectively served in the current environment.

29 There is nothing to suggest to Paymark that merchants are not willing or able to behave in their own commercial interests; in other words, if switching costs went up or alternative technologies were offered that had benefits for merchants, Paymark would expect merchants to react in their best interests. As the Commission is aware, the Warehouse moved its transaction volumes in response to a solution from Payment Express that the Warehouse perceived as beneficial.

79. We submit that the merged entity will not be constrained by its competitors in the digital payment market:

(a) *many digital payment options require access to Paymark's switch, and the merged entity will be in a position to refuse that access or set terms of access that restrict competition;*

30 It is incorrect that digital payment options require access to Paymark's switch.

31 First, some digital payment options such as PoLi and WeChat bypass conventional switching altogether and do not require access to any switch.

32 Secondly, the options that do utilise conventional switching do so using the STA switching process. Given they do not require STI functionality, they have no need to use Paymark's switch (even via Verifone) and can just as easily switch using Verifone (standalone) or Payment Express. Examples include ApplePay, GooglePay and PayPal.

33 Accordingly, Paymark has no conceivable digital foreclosure strategy available to it.

83. Direct access payment methods will not constrain the merged entity in respect of a very significant portion of the market. Although some merchants might be open to new direct payment options that bypass the need for a switch, a significant portion of merchants will not be willing to use direct access payment options at all. As outlined in paragraph 75, a significant portion of New Zealand merchants are slow to move to new payment technologies. This is particularly the case for bricks and mortar retailers, as opposed to online retailers. In that context, the switching revenue that the merged entity might lose if merchants choose to bypass its switch to avoid a foreclosure strategy is limited.

34 As above, Paymark's view is that merchants are only slow to move to new payment technologies because they have no incentive to move currently. However, if merchants' fees went up, or customers led the take-up of new technology, they could and in all likelihood would take up alternative payment technologies quickly.

Progressive Enterprise's submission

p.2 Paymark presents a high barrier to entry for new payment technologies and payment terminals, all of whom must subscribe to the Paymark specification in order to gain access to the domestic payments network. This specification mandates the rules and conditions that all payment terminal software must build/adhere to and must be certified by Paymark prior to gaining network access.

35 It is not accurate to say that all payment technologies and payment terminals must subscribe to the Paymark specification in order to gain access to the domestic payments network. Paymark offers its aggregation model as an alternative for terminal providers that would prefer not to use Paymark's specification. Paymark considers its incentive to do so would be unchanged by the proposed transaction.

p.2 Each certification round for a new payment device can cost anywhere between $0.25m to $0.50m payable to Paymark and is a lengthy, iterative and time consuming process. The Paymark specification is also subject to change at any time by Paymark simply giving notice to the market of changes to its standards (these changes can also be driven by the payment schemes e.g. Visa, Mastercard etc).

36 Paymark notes that development to any other New Zealand technical specification would cost a similar amount to the cost to meet Paymark's specification.

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p.2 *Paymark's real value also lies in the bilateral access points and linkages it has that provide the plumbing between banks, retailers, acquirers and issuers. These bilateral linkages provide a commercial construct between Paymark and the connecting party (acquirer or issuer). These linkages also constitute the high barrier to entry for new entrants.*[3]

38 As outlined above, Paymark's view is that a third party (particularly Verifone and Payment Express) could quickly and cheaply build links to issuing banks. The cooperation of issuers is not a barrier to building links – if Paymark were to offer worse terms then issuers would be quick to enter into arrangements with Verifone to build links. This would not change as a result of the proposed transaction.

Payment Express' submission

22 *PE has repeatedly sought access to the Paymark switch on the basis that it can switch only those transactions it must route through Paymark, and bypass it for the rest. Paymark has consistently and repeatedly refused to grant access on those terms. That has moved from an outright refusal in past years (PE has been trying to address this since 2011) to now allowing access on the basis of minimum volumes that can only be satisfied by PE passing through all or nearly all of its volume, including that which might otherwise bypass it. The net effect is the same.*

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[3] An anonymous submission received by the Commerce Commission on 7 May 2018 raises similar issues at page 2.