

## **Determination**

### **epay New Zealand Limited and Ezi-Pay Limited & Ors [2012] NZCC 13**

- The Commission:** Dr Mark Berry  
Gowan Pickering  
Dr Stephen Gale
- Summary of application:** The application by epay New Zealand Limited to acquire up to 100% of the assets of Ezi-Pay Limited and/or Compass Communications Limited and/or EFTDATA Holdings Limited; and/or the shares in Ezi-Pay Limited and/or EFTDATA Holdings Limited.
- Determination:** Pursuant to s 66(3)(b) of the Commerce Act 1986, the majority of the Division of the Commission determines to decline to give clearance to the proposed acquisition.
- Date of determination:** 15 June 2012

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

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## Acronyms and abbreviations

2degrees	Two Degrees Mobile Limited
Bill Express	Bill Express Limited
Blackhawk	Blackhawk Network, Inc.
CardCall	Calling card brand of gotalk pty Limited.
Commission	Commerce Commission
Compass	Compass Communications Limited
Contact	Contact Energy Limited
Content provider	Collective term for mobile phone companies, calling card companies, pre-paid electricity providers, gift card owners and digital content companies
Distributor -agent	General term for the role of epay, Ezi-Pay and their competitors
EFTDATA	EFTDATA Holdings Limited
EFTPOS	Electronic funds transfer at point of sale
EFTPOS NZ	EFTPOS New Zealand Limited
epay	epay New Zealand Limited
e-voucher	Electronic voucher
Ezi-Pay	Ezi-Pay Limited
Foodstuffs	Collective term for Foodstuffs (New Zealand) Limited, Foodstuffs Own Brands Limited, Foodstuffs (Auckland) Limited, Foodstuffs (Wellington) Co-operative Society Limited and Foodstuffs South Island Limited
Foodstuffs Auckland	Foodstuffs Auckland Limited
Foodstuffs SI	Foodstuffs South Island Limited
Foodstuffs Wellington	Foodstuffs (Wellington) Co-operative Society Limited
Genesis	Genesis Energy Limited
InComm	InComm, Inc.
IT	Information technology

Kiwibank	Kiwibank Limited
LET test	Test as to whether entry is likely in commercial terms; sufficient in extent to cause market participants to react in a significant manner; and timely, that is, feasible within two years from the point at which market power is first exercised
Majority	The majority of the Division of the Commission that made this determination
Mercury	Mercury Energy Limited
Meridian	Meridian Energy Limited
MNO	Mobile network operator
NFC	Near field communications
NZ Post	New Zealand Post Limited
OECD	Organisation for Economic Co-operation and Development
Optus	SingTel Optus Pty Limited, trading as Optus Communications
para	Paragraph
Paymark	Paymark Limited
POS	Point of sale
Pre-loaded cards	Calling cards in the form of scratch cards (sold in fixed denominations of pre-loaded credit), which do not require activation at POS and cannot be recharged
Pre-paid product	Collective term for pre-paid mobile phone top-ups, calling cards, pre-paid electricity, gift cards, and digital content cards
Progressive	Progressive Enterprises Limited
Recharge	Where a consumer adds credit or value onto a pre-existing magnetic swipe card (eg calling card or gift card)
Retail chain	Retailers that share a brand or central management
Retailers	Supermarkets, fuel stations, dairies, convenience stores, NZ Post and the other retail locations that sell pre-paid products in-store
s	Section
Scratch cards	Pre-paid content cards containing fixed denominations of pre-loaded credit or value. To use, consumers scratch a panel to reveal a PIN.

SLC	Substantial lessening of competition
SmartPay	SmartPay Limited
SSNIP	Small yet significant and non-transitory increase in price
subs	Subsection
Swipe cards	Pre-paid content cards activated and loaded with credit or value at POS which can be recharged
Telecom	Telecom NZ Limited
Telstra	Telstra Corporation Limited
TelstraClear	TelstraClear Limited
the Act	Commerce Act 1986
the majority	The majority of the Division of the Commission that determined this application
The Warehouse	The Warehouse Group Limited
TopUp NZ	TopUp NZ Limited
Touch	Touch Holdings Limited
Vodafone	Vodafone New Zealand Limited
Woolworths	Woolworths Limited, Australian parent company of Progressive



## Executive summary

- X1. On 17 January 2012, epay New Zealand Limited filed a notice under s 66(1) of the Commerce Act 1986 seeking clearance to acquire up to 100% of:
- the assets of Ezi-Pay Limited and/or Compass Communications Limited and/or EFTDATA Holdings Limited; and/or
  - the shares in Ezi-Pay and/or EFTDATA.

### The services provided by epay and Ezi-Pay

- X2. epay and Ezi-Pay act as distributor-agents for various pre-paid products, namely: pre-paid mobile phone credit, calling cards, gift cards, digital content cards and pre-paid electricity credit. The 'pre-paid' products are so labelled because they involve consumers pre-paying or buying credit in advance for certain goods and services.
- X3. Distributor-agents facilitate the sale of a content provider's pre-paid products to consumers (both initial sales and top-ups) through retailers. To achieve this, distributor-agents enter into contracts with content providers (such as mobile phone companies) to obtain content, and then with retailers to be able to distribute that content.

### A substantial lessening of competition and the clearance regime

- X4. The Commission can only give clearance for a proposed acquisition if the Commission is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of a substantial lessening of competition (SLC) in a market. A SLC will be "likely" if there is a real and substantial risk of it occurring.
- X5. The onus is on epay to satisfy the Commission that the Commission can exclude a likely SLC. If the Commission is not so satisfied or is left "in doubt" or is not sure whether a SLC is likely it must decline clearance.
- X6. The SLC assessment is forward looking and compares the likely state of competition if the acquisition proceeds ("the factual") against the likely state of competition if it does not ("the counterfactual").
- X7. A SLC is a lessening of competition that is real or of substance. Competition is the process of rivalry between competitors on price, product and service, and a reduction in any of those dimensions may amount to a SLC. Where the impact of a merger is likely to be on price, as a rule of thumb a price increase of 4% to 5% in the factual compared to the counterfactual may identify proposed mergers that are of concern, although price increases below this level, or which otherwise lead to a reduction in any other dimension of competition (eg, service or quality) may also give rise to concerns.
- X8. Being forward looking, the factual/counterfactual assessment requires the Commission to make a pragmatic and commercial assessment of what is likely to

occur in the future. The question for the Commission is what can be determined now about the likely future.

- X9. For this reason the Commission’s general approach is to examine developments and conduct its competition analysis over a two year period. While in some situations this period is extended, the majority considers the two-year time-frame is appropriate in this case particularly given the dynamic nature of these markets.
- X10. A useful tool in the SLC analysis is market definition. Market definition assists to frame analysis of the competitive constraints acting on the merged entity. In undertaking the competition analysis all relevant constraints on the merged entity are taken into account to assess whether or not a SLC is likely, whether those constraints are within a defined market or outside the defined market.

### **Focus on the “selling side” of distributor-agent relationships**

- X11. Distributor-agents “sell” a service to content providers, namely the ability to distribute the provider’s product through retailers. Distributor-agents charge content providers a commission for this service and also pay retailers a commission for selling the relevant content. Therefore it is possible that epay could exercise market power by increasing commissions charged to content providers or reducing commissions paid to retailers.
- X12. However, in this case because content providers want retailers to stock their products, content providers are likely to react to an anti-competitive (output reducing) reduction in retailer commissions in the same way as they respond to an increase in the commissions they are charged. In other words if content providers can resist an increase in the commissions they are charged, they are also likely to be able to resist an anti-competitive reduction in retailer commissions.
- X13. For that reason, the Commission has focussed on the alternatives available to content providers as buyers of distributor-agent services; if there is no likely SLC in these markets, it is unlikely that a SLC would arise in relation to retailers.

### **Commission satisfied in relation to calling cards, gift cards, digital content and pre-paid electricity markets**

- X14. The majority considers the relevant markets are markets in New Zealand for :
- the distribution and in-store payment processing of pre-paid mobile phone top-ups (**in-store mobile top-up market**);
  - the distribution and in-store payment processing of calling cards (**in-store calling card market**);
  - the third-party distribution and payment processing of gift cards (**third-party gift card market**);
  - the distribution and in-store payment processing of digital content (**in-store digital content market**); and

- the distribution and payment processing of pre-paid electricity (**pre-paid electricity top-up market**).

X15. The Commission is unanimous in being satisfied that the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in the last four of these markets because:

- In relation to the in-store calling card market, the ability of calling card suppliers supplying directly to retailers to expand their sales is likely to be sufficient to constrain epay.
- In relation to the third-party gift card market, while post-acquisition epay would have a large market share, the acquisition itself would lead to only a minor increase in the merged entity's market share (epay currently has only a [ ]% market share).
- In relation to the in-store digital content market, the countervailing power of large digital content providers and some constraint from existing competition is likely to provide sufficient constraint on epay.
- In relation to the pre-paid electricity top-up market, epay will likely be constrained by the widely used range of payment options already on offer ([ ]% of pre-pay electricity payments are made via methods that do not involve distributor-agents).

X16. However, for the reasons summarised below and detailed in the decision, the majority is not satisfied that the acquisition will not have, or would not be likely have the effect of substantially lessening competition in the in-store mobile top-up market.

X17. For reasons explained in his dissenting opinion, Associate Commissioner Pickering is satisfied that the acquisition will not have, or would not be likely to have the effect of substantially lessening competition in the in-store mobile top-up market.

### **The in-store mobile phone top-up market**

X18. In defining the relevant market, the majority assessed whether mobile phone companies would be able to render a small but significant increase in the price of pre-paid commissions unprofitable by switching enough of their demand away from distributor-agents.

X19. A complication in the case of mobile top-ups is that it is consumers – not the mobile phone companies – who decide when, where and how to top-up their mobile phones. It follows that mobile phone companies' ability to switch demand away from distributor-agents is dependent on the mobile phone companies' ability to persuade their customers to use options other than the in-store top-up option.

X20. For the reasons summarised below, the majority considers the in-store mobile top-up market to be the relevant market. This market does not include direct top-up

options provided by mobile phone companies (eg on-line, phone, ATM) or post-pay mobile phone plans.

*Post-pay phones not in the same market*

X21. The majority considers (and the minority agrees) that post-paid mobile phone payments are not in the same market as pre-paid mobile phone top-ups. The evidence indicates it is unlikely that mobile phone companies would be able to, or profitably want to, persuade customers to switch in sufficient amounts from pre-paid to post-paid phones so as to render a price increase by distributor-agents unprofitable.

*Direct top-ups not in the same market*

X22. The majority also considers that direct top-ups are unlikely to be in the same market as in-store mobile top-ups. The minority disagrees.

X23. While the majority acknowledges that a growing number of consumers are choosing to top-up direct today, in-store top-ups remain the predominant method ([ ]%) by which consumers top-up. This pattern is not unique to New Zealand and occurs in other markets around the world of which the Commission is aware.

X24. The evidence gathered by the Commission confirms that there are a variety of reasons why this large group of consumers do not appear to consider direct top-ups to provide a viable substitute for in-store top-ups. Further, the evidence suggests that these consumer preferences are strong – indeed, [ ]].

X25. This evidence suggests that mobile phone companies would only have a limited ability to persuade additional consumers to top-up direct in the face of a price increase from a monopolist distributor-agent.

X26. Nor is the majority convinced that mobile phone companies' would have a materially greater incentive to seek to persuade consumers to top-up direct in the event of a price increase.

X27. The majority considers that mobile phone companies already have a strong incentive to encourage customers to use direct top-up methods and any increase in the commissions charged by distributor-agents would have a negligible incremental impact on this incentive. As a result, the majority considers it unlikely that mobile phone companies could successfully further increase migration to direct top-ups in the face of an increase in commissions.

X28. For these reasons, the majority considers direct top-ups are not a sufficiently close substitute to be in the same market as in-store mobile top-ups.

X29. The majority records that this is its view today. The development of new ways in which customers can directly top-up may well mean that direct top-ups will become a closer substitute over time and exert greater constraint, an issue which is discussed in the competition analysis.

**Competition analysis – mobile phone top-ups**

- X30. The question for the Commission is whether it can be satisfied that there is no likelihood of a SLC.
- X31. The majority has conducted its assessment using the standard two-year period, asking whether it can exclude a real and substantial chance that competition is substantially less than in the counterfactual.
- X32. A focus on counterfactual prices is particularly important in this case given the evidence that commission rates have been declining, a trend that, in the majority’s judgement, will continue. Hence, in this case, the comparison of factual and counterfactual prices is, in essence, a comparison of the likely future rate of change of prices.
- X33. It follows that a SLC may occur in subtle ways; in particular, the merged entity may not decrease prices as quickly in the factual as epay and Ezi-Pay would have done in the counterfactual. In the majority’s view, this is a relevant price increase for the purposes of assessing whether a SLC is likely.

*Will existing contractual provisions constrain the merged entity?*

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 ] This is particularly so given the majority’s views on the likely future growth of direct top-up technologies in three to five years time (which are discussed below).

*Competition between epay and Ezi-Pay*

- X39. epay and Ezi-Pay account for nearly all of the in-store sales of mobile phone top-ups in New Zealand.

- X40. While epay submitted (despite the large market shares) that the price constraint provided by Ezi-Pay is relatively minor, the majority is not satisfied that Ezi-Pay's constraint is relatively minor. The evidence provided by mobile phone companies, and commercial commonsense, suggests that Ezi-Pay and epay are each other's closest competitors. They are certainly regarded by customers and retailers as such. Hence in the majority's view the removal of Ezi-Pay would result in the removal of a substantial constraint on epay.
- X41. It follows that the question is whether sufficient other constraints would remain to prevent a SLC. Those constraints are addressed below.

*Constraint from existing competitors*

- X42. In comparison to epay and Ezi-Pay, the other distributor-agents are small and have limited retailer networks. Based on the evidence received, the majority considers that they are unlikely to expand in a way that would constrain epay over the next two years.

*Constraint from the threat of direct integration*

- X43. Direct integration involves mobile phone companies investing to establish links directly with large retailers such as the supermarket chains, thereby by-passing epay's services altogether.
- X44. The questions for the Commission are:
- Whether the threat of direct integration with large retailers is "credible". This necessarily involves an objective assessment of how likely direct integration is to occur. If objectively, it is not likely, then the threat of direct integration is unlikely to be credible and hence will not constrain epay.
  - If the threat is credible, would the threat of direct integration with large retailers also constrain the merged entity in relation to distribution through smaller retailers?
- X45. In relation to the first question, direct integration requires investment by both mobile phone companies and retailers. Both sides would need to see a return on the investments they make.
- X46. The evidence on the returns from direct integration is mixed: [
- ]
- X47. The majority considers that evidence of past conduct, while not determinative, is relevant to an assessment of what is likely to happen in the future. Direct integration has not occurred in the past (other than in one case) and [
- ]. This is the case even though commissions and volumes were higher in the past than they are today (albeit evidence on historical costs of integration is uncertain). This evidence is particularly

relevant given that the majority is assessing whether the rate of decline in commissions in the factual would be slower than in the counterfactual.

- X48. For these reasons, the majority is not satisfied that the threat of direct integration is sufficiently likely to, in itself, constrain epay post-acquisition. The minority agrees.
- X49. Further, even if the threat of direct integration with some large retailers such as the supermarkets was credible, the majority cannot be satisfied that this would constrain price increases directed towards distribution through other retailers, which are a substantial part of the market.

*Constraint from the threat of new entry*

- X50. The majority consider that there are a number of conditions a new entrant would have to address before entering the market and expanding in a way that would constrain epay. The majority considers that the entry conditions differ for large and small retailers but the main difficulty cited by entrants and other interested parties is that of signing up sufficient retailers to distribute product.
- X51. In relation to large retailers, switching costs appear to be more acute than for smaller retailers, although for smaller retailers an entrant would need to sign up a sufficient number in order to provide a credible alternative for the mobile phone companies.
- X52. In respect of large retailers, there are a small number through which some potential entrants are already distributing other prepaid content. Switching costs for these large retailers and these potential entrants would be lower and hence the majority consider it likely that these entrants could expand their offering to these retailers and begin to supply mobile top-up services. However, the majority is not satisfied that this limited potential entry will be sufficient to constrain epay and further entry would be required by other large retailers or by an entrant targeting smaller retailers.
- X53. In terms of further entry, the majority's view is that the conditions for entry appear onerous, given the size of the market opportunity available, the expectation that the size of the market will decline over time, and that commissions will continue to decline.
- X54. epay suggested that a mobile phone company could sponsor entry (eg by granting exclusive rights) to overcome these conditions of entry. While the majority acknowledge that sponsorship of entry has occurred in other jurisdictions, on the New Zealand evidence before it, the majority does not find that mobile phone companies would likely sponsor such entry.
- X55. Therefore, the majority is not satisfied that new entry is "likely" in terms of the LET test for entry and is therefore not satisfied that new entry will constrain epay post-acquisition.

- X56. Nevertheless, the majority acknowledges that entry is “possible” and considers Touch to be the most plausible new entrant. While the majority is not satisfied that Touch is a “likely” entrant in terms of the LET test for entry, even if it were, the majority is not satisfied that Touch would be able to expand sufficiently within the next two years such that it would provide an effective price constraint.

*Constraint from direct top-ups*

- X57. Despite not being within the relevant market, the threat of increased direct top-ups may nonetheless constrain epy post-acquisition.
- X58. There is no doubt that there is a trend towards direct top-ups, a trend that will likely continue regardless of this acquisition and regardless of the prices charged by distributor-agents. Indeed, based on evidence before the Commission, the majority considers that in-store top-ups are a declining market and that in five to ten years time a significantly greater portion of top-ups may be direct.
- X59. However, the question is whether over the next two years, mobile phone companies would be able to persuade sufficient additional customers to top-up directly so as to ensure that competition is not substantially lessened relative to the counterfactual.
- X60. As explained in the market definition section, the majority ([ ]%) of customers currently prefer to top-up in-store and what limited evidence there is, suggests that [ ]. This suggests mobile phone companies currently have only a limited ability to expand direct top-ups quickly and effectively in response to a price increase.
- X61. While that is the position today, the majority reiterates that it recognises that the ways in which customers can top-up directly are likely to expand in the future as new technologies are developed and uptake increases (eg smart phones, near field communications, direct payment from bank accounts). This may fundamentally change consumers preferred method of top-up, and increase mobile phone companies’ ability to expand direct top-ups in response to a price increase. In short, the market may look very different in five (or even three) years’ time.
- X62. While the majority notes the minority’s confidence in the emergence of new technologies, the majority remains uncertain as to when or if new technologies will cause a sufficient change in consumer preferences, and so mobile phone companies’ ability to influence such preferences. There is a possibility such changes might occur quickly, but the majority is not satisfied at this time that such changes are sufficiently likely to occur within the next two years given the evidence of what is currently happening in the market.
- X63. For these reasons the majority cannot be satisfied that, over the relevant two-year time period, direct top-ups will be sufficient to constrain epy post-acquisition.



*The constraints taken together*

- X64. The majority recognises that while none of the constraints listed above, by itself, may be sufficient to constrain the merged entity post-acquisition, the merged entity could nonetheless be constrained by all of the constraints taken together.
- X65. However, the majority is not satisfied that even taken together, these constraints are sufficient to satisfy it that a SLC is not likely.

*Countervailing power of mobile phone companies*

- X66. While the mobile phone companies are large organisations, size itself does not imply countervailing power. Countervailing power stems from buyers having alternatives to epay, or having other forms of leverage to prevent a price increase.
- X67. For the reasons already explained, the majority is not satisfied that existing competitors, direct integration, new entry or direct top-ups will be sufficient alternatives to prevent a SLC.
- X68. In contrast, what will be removed is the alternative of Ezi-Pay, which is the closest competitor to epay.
- X69. For these reasons the majority is not satisfied that the mobile phone companies would have sufficient countervailing power to prevent a SLC.

*Impact of the claimed efficiencies*

- X70. epay expects to derive some scale efficiencies from the acquisition.
- X71. The Commission considers that efficiencies tend to be most relevant in the context of an authorisation. However, to the extent that efficiencies are relevant under the clearance regime, the majority is not satisfied that the efficiencies claimed would be likely to be sufficient to ensure that competition would not be substantially lessened.

**Commission's decision**

- X72. The majority is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in the in-store calling card, third-party gift card, in-store digital content and pre-paid electricity top-up markets. The minority agrees.
- X73. The majority is not satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in the in-store mobile top-up market. The minority disagrees.
- X74. Therefore, pursuant to s 66(3)(b) of the Commerce Act 1986, the majority of the Division of the Commission determines to decline to give clearance for the proposed acquisition.

## The proposal

1. A notice under s 66(1) of the Commerce Act 1986 (the Act) was registered on 17 January 2012. The Notice sought clearance for epay New Zealand Limited (epay) to acquire up to 100% of:
  - 1.1 the assets of Ezi-Pay Limited (Ezi-Pay) and/or Compass Communications Limited (Compass) and/or EFTDATA Holdings Limited (EFTDATA); and/or
  - 1.2 the shares in Ezi-Pay and/or EFTDATA.

## The decision

2. The majority of the Division of the Commission (the majority) considers that relevant markets for the assessment of this application are markets in New Zealand for the:
  - 2.1 the distribution and in-store payment processing of pre-paid mobile phone top-ups;
  - 2.2 the distribution and in-store payment processing of calling cards;
  - 2.3 the third-party distribution and in-store payment processing of gift cards;
  - 2.4 the distribution and in-store payment processing of digital content; and
  - 2.5 the distribution and payment processing of pre-paid electricity.
3. The majority is not satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in the market in New Zealand for the distribution and in-store payment processing of pre-paid mobile phone top-ups.
4. However, Associate Commissioner Pickering is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in that market. As such, he has dissented from the majority decision (for the reasons set out in his dissenting opinion attached to this determination).
5. The Commission is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in the other four markets.

## Procedure

6. Section 66(3) of the Act requires the Commission to either clear or decline to clear the acquisition referred to in a s 66(1) notice within 10 working days, unless the Commission and the person who gave notice agree to a longer period. An extension of time was agreed between the Commission and epay. Accordingly, a decision on the application was required by 15 June 2012.

## Statutory framework

7. Any person who proposes to acquire assets of a business or shares can apply for clearance of that acquisition under s 66 of the Act.
8. If the Commission is satisfied under s 66(3)(a) of the Act that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market, the Commission must give a clearance for the proposed acquisition.
9. The Court of Appeal in *Port Nelson v Commerce Commission*<sup>1</sup> noted that for something to be “likely” it must be “above the mere possibility but not so high as more likely than not and is best expressed as a real and substantial risk that the stated consequence will happen.”
10. The High Court in *Woolworths & Ors v Commerce Commission* observed that “...a substantial lessening of competition is one that is “real or of substance” as distinct from ephemeral or nominal. Accordingly a substantial lessening of competition occurs if it is likely that there will be a reduction in competition that is real or of substance.”<sup>2</sup> A substantial lessening of competition (SLC) in a significant section of a market, may, according to circumstances, be a SLC in a market.<sup>3</sup> Hence the Commission conducts its analysis across all customers in a market.
11. The High Court in *Woolworths & Ors v Commerce Commission* also explained that where a merged entity can increase prices by 4% to 5% compared to the position absent the merger, this will often identify proposed mergers that are of concern. However, mergers that lead to price increases below this level, or which otherwise lead to a reduction in other dimensions of competition such as range, quality, service may also be of concern.<sup>4</sup>
12. In assessing a SLC under s 27 of the Act the courts have, in certain circumstances, considered efficiencies to be pro-competitive.<sup>5</sup> The courts have not considered the role of efficiencies under the merger clearance regime. The Commission considers that efficiencies tend to be most relevant in the context of an authorisation. But to the extent that efficiencies are relevant under the clearance regime, efficiency gains

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<sup>1</sup> *Port Nelson v Commerce Commission* [1996] 3 NZLR 562-563 (CA).

<sup>2</sup> *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC).

<sup>3</sup> As the Federal Court of Australia noted in *Dandy Power Equipment Pty Ltd & Anor v Mercury Marine Pty Ltd* (1982) 64 FLR 238, 260; 44 ALR 173, 192; ATPR 40-315, 43,888, cited with approval by and as cited by McGechan J in *Commerce Commission v Port Nelson Ltd* (1995) 6 TCLR 406 at 435: “Although the words “substantially lessened in a market” refer generally to a market, it is the degree to which competition has been lessened which is critical, not the proportion of that lessening to the whole of the competition which exists in the total market. Thus a lessening in a significant section of the market, if a substantial lessening of otherwise active competition may, according to circumstances, be a substantial lessening of competition in a market”.

<sup>4</sup> *Woolworths & Ors v Commerce Commission* (HC) above n2 at para 136. *Re Queensland Co-operative Milling Association Ltd (QCMA)*(1978) ATPR 40-012 at 17,245 and 17,246.

<sup>5</sup> *Fisher & Paykel v Commerce Commission*, [1990] 2 NZLR 731, 740. *Commerce Commission v Port Nelson*, (1995) 6 TCLR 406 at 433; *Shell (Petroleum Mining) Company Ltd v Kapuni Gas Contracts Ltd*, (1997) 7 TCLR 463, 531.

of the required magnitude and credibility will very rarely be sufficient to satisfy the Commission that competition would not be substantially lessened.

13. The burden of proof lies with the applicant, to satisfy the Commission on the balance of probabilities that the acquisition is not likely to be a SLC.<sup>6</sup> The decision to grant or refuse a clearance is necessarily to be made on the basis of all the evidence.<sup>7</sup> The Commission will sometimes have before it conflicting evidence from different market participants and must determine what weight to give to the evidence of each party.<sup>8</sup>
14. If the Commission is not satisfied that the proposed acquisition will not have or would not be likely to have the effect of substantially lessening competition in a market or it is left “in doubt” as to whether that is the case, it must decline the application under s 66(3)(b) of the Act.<sup>9</sup> It is open to the Commission to say: “We are not sure and therefore we are not satisfied that there will be no substantial lessening of competition”.<sup>10</sup>

### Analytical framework

15. The Commission’s analytical framework for assessing a SLC in the context of an acquisition is described in the Commission’s Mergers and Acquisitions Guidelines.<sup>11</sup>
16. A useful tool in the Commission’s assessment is determining the affected market or markets. To do this, the Commission identifies the areas of overlap between the acquirer and the target, and then considers what, if any, products and geographic regions, constitute relevant close substitutes from both a customer’s and a supplier’s point of view.<sup>12</sup>
17. The Commission uses a forward-looking analysis to assess whether a SLC is likely. This exercise “requires a comparison of the likely state of competition if the acquisition proceeds (the factual), against the likely state of competition if it does not (the counterfactual).”<sup>13</sup>
18. In framing a suitable counterfactual, the Commission bases its view on a pragmatic and commercial assessment of what is likely to occur in the absence of the proposed acquisition.<sup>14</sup>

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<sup>6</sup> *Commerce Commission v Southern Cross Medical Care Society* (2001) 10 TCLR 269 (CA) at para 7 and *Commerce Commission v Woolworths Ltd* (2008) 8 NZBLC 102,336 (CA) at para 97.

<sup>7</sup> *Commerce Commission v Woolworths Ltd* (CA) above n6 at para 101.

<sup>8</sup> *Brambles New Zealand Ltd v Commerce Commission* (2003) 10 TCLR 868 at para 64.

<sup>9</sup> In *Commerce Commission v Woolworths Ltd* (CA) above n6 at para 98, the Court held that “the existence of a “doubt” corresponds to a failure to exclude a real chance of a substantial lessening of competition”.

<sup>10</sup> In *Commerce Commission v Woolworths Ltd* (CA) above n6 at para 207(a).

<sup>11</sup> *Commerce Commission Mergers and Acquisitions Guidelines* (2004).

<sup>12</sup> The Commission’s approach to defining markets is discussed further in the market definition section at paras 54 to 61 below.

<sup>13</sup> *Commerce Commission v Woolworths Ltd* (CA) above n6 at para 63.

<sup>14</sup> *New Zealand Electricity Market* (Commerce Commission Decision 277, 1996), at p 16.

19. A comparison of the extent of competition in the relevant markets in the factual and counterfactual scenarios enables the Commission to assess the probable extent of the lessening of competition under the proposed acquisition, and whether that contemplated lessening is likely to be substantial.
20. The High Court in *Air New Zealand v Commerce Commission (No.6)*<sup>15</sup> accepted that an absence of market power would suggest there had been no SLC in a market but did not see this as a reason to forgo an analysis of the counterfactual as well as the factual.
21. The Commission's standard time frame for conducting competition analysis in respect of proposed acquisitions is two years.<sup>16</sup> This two year time frame was adopted in *Air New Zealand v Commerce Commission (No.6)*<sup>17</sup> when assessing the LET test for entry and the prospect of a SLC,<sup>18</sup> although the Commission recognises that, in certain cases, a different time frame may be appropriate.<sup>19</sup> As the High Court noted in *Woolworths & Ors v Commerce Commission*,<sup>20</sup> the question is what the Commission can determine now about the likely future.
22. The timeframe for analysis has been particularly relevant when assessing the impact of the proposed acquisition, given the potential for further developments in technology to increase the constraints provided by direct pre-paid mobile phone top-ups. However, in assessing the extent to which competition will be substantially lessened in this instance, the majority sees no reason to depart from the standard two year time frame for its competition analysis.

## Industry background

23. ePay and Ezi-Pay act as distributor or agent<sup>21</sup> for a range of pre-paid products. The products are 'pre-paid' because they involve consumers pre-paying (or buying credit in advance) for certain goods and services.<sup>22</sup>
24. ePay and Ezi-Pay facilitate the sale of pre-paid products 'over the counter' in retailers throughout New Zealand. For a commission<sup>23</sup> ePay and Ezi-Pay dispense PINs, activate products and initiate payments in retailers for a range of pre-paid products.

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<sup>15</sup> *Air New Zealand v Commerce Commission (No.6)* (2004) 11 TCLR 347. Justice Rodney Hansen stated at para 42 that "...a comparative judgment is implied by the statutory test which now focuses on a possible change along the spectrum of market power rather than on whether or not a particular position on that spectrum, that is, dominance has been attained."

<sup>16</sup> Merger and Acquisitions Guidelines, above n11 at p 13.

<sup>17</sup> *Air New Zealand v Commerce Commission (No 6)* above n15.

<sup>18</sup> A longer period was adopted by all parties for assessing benefits and detriments under the public benefit test required by the authorisation regime.

<sup>19</sup> In *Commerce Commission v New Zealand Bus Limited* (2006) 11 TCLR 679 Miller J adopted a three year time frame to examine the likelihood of entry, see para 155.

<sup>20</sup> *Woolworths & Ors v Commerce Commission* (HC) above n2.

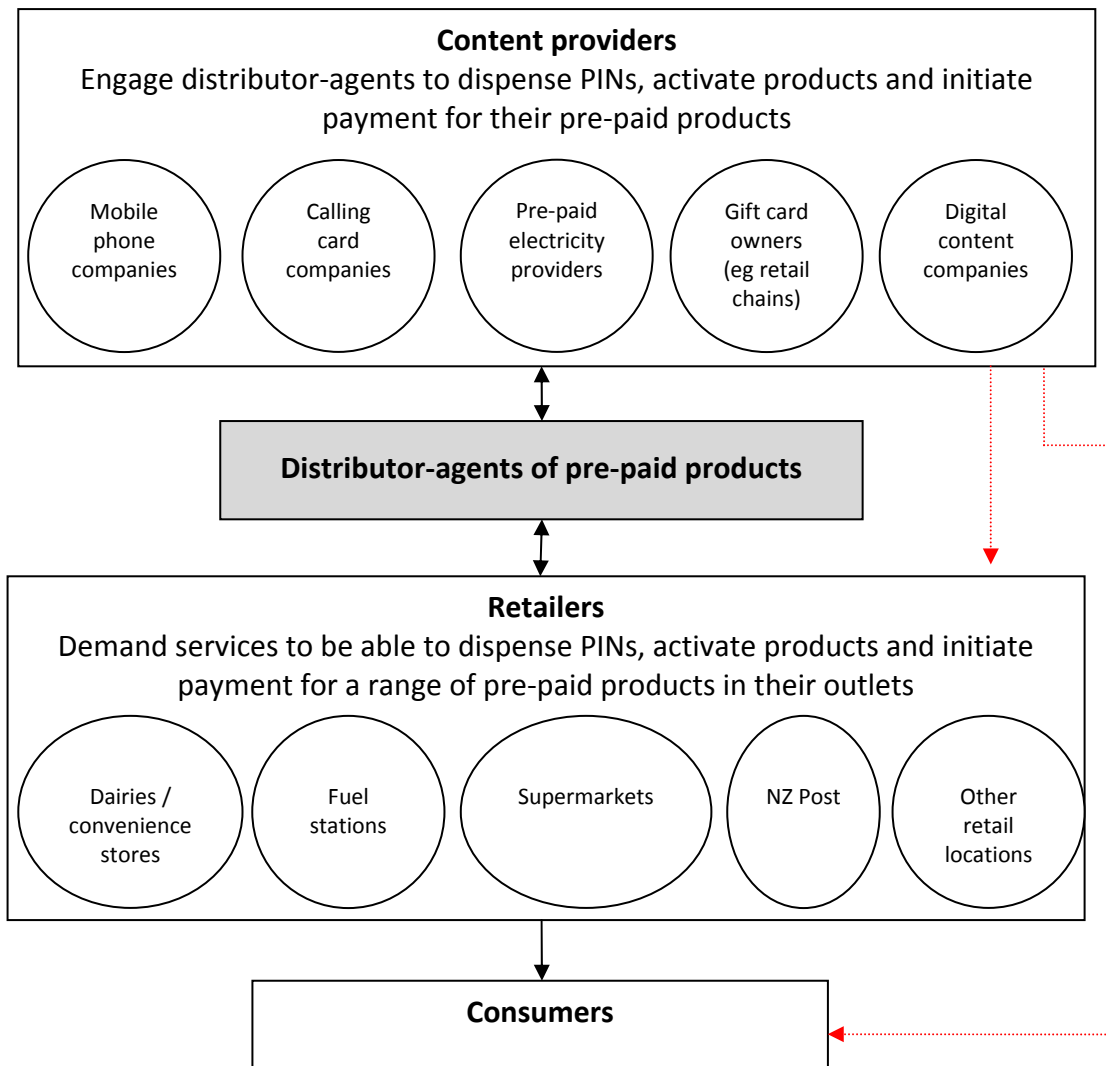
<sup>21</sup> In its application for clearance, ePay uses a generic term of distributor-agent, which is used hereafter.

<sup>22</sup> The opposite of pre-paid (or pre-pay) where consumers buy credit before use is post-paid (or post-pay) where the consumer is billed after use, usually on a monthly basis.

<sup>23</sup> [ ]

- 25. The pre-paid products for which ePay and Ezi-Pay act as distributor-agent are:
  - 25.1 pre-paid mobile phones;
  - 25.2 calling cards;
  - 25.3 pre-paid electricity;
  - 25.4 gift cards; and
  - 25.5 digital content cards (eg for computer software, music and games).
- 26. ePay and Ezi-Pay – along with other distributor-agents – separately contract with both content providers and retailers. Figure 1 below provides a high-level overview of the structure of the industry in which ePay and Ezi-Pay operate.<sup>24</sup>

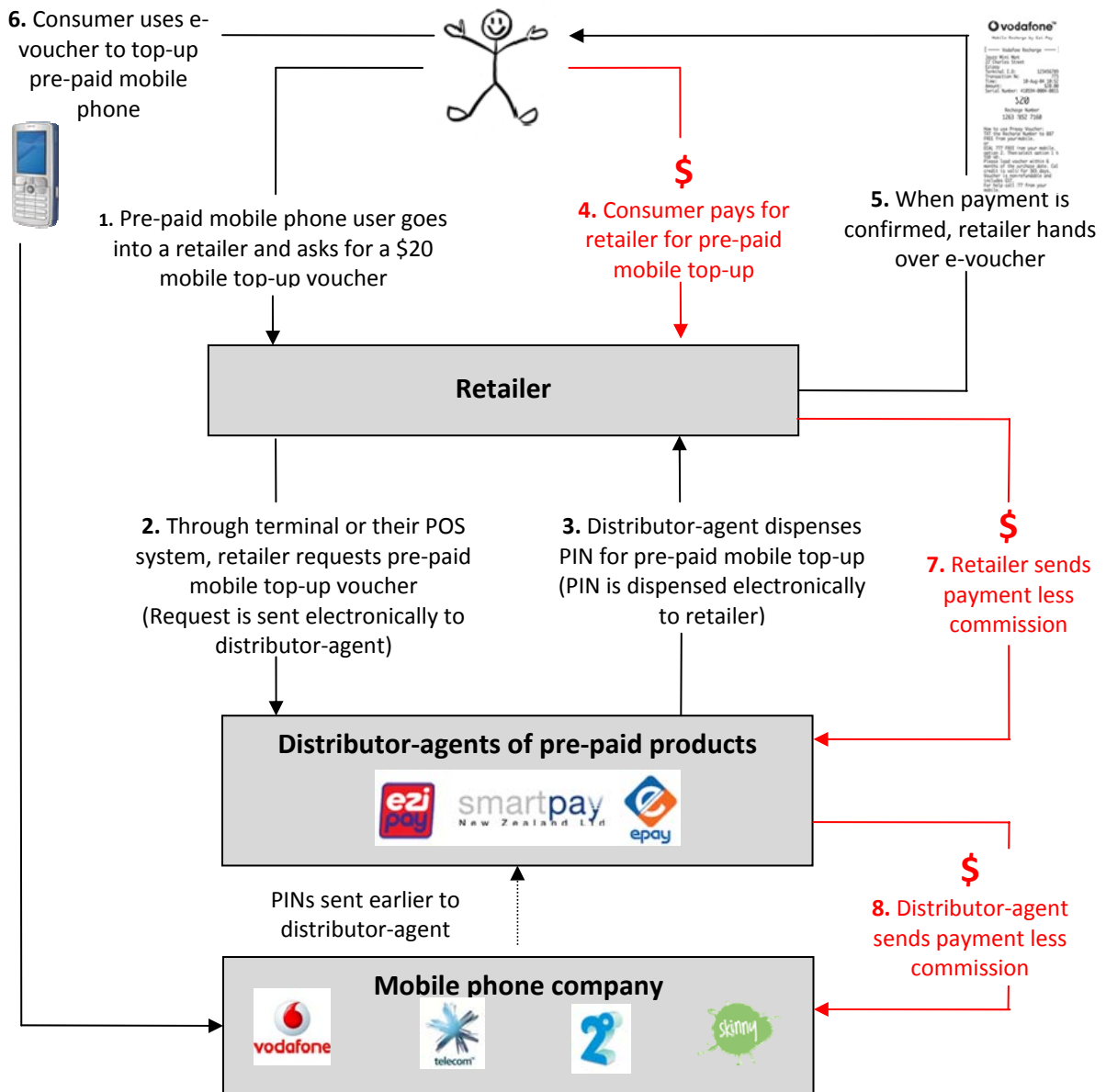
**Figure 1: High-level industry structure**



<sup>24</sup> The dotted red lines in Figures 1 and 5 are included to highlight the fact that content providers in some instances by-pass distributor-agents and supply pre-paid content directly to retailers and consumers.

27. Pre-paid mobile phone top-ups, calling cards and pre-paid electricity are the pre-paid products that consumers purchase most often. The retailers that consumers visit most frequently represent a large portion of the transactions for pre-paid products (both in volume and by value).
28. There are several ways in which retailers can connect with a distributor-agent. In the case of larger retail chains (eg supermarkets), epay and Ezi-Pay are directly integrated into their point of sale (POS) system. Smaller retailers will connect with a distributor-agent in one of the following ways:
  - 28.1 by using a stand-alone terminal supplied by a distributor-agent;
  - 28.2 by renting a combined EFTPOS and pre-paid products terminal from a distributor-agent; or
  - 28.3 having software downloaded onto an existing EFTPOS terminal not supplied by a distributor-agent.
29. When consumers purchase a pre-paid product through a retailer, they may be issued with:
  - 29.1 An electronic voucher (e-voucher), which is a paper receipt printed out by the retailer. E-vouchers are used predominately for pre-paid mobile phone top-ups. Printed on the e-voucher is a unique PIN that the consumer can then use to load the credit he or she has purchased onto his or her mobile phone
  - 29.2 A plastic magnetic swipe card, which are used for calling cards, gift cards and digital content cards. The cards are activated at the time of purchase and loaded with credit or value. In contrast to e-vouchers, additional credit or value can be added to the swipe cards on an ongoing basis (ie they can be recharged).
  - 29.3 Less commonly, a scratch card.
30. epay and Ezi-Pay issue the first two only.
31. The functions performed by a distributor-agent are the back-office processes that support a retailer and that are not visible to consumers. Figure 2 provides an example of the process that occurs when a consumer purchases a pre-paid mobile phone top-up, via a distributor-agent such as epay, through a retailer.

**Figure 2: Process for pre-paid mobile phone top-up**



**Key parties**

**epay**

- 32. epay, the applicant, is a division of Euronet Worldwide Incorporated. epay acts as a distributor-agent of pre-paid product in various countries around the world.
- 33. In New Zealand, epay is involved in dispensing PINs, activating products and initiating payment for a range of pre-paid products. epay conducts pre-paid product transactions at around [ ] retailers across New Zealand. Its retail network includes Progressive Enterprises Limited (Progressive) supermarkets, BP, Caltex, Mobil and Z/Shell service stations and [ ] dairies/convenience stores.
- 34. Through these retailers epay distributes pre-paid products worth \$[ ] per year. Pre-paid mobile phone top-ups are a substantial portion of this \$[ ], accounting



for \$[ ] or [ ]%.<sup>25</sup> Calling cards, gift card, digital content and pre-paid electricity together make up the remaining [ ]%.

### **Ezi-Pay**

35. Ezi-Pay is New Zealand owned and operated. It has the same shareholders as Compass and EFTDATA. The proposed acquisition includes certain assets of Compass and EFTDATA related to the business of Ezi-Pay, and shares in EFTDATA. However, the calling card business of Compass is not part of the proposed acquisition.
36. Ezi-Pay's business is similar to epay's business. Ezi-Pay has a national retail distribution network, with approximately double the number of retailers that epay has. Ezi-Pay's retail network includes Foodstuffs supermarkets, The Warehouse, Paper Plus and [ ] dairies/convenience stores.
37. Ezi-Pay distributes pre-paid products worth \$[ ] per year. Like epay, pre-paid mobile phone top-ups are a substantial portion of the pre-paid products handled by Ezi-Pay – \$[ ] or [ ]%. However, calling cards and gift cards represent a larger proportion of Ezi-Pay's business than they do for epay.

### **Other parties**

#### **SmartPay**

38. SmartPay Limited (SmartPay) provides payment solutions for merchants in New Zealand and Australia. Its main business is the supply of EFTPOS terminals (of which it has in excess of 30,000 across New Zealand). SmartPay runs value added applications across some of those terminals enabling it to supply pre-paid mobile phone top-ups and calling cards. SmartPay's retail network for pre-paid products consists of [ ] dairies, convenience stores and independent fuel stations. Through that network, SmartPay distributes pre-paid products worth \$[ ] per year. Pre-paid mobile phone top-ups are a substantial portion of the pre-paid products handled by SmartPay – \$[ ] or [ ]%. Calling cards are a small part ([ ]%) of SmartPay's pre-paid product business, with it handling sales and recharges worth \$[ ] per annum.

#### **Kiwibank**

39. Kiwibank Limited (Kiwibank) is a subsidiary of New Zealand Post Limited (NZ Post), a state owned enterprise. Within Kiwibank is a division called Payment Services that manages a number of services for Kiwibank and NZ Post. Through Payment Services, Kiwibank supplies pre-paid mobile phone top-ups and calling cards in around 300 NZ Post shops throughout New Zealand. Kiwibank handles around \$[ ] worth of pre-paid mobile phone top-ups per year.
40. Kiwibank also supplies gift cards and digital content cards to retailers in New Zealand through a relationship with Blackhawk Network, Inc. (Blackhawk). Blackhawk supplies Kiwibank with gift cards and digital content cards, [ ]

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<sup>25</sup> Throughout this determination, figures and % are subject to rounding.

] Kiwibank's retail network is currently confined to the 300 NZ Post shops, although it advised that it is soon to have a stand of cards in [ ] stores.<sup>26</sup> In the past year, Kiwibank's sales of Blackhawk gift cards and digital content cards totalled \$[ ].

### TopUp NZ

41. TopUp NZ Limited (TopUp NZ) is a wholly New Zealand owned company and subsidiary of Oceanic Holdings (International) Limited. It is contracted by Telecom NZ Limited (Telecom) to distribute pre-paid mobile phone top-ups and calling cards through Telecom stores. Through Telecom stores, TopUp NZ handles around \$[ ] worth of pre-paid mobile phone top-ups per year. Like SmartPay, calling cards are a much smaller part of TopUp NZ's business, with it handling sales and recharges worth only \$[ ] per year. This is the sole extent of its presence in the provision of pre-paid products in New Zealand.

### Blackhawk

42. Blackhawk is a global provider of pre-paid products, headquartered in the United States. It has experience overseas in providing the full range of pre-paid products, including pre-paid mobile phone top-ups. In New Zealand, its business is currently limited to the supply of gift cards and digital content cards. In the past year, sales of digital content cards have made up around [ ]% of Blackhawk's sales.
43. Blackhawk distributes some cards directly to Woolworths Limited (Woolworths) – the Australian parent company of Progressive and Dick Smith – [ ]. Otherwise, its distribution of pre-paid products in New Zealand is through its relationship with Kiwibank. Blackhawk's sales of gift cards and digital content cards outside of its relationship with Kiwibank are around \$[ ] per year.

### InComm

44. InComm, Inc. (InComm) is another global provider of pre-paid products. Like Blackhawk, it has experience overseas in providing the full range of pre-paid products, including pre-paid mobile phone top-ups. In New Zealand, its business is currently limited to the supply of digital content cards. InComm distributes some cards directly to Woolworths [ ]. Otherwise, its distribution of pre-paid products in New Zealand is through a strategic partnership with Ezi-Pay. Under this partnership Ezi-Pay distributes InComm digital content cards through Ezi-Pay's retail network alongside Ezi-Pay's own range of gift cards. InComm's sales of digital content cards outside of its partnership with Ezi-Pay are around \$[ ] per annum.

### Key issues raised by the application

45. The proposed acquisition merges two distributor-agents of pre-paid products, linking content providers' products with retailers. As indicated in Figure 2 above, distributor-agents charge the content provider a commission (usually on the basis of revenue) for distributing the product and pay retailers a commission (also on the

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<sup>26</sup> [ ]

basis of revenue) for selling that product. The difference between those commissions is essentially the distributor-agent's gross margin.

46. This can be thought of as the distributor-agents *selling* a service to content providers, and *paying* retailers to sell the content providers' products to final consumers.
47. This means that epay would be able to increase its gross margins if it could profitably sustain:
  - 47.1 charging a higher commission to content providers; and/or
  - 47.2 paying a lower commission to retailers.
48. If epay were able to achieve a higher commission from content providers (than it otherwise would be able to do without the merger), then this is a strong indication that there is likely to be a lessening of competition in that market or in other words, an increase in market power.
49. Similarly, reductions in commissions paid to retailers below competitive levels may also be a likely indication of a lessening of competition. A reduction in commissions may result in fewer retailers selling content providers' products, which may in turn reduce output.
50. The majority expects that content providers would likely be resistant to any reduction in output and as such, an assessment of the impact of the acquisition on retailers will necessarily take account of content providers' alternative options. This analysis is much the same as the analysis for the possibility of a lessening of competition by way of an increased commission charged to content providers.
51. In other words, if the acquisition is likely to result in a SLC in relation to commissions charged to content providers, it may also result in a SLC in relation to commissions paid to retailers. Conversely, if the acquisition is unlikely to result in a SLC in relation to commissions charged to content providers, it is unlikely to result in a SLC in relation to commissions paid to retailers.
52. Therefore, the majority's decision focuses on the likelihood of a SLC by way of increased commissions charged to content providers.

### **Market definition**

53. The majority considers the relevant markets for the assessment of this application are markets in New Zealand for:
  - 53.1 the distribution and in-store payment processing of pre-paid mobile phone top-ups (the **in-store mobile top-up market**);
  - 53.2 the distribution and in-store payment processing of calling cards (the **in-store calling card market**);

- 53.3 the third-party distribution and in-store payment processing of gift cards (the **third-party gift card market**);
- 53.4 the distribution and in-store payment processing of digital content (the **in-store digital content market**); and
- 53.5 the distribution and payment processing of pre-paid electricity (the **pre-paid electricity top-up market**).

### Commission's approach to market definition

- 54. The Act defines a market as:<sup>27</sup>

a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them.
- 55. As part of defining the relevant markets, the Commission looks to evidence that serves to identify appropriate markets in accordance with commercial common sense and uses the internationally accepted SSNIP test as an analytical tool to aid the market definition exercise.
- 56. The SSNIP test assesses substitutability by identifying the smallest space within which a hypothetical, profit maximising, sole supplier of a good or service, not constrained by the threat of entry could impose at least a small yet significant and non-transitory increase in price, assuming all other terms of sale remain constant. Under the SSNIP test, the smallest space in which such market power may be exercised is considered to be the relevant market.
- 57. The SSNIP test is generally applied using a hypothetical 5-10% price increase applied over a one year period.
- 58. Applying the SSNIP test in this case means asking: if a hypothetical monopolist of a pre-paid payment network were to impose a 5-10% price increase, would content providers be able to switch, or persuade enough consumers to switch, to alternative payment methods within one year so as to render the price increase unprofitable?
- 59. The SSNIP test usually involves hypothetically increasing the prices of the product in question and keeping the price of other products constant. In this instance, the customer is the content provider, which in some cases cannot simply choose to switch products itself, but must persuade its customers – the final consumers – to pay via other methods.
- 60. Market definition is a tool for competition analysis rather than an end in itself.<sup>28</sup> In *Commerce Commission v New Zealand Bus*,<sup>29</sup> Miller J in the High Court acknowledged the need to recognise constraints from outside the market:

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<sup>27</sup> Section 3(1A) of the Act.

<sup>28</sup> *Brambles New Zealand Limited v Commerce Commission* (2003) 10 TCLR 868 (HC).

<sup>29</sup> *Commerce Commission v New Zealand Bus Limited* above n19 at 123.

Market definition is a tool for competition analysis rather than an end in itself. It is intended to reveal the effective constraints upon a firm's business behaviour. Accordingly, it should focus on the real competition issue in the case, while recognising potential substitutability and constraints from products or services that may fall outside the chosen market definition.

61. It follows that the way in which the market is defined does not determine whether or not the merger substantially lessens competition. The assessment of whether there is a SLC or not is made by assessing the effective constraints on epay, constraints which can come from inside or outside the defined market.

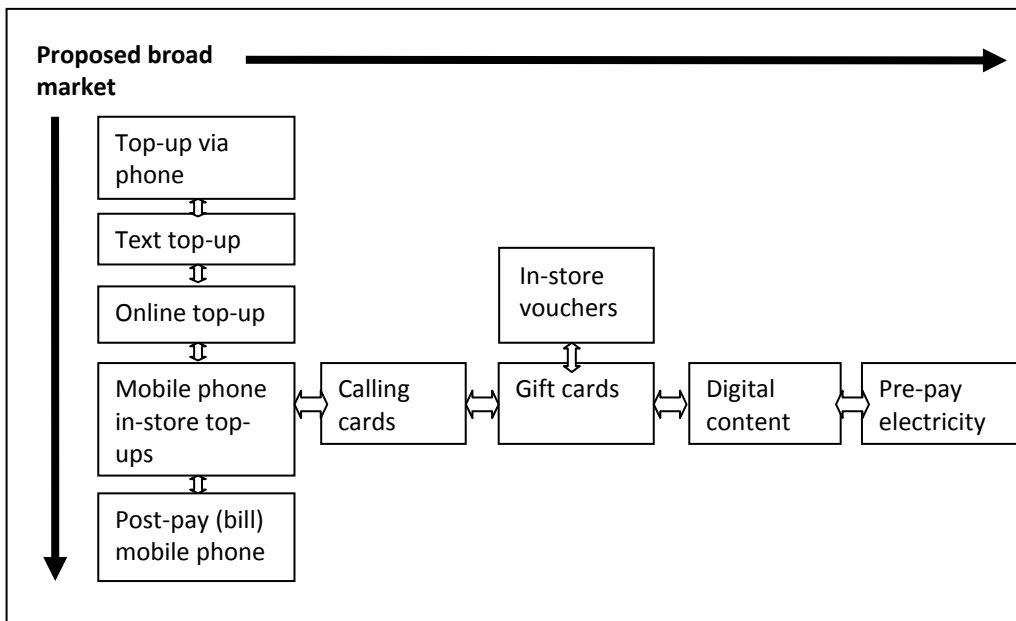
### epay's proposed market definition

62. epay submitted that the market is "the national market for payment processing".<sup>30</sup> epay's proposed market is broad in two senses (Figure 3):

62.1 it includes products with various content; and

62.2 it includes various payment methods for those products.

**Figure 3: Example of the epay's proposed market**



Note: Each product has multiple payment methods – Figure 3 shows options for pre-paid mobile phone top-ups, but other products also have multiple options.

63. The majority does not consider the different pre-paid products to be demand side substitutes such that they should fall in one market. The minority agrees.
64. Nor does the majority consider distributor-agents of the different pre-paid products to be supply-side substitutes such that they should fall into one market. The Commission considers that close substitute products on the supply-side are in the

<sup>30</sup> Application, para 8.1.

relevant market if those suppliers could and would easily shift production with little additional investment.

65. The majority considers it unlikely that distributor-agents for gift cards and digital content would be able to swiftly start supplying mobile phone pre-paid payment processing (and vice versa) without incurring significant costs and at least some time delay. Potential competitors would need to sign contracts and integrate with mobile phone companies before they could enter the market, and would also need to establish a retail network to distribute pre-paid top-ups, perhaps different in scope to their current retail networks.
66. Similarly, if content providers (such as mobile phone companies) were to directly integrate with retailers, the mobile phone companies would need to invest significant resources into doing this.
67. For these reasons the majority consider that the constraints placed upon epay from potential competitors, such as existing distributor-agents for other products, and direct integration, are appropriately considered as forms of potential entry rather than as falling within the same market.
68. Therefore, the Commission has assessed the relevant market for each pre-paid product in the sections which follow.

#### **Mobile top-ups**

69. epay submitted that the in-store pre-paid mobile top-up services provided by epay and Ezi-Pay compete with the direct top-up options provided by mobile phone companies and that defining a market for just the provision of in-store pre-paid mobile phone top-ups would be “overly narrow”.<sup>31</sup>
70. epay also submitted that pre-paid mobile phones compete with post-paid mobile phones, and therefore payment options for post-paid mobile phones should be considered in the same market.<sup>32</sup>

#### *Commission’s previous market definitions*

71. The Commission has not previously considered the relevant market definition for the distribution and in-store payment processing of pre-paid mobile top-ups.<sup>33 34</sup>

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<sup>31</sup> Application, para 8.4 and submission from epay to the Commerce Commission (28 March 2012).

<sup>32</sup> Application, para 8.4.

<sup>33</sup> Under the Commerce Act, the Commission has not analysed mobile markets in any depth. The Commission’s work under the Telecommunications Act 2001 has focussed on wholesale mobile markets rather than retail mobile markets. In any case, the market definition analysis in this instance does not consider the retail markets for mobile phone services.

<sup>34</sup> In support of its submission that top-up options for pre-paid mobile phones were provided in the same market as post-pay mobile phones, epay referred the Commission to decisions from a number of European competition authorities. The Commission assessment of the relevant market is based on the particular facts of each case and market conditions often materially differ between jurisdictions. The market definition discussions in the European decisions shed little light on evidence underlying those

*Are post-pay mobile phone accounts in the relevant market?*

72. epay submitted that globally, “telcos are actively promoting post paid packages to consumers of mobile services who are currently on pre pay” and that the distinction between pre-pay and post-pay is becoming blurred.<sup>35</sup> epay further submitted that “there will be sufficient credit worthy customers that the telco will be able to switch” from pre-pay to post-pay.<sup>36 37</sup>
73. As an initial point, the evidence shows that pre-paid phones continue to be an important part of the mobile market. In the year to 31 March 2011, 65.7% of all mobile phone connections were pre-paid. This figure is down only slightly from the corresponding period five years earlier when 68.2% of all mobile phone connections were pre-paid.<sup>38</sup>
74. However, that majority accepts that, conceivably, if costs to serve pre-paid customers increased sufficiently, and these costs were passed on to consumers (by way of a price increase or a decrease in the breadth/quality of service), then some consumers might switch to post-paid payment methods.
75. However, the majority considers it unlikely that post-paid mobile phone payments are close enough substitutes to put them in the same market as pre-paid mobile phone payments.
76. This is because it appears unlikely that mobile phone companies would be able to, or would not wish to, persuade sufficient numbers of customers to switch from pre-paid to post-paid phones so as to render a price increase by distributor-agents unprofitable.<sup>39</sup> The Commission has been advised of a number of reasons for this:<sup>40</sup>

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definitions and hence it is difficult for the Commission to compare conclusions reached with its own analysis of the evidence in New Zealand.

<sup>35</sup> E-mail from Bell Gully (on behalf of epay) to the Commerce Commission (14 February 2012) and submission from epay to the Commerce Commission (28 March 2012).

<sup>36</sup> Submission from epay to the Commerce Commission (16 May 2012).

<sup>37</sup> While epay accepted that “there may be some customers who would not switch to a post-pay plan for whatever reason”, “there is a large group of customers which would switch to post-pay should telcos give them a small incentive to do so. This would be sufficient to defeat a price rise by a hypothetical monopolist ([ ]).” Submission from epay to the Commerce Commission (28 March 2012).

<sup>38</sup> Commerce Commission “Annual Telecommunications Monitoring Report 2011” (30 April 2012).

<sup>39</sup> [ ] stated that it does not try to move customers from pre-pay to post-pay because of the commissions it pays for in-store pre-paid mobile phone top-ups. [ ]

<sup>40</sup> Similarly the Irish Competition Authority in considering a merger between two distributor-agents for pre-paid mobile phone top-ups has recognised that “a small but significant subsection of end-consumers might not be able to avail of post-paid accounts for any number of reasons, including but not limited to, failing to meet the account opening criteria of the mobile phone operators”. *Alphyra Ireland Limited and Eason Electronic Limited* (Irish Competition Authority Decision M/05/028, 2005), para 18.

- 76.1 Customers under 18 cannot usually sign-up to a post-pay account.<sup>41</sup> [ ] estimates that [ ]% of its pre-pay customers are under 18.<sup>42 43</sup>
- 76.2 Consumers have a preference to control their spending spend.<sup>44 45</sup>
- 76.3 Poor credit history. The mobile phone companies would not want to have customers switch to post-pay, as the increased cost of pre-pay (in terms of commissions on top-ups) would still be outweighed by the cost of servicing these customers through post-pay (eg collecting bad debts).<sup>46</sup>
77. Vodafone submitted that:<sup>47</sup>
- [ ]
- [ ]
78. The majority accept that it is possible that in the face of a price increase for the distribution and in-store payment processing of pre-paid mobile phone top-ups, mobile phone companies could begin to offer lower-cost post-pay plans or other inducements, including “one-offs”, to entice lower frequency users away from pre-pay. However, this is not something which mobile phone companies have done to date and if mobile phone companies were to do so, they would have to take account of the lost revenue from current post-pay users who may switch to any new lower cost post-pay plan.
79. Further, commissions paid by mobile phone companies to distributor-agents are only a moderate component of the total top-up cost for final consumers, [ ]. Should a hypothetical monopoly distributor-agent seek to increase its price to mobile phone companies by 5-10%, and this price increase was passed on to consumers, this would result in a much smaller [ ] price increase to consumers.
80. Therefore, even if mobile phone companies faced a price increase, unless final consumers were extremely sensitive to very small changes in the price of pre-paid phone services and enough consumers considered post-pay mobile phone to be a close substitute for pre-paid phone services, mobile phone companies would be

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<sup>41</sup> [ ] submitted it “will not sign up persons under the age of 18 to PostPay accounts, as [ ] cannot enforce such contracts”. [ ]

<sup>42</sup> [ ]

<sup>43</sup> New Zealand’s 2006 census results revealed that 27% of the population were less than 18 years of age and 9% between the ages of 13 and 18.

<sup>44</sup> [ ] submitted that “some customers prefer Prepay regardless of whether they would derive more value from being on a Post Pay plan”. [ ]

<sup>45</sup> Vodafone advised that [ ]

[ ]. E-mail from Vodafone to the Commerce Commission (23 February 2012).

<sup>46</sup> [ ] has submitted that it “will not migrate those with a poor credit history to post pay accounts”. [ ]

<sup>47</sup> Submission from Vodafone to the Commerce Commission (15 February 2012).



unable to convince sufficient of their customers to switch from pre-paid to post-pay plans to render the price increase unprofitable.

81. The majority considers this unlikely given the evidence discussed next which indicates that [ ]
82. Therefore, for the reasons outlined above, the majority considers the market does not include payment methods for post-paid mobile phones.

*Top-up of pre-paid mobile phones*

83. epay submitted that, in order to reduce costs, mobile phone companies have the incentive to bypass distributor-agents like epay and have pre-paid mobile phone customers top-up directly with their mobile phone provider.<sup>48</sup> epay submitted that it would be constrained because “there is a large group of customers which would switch to direct top-up if telcos gave them a small incentive to do so”.<sup>49</sup>
84. Ezi-Pay similarly submitted that direct top-ups are a close substitute for in-store top-ups and that there is a strong global trend towards online bill payments, including for pre-pay mobile phone top-ups.<sup>50</sup>
85. Since mobile phone companies are the customers of concern, it is the mobile phone companies’ ability to persuade their customers (consumers) to switch that determines whether top-ups are in the same market.

Options for topping up a pre-paid mobile phone

86. For pre-paid mobile phones, consumers can top-up their mobile phone credit:
- 86.1 in a retailer, including dairies, supermarkets, petrol stations and mobile phone companies’ own stores;
- 86.2 direct with a phone company using a credit card or debit card either by phone, text or online; and/or
- 86.3 by various other methods including from selected ATM machines or selected internet banking services.<sup>51</sup>
87. The majority of top-ups are consumers topping up in-store. Table 1 shows the proportion of pre-pay mobile phone top-ups for the different top-up methods over the last five years.

**Table 1: Shares of pre-paid top-ups by payment method (value in \$millions)**

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<sup>48</sup> Application, para 8.8.

<sup>49</sup> Submission from epay to the Commerce Commission (28 March 2012). In support of its submission, epay advised that, [ ]

<sup>50</sup> E-mail from Simpson Grierson (on behalf of Ezi-Pay) to the Commerce Commission (18 April 2012).

<sup>51</sup> [ ]

] ]

	2007		2008		2009		2010		2011	
	\$	%	\$	%	\$	%	\$	%	\$	%
In-store	\$[ ]	[ ]%	\$[ ]	[ ]%	\$[ ]	[ ]%	\$[ ]	[ ]%	\$[ ]	[ ]%
Not in-store										
- credit or debit card	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%
- other <sup>52</sup>	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%
Total	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%
<b>Total</b>	<b>\$[ ]</b>	<b>100%</b>	<b>\$[ ]</b>	<b>100%</b>	<b>\$[ ]</b>	<b>100%</b>	<b>\$[ ]</b>	<b>100%</b>	<b>\$[ ]</b>	<b>100%</b>

Source: Vodafone, Telecom and 2degrees.

88. Table 1 indicates that total expenditure on pre-paid mobile phone top-ups has [ ] over the last five years. It also shows that the value and total share of top-ups made direct to mobile phone companies has increased [ ] over the same period. The value of top-ups purchased direct and by other mechanisms has [ ], with most of that growth occurring in the last two years, since the entry of Two Degrees Mobile Limited (2degrees).

Impact of price increase on mobile phone companies' incentives to persuade consumers to top-up direct

89. While direct top-ups are increasing, the question is whether mobile phone companies would be able to increase the rate of growth in response to a price increase by a hypothetical monopolist distributor-agent.
90. Direct top-ups are a significantly lower cost for mobile phone companies as compared to in-store top-ups.<sup>53</sup> Vodafone already pays total commissions for in-store top-ups that are [ ] times greater than the cost it faces for direct top-ups.<sup>54</sup> Despite this, only [ ]% of Vodafone's demand is for direct top-ups. [ ] For this reason, mobile phone companies are currently putting significant effort into persuading consumers to switch to top-up directly.
91. A SSNIP of 5% , has the following relative impact:

**Figure 4: Impact of 5% price increase on mobile phone companies' incentives to persuade consumers to top-up direct**

[ ]

Note: We assume an average of [ ]% for credit card transactions. We assume [ ]% commission for in-store pre-paid mobile phone top-ups.

<sup>52</sup> This includes online banking and via ATMs.

<sup>53</sup> [ ] has advised that the marginal cost faced by a mobile phone company when consumers top-up directly is only the fee for transacting the credit card payment – approximately 1.6% to 2.4%, depending on the credit card – as compared to the approximate [ ]% commission for in-store pre-paid mobile phone top-ups. [ ]

<sup>54</sup> Vodafone currently pays commission of [ ]% to epay and Ezi-Pay and we assume an average of [ ]% for credit card transactions so that the percentage difference is [ ]% [ ].

92. That is, rather than an in-store price that is [ ] times greater than price of direct top-up, with a 5% SSNIP the price is [ ] times greater. The incremental incentive to promote direct top-ups this creates is discussed further below.
93. In terms of the mobile phone companies incentives, epay submitted that “the fact telcos are already spending resources to promote direct sales reveals that is a profitable strategy – or else they would cease doing so”<sup>55</sup> and that once a pre-paid mobile phone customer has switched to topping up direct, they are “unlikely to revert to topping up via voucher”.<sup>56</sup>
94. While the majority accept that mobile phone companies have an incentive to persuade consumers to top-up direct, to the extent that epay has submitted that further promotion would necessarily be profitable in face of a price increase in the factual compared to the counterfactual, the evidence collected from mobile phone companies does not support epay’s submission.
95. For instance, Vodafone has recently run promotions that provide customers with bonuses for topping up directly, regardless of the method the customer normally uses to top-up. Vodafone provided the following details:<sup>57</sup>
- [
- ]
96. The majority consider it is unlikely that such direct top-up bonuses would be sustainable for Vodafone on a long-term basis because:
- 96.1 The cost to Vodafone is likely to be large since the bonus paid for topping up directly ([ ]) is applied to all customers topping up direct, regardless of whether they were previously topping up direct or not.
- 96.2 Conversely, any savings arise only as a result of the lower transaction costs incurred for the additional customers that top-up direct rather than in-store. While those savings would be larger if customers continued to top-up direct once promotions end, [ ].
97. In contrast to Vodafone, Telecom has not run any specific promotions solely around direct top-ups. Telecom has been running a “top up and win” promotion where after topping-up their mobile phone, customers are prompted (by a text message) to go online and enter a daily prize draw. Telecom advised that the promotion [

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<sup>55</sup> Submission from epay to the Commerce Commission (16 May 2012).

<sup>56</sup> Ibid.

<sup>57</sup> E-mail from Vodafone to Commerce Commission (26 March 2012).

].<sup>58 59</sup>

98. These promotions were applied across all customers regardless of their method of top-up. epay submitted that “it is not the case that all existing customers using direct top-up need to benefit from a promotion designed to shift new customers to direct top-up”; promotions and incentives could be directed at only customers not already topping up direct.<sup>60</sup> The Commission put this to the mobile phone companies for comment.
99. All three mobile phone companies advised that, under the Unsolicited Electronic Messages Act 2007, they cannot e-mail or text customers marketing or promotion material unless customers opt to receive such communications, so this limits the pool of customers with whom they can directly communicate. Where customers do consent to receive such communications:
- 99.1 2degrees advised the Commission that it [ ]<sup>61</sup>
- 99.2 Vodafone similarly advised that it [ ]<sup>62</sup>
- 99.3 Telecom advised that [ ]<sup>63</sup> [ ]<sup>64</sup>
100. In the majority’s view, this evidence suggests that mobile phone companies have limited ability to persuade consumers to switch to direct top-up methods.

Are customers likely to switch to topping-up direct?

101. While the majority acknowledges that a substantial proportion of customers have switched to topping up directly, the majority of customers still continue to top-up in-store.
102. Further:

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<sup>58</sup> Commerce Commission interview with Telecom (19 March 2012).

<sup>59</sup> [ ] In terms of the impact of the promotion on the number of customers topping-up online, Telecom advised it [ ]

[ ] Commerce Commission interview with Telecom (19 March 2012).

<sup>60</sup> Submission from epay to the Commerce Commission (16 May 2012).

<sup>61</sup> E-mail from 2degrees to Commerce Commission (23 May 2012).

<sup>62</sup> E-mail from Vodafone to Commerce Commission (21 May 2012).

<sup>63</sup> E-mail from Telecom to Commerce Commission (21 May 2012).

<sup>64</sup> Ibid.

102.1 2degrees [

].<sup>65</sup>

102.2 Vodafone submitted that [

].<sup>66</sup>

102.3 Telecom noted:<sup>67</sup>

[

]

103. The Commission has been advised of a number of reasons why many customers prefer to top-up in-store, including:

103.1 Lack of access to credit cards, whether due to age, credit history or income.<sup>68</sup>

103.2 Reluctance to enter credit card details into the phone or online.<sup>69</sup>

103.3 Habit of topping up in-store and the expense and difficulty associated with promoting other forms of payments to change those habits.

103.4 Only certain banks being linked directly with mobile phone companies for ATM and internet banking transactions.<sup>70</sup>

103.5 Reluctance to register pre-pay phone number and personal details with mobile phone companies. To pay via internet banking customers would need to register their details with their phone companies.<sup>71</sup>

104. These factors serve to limit the set of pre-paid customers that may switch to topping up directly. In this respect international comparisons from Vodafone show that in the countries within which it operates, the lowest proportion of pre-pay customers

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<sup>65</sup> Commerce Commission interview with 2degrees (10 February 2012).

<sup>66</sup> Submission from Vodafone to the Commerce Commission (15 February 2012).

<sup>67</sup> Commerce Commission interview with Telecom (9 February 2012).

<sup>68</sup> The Irish Competition Authority in *Alphyra* above n40 similarly recognised that there were a group of customers that were limited to purchasing pre-paid mobile phone top-ups in-store with cash as they did not have credit or debit cards.

<sup>69</sup> Telecom advised that "market research conducted in 2010 indicated at the time that more than 40% of consumers would not top-up online using credit cards, despite being aware of that option." E-mail from Telecom to Commerce Commission (29 February 2012).

<sup>70</sup> Vodafone has advised that [

] Commerce Commission interview with Vodafone (9 February 2012) and

Commerce Commission interview with Vodafone (16 March 2012).

<sup>71</sup> Vodafone has stated that [

] Commerce Commission interview with Vodafone (16 March 2012).

topping up in-store is [ ].<sup>72</sup> As noted above, in New Zealand around [ ]% of all pre-pay mobile phone customers top-up in-store.

105. While the majority accepts that if enough of these in-store customers were likely to switch to topping up direct, they would protect the customers who are less likely to switch from price increases, as evidence above shows, the [ ].<sup>73 74</sup>
106. Therefore, in the majority's view, the evidence suggests that despite a general trend towards direct top-ups, the set of additional customers who are likely to switch in response to a price increase by a hypothetical monopolist distributor-agent of in-store pre-paid mobile phone top-ups is currently sufficiently limited so as to render a price increase profitable.

#### *Conclusion on pre-paid mobile phone top-up market*

107. The majority acknowledges that mobile phone companies have already put significant effort into persuading consumers to switch to direct payment methods. The majority also acknowledges that the trend towards direct top-ups is clear. However, the majority also considers that the evidence indicates that:
- 107.1 for a significant proportion of the pre-paid mobile phone customer base, direct top-ups are not a close substitute for in-store top-ups at this time;
- 107.2 while an increase in prices from epay would increase the mobile phone companies' incentives to persuade customers to switch, this would only be a marginal change to the strong incentive that already exists; and
- 107.3 an increase in prices from epay would not enhance mobile phone companies' ability to persuade customers to switch and there is little evidence to suggest that mobile phone companies would be able to substantially hasten any trend to direct top-ups.
108. Therefore, the majority considers that the relevant market to be the market for the distribution and in-store payment processing of pre-paid mobile phone top-ups in New Zealand (including top-ups made in a mobile phone company's own stores).

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<sup>72</sup> E-mail from Vodafone to the Commerce Commission (23 February 2012).

<sup>73</sup> Even a 5% price increase by a distributor-agent to the mobile phone companies would only account for a small increase in the final price to consumers if fully passed on. Yet, according to Vodafone, even when they offered customers significant inducements to change their payment methods, [

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<sup>74</sup> epay also submitted that "commercially, the telcos would not pass through a small price increase to consumers", whether by increasing the cost of a pre-paid mobile phone top-up purchased in-store or by decreasing the value of credit that consumers get from purchasing a top-up in-store. This is because doing so "directly affects a telco's competitiveness in the downstream mobile telephony market", such that it would risk losing customers to its competitors. Submission from epay to the Commerce Commission (16 May 2012). However, without providing some incentive for consumers to top-up direct, or imposing some downside for consumers topping up in-store, the majority questions how mobile phone companies will be able to switch more consumers to direct top-ups.

109. That said, the majority acknowledges the market is dynamic and alternative top-ups options are becoming more available and accessible. The majority has considered this impact in the competition analysis.
110. Finally, the majority reiterates that its market definition is based on its judgement based on facts (including an economic assessment of those facts) and commercial commonsense. As market definition is a judgement, views can legitimately differ.
111. In this respect the majority acknowledges that the minority has found a wider market including direct top-ups on the basis that: the option to top-up direct exists, [ ]% of all pre-pay mobile phone customers currently top-up direct, and the proportion of direct top-ups has been growing.
112. Nevertheless, market definition should not be determinative of the competition issues and has not been in this case. Even if a wider market that included direct top-ups were adopted, the majority's conclusion on the competition issues would remain the same.

### Calling cards

113. Calling cards are cards or e-vouchers that allow consumers to make long-distance calls from a phone, bypassing the usual toll network on which they are calling. Calling cards can be purchased or recharged, either in-store, over the phone or online. In this decision, both initial purchases and recharges of calling cards are broadly referred to as calling card sales.
114. epay and Ezi-Pay are distributor-agents providing electronic payment services to calling card companies, including in-store activation and recharge of calling cards. Distributor-agents distribute calling cards via retailers and electronically transfer credit onto these cards<sup>75</sup>, either as an initial sale activation or a recharge.
115. epay submitted that it competes with:<sup>76</sup>
- 115.1 calling card companies which provide pre-loaded calling cards<sup>77</sup> direct to retailers; and
- 115.2 calling card companies which sell and recharge calling cards online and over the phone.<sup>78</sup>
116. epay also submitted that calling card companies compete downstream with other calling options such as Skype and other internet based calling services, and,

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<sup>75</sup> In general, calling cards sold via distributor-agents are not shipped with credit loaded on the cards, rather they require "activation" at point of sale whereby credit is transferred to the card.

<sup>76</sup> Application, para 8.11.

<sup>77</sup> Physical "pre-loaded" calling cards are fixed denomination cards which do not require activation and are not rechargeable.

<sup>78</sup> Customers can purchase cards online by providing credit card details. Customers are then provided with a PIN and batch number electronically that enables them to start making call immediately.

therefore, these calling options are a constraint on calling card distributor-agents' ability to raise prices.<sup>79</sup>

### Calling card sales channels

117. Table 2 shows calling card sales by channel.

**Table 2: Sales channels used by calling card companies**

	Sales channel used (%)			Total downstream sales (\$m, 2011)
	Distributor-agent	Pre-loaded cards	Direct online or phone	
Telecom	[ ]%	[ ]%	[ ]%	[\$ [ ]]
TelstraClear	[ ]%	[ ]%	[ ]%	[\$ [ ]]
CardCall	[ ]%	[ ]%	[ ]%	[\$ [ ]]
Compass	[ ]%	[ ]%	[ ]%	[\$ [ ]]
<b>Total</b>	<b>[ ]%</b>	<b>[ ]%</b>	<b>[ ]%</b>	<b>[\$ [ ]]</b>

Source: Calling card companies.

118. Table 3 shows the trends in calling card sales by channel over the last four years.

**Table 3: Shares of calling card sales by sales channel (value in \$millions)**

	2008		2009		2010		2011	
	\$	%	\$	%	\$	%	\$	%
Pre-loaded cards in-store direct by calling card companies	[\$ [ ]]	[ ]%	[\$ [ ]]	[ ]%	[\$ [ ]]	[ ]%	[\$ [ ]]	[ ]%
Online and phone sales (self-supply)	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%
In-store sales via distributor-agents	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%	[ ]	[ ]%
<b>Total</b>	<b>[\$ [ ]]</b>		<b>[\$ [ ]]</b>		<b>[\$ [ ]]</b>		<b>[\$ [ ]]</b>	

Source: Calling card companies.

### Are sales of pre-loaded calling cards direct to retailers in the same market?

119. The Commission considers that sales of pre-loaded cards by calling card suppliers to retailers are sufficiently close substitutes for the services provided by the distributor-agent to mean that they are in the same market.

120. Some calling card companies consider that pre-loaded cards sold in-store are not good substitutes for electronic calling card activations and recharges, as the pre-loaded cards are more costly to produce and are less popular with retailers than electronic activations and recharges due to the risk of theft.<sup>80</sup>

<sup>79</sup> Submission from epay to the Commerce Commission (28 March 2012).

<sup>80</sup> Commerce Commission interview with [ ] (2 February 2012) and Commerce Commission interview with [ ] (16 March 2012).



121. However, the proportion of pre-loaded cards sold has [ ].
122. [ ], the Commission considers that calling card companies could switch to providing greater numbers of pre-loaded cards should a hypothetical monopolist calling card distributor-agent seek to increase the price of its services.

*Are online and phone sales of calling cards in the same market?*

123. The Commission has considered whether calling card companies could increase the volume of online or phone sales in the face of a SSNIP. That is, could a calling card company convince sufficient numbers of its customers to switch to purchasing or recharging cards online or over the phone to render a SSNIP by distributor-agents unprofitable?
124. The evidence in relation to mobile-top-ups suggests that mobile companies have limited ability to persuade customers to use direct methods (see discussion at paras 103.1 to 103.5). Some of these factors may also apply to calling cards. For example, some calling card purchasers may be reluctant to provide credit card details online or over the phone, some calling card purchasers tend to have a preference for transacting in cash,<sup>81</sup> and calling card companies may face the difficulty of switching consumers' purchasing habits.
125. Table 3 above shows that in the last three years aggregated online and phone sales [ ]. The data from the each of the calling card companies indicates that [ ].<sup>82</sup> [ ]
126. The Commission considers that there is not sufficient evidence of substitutability to include online and phone sales in the same market as in-store sales via distributor-agents or direct pre-loaded cards.
127. In any event, even if a wider market including online and phone sales were adopted, the majority's conclusion on the competition issues would remain the same.

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<sup>81</sup> Commerce Commission interview with [ ] (16 March 2012) and submission from [ ] to the Commerce Commission (24 February 2012), para 26.

<sup>82</sup> [ ] E-mail from [ ] to the Commerce Commission (5 April 2012). [ ]

[ ] E-mail from [ ] to the Commerce Commission (1 March 2012). [ ]

[ ] E-mail from [ ] to the Commerce Commission (4 April 2012). [ ]

[ ] Submission from [ ] to the Commerce Commission (24 February 2012).

### *Other calling options*

128. epay submitted that there are many consumers of calling cards who can easily switch to traditional toll calling or to Skype or other internet-based services in the event of a price increase by calling card companies.<sup>83</sup>
129. Calling card sales have been declining in the last few years, and calling card companies attribute this, at least in part, to competition from other modes of calling.<sup>84</sup>
130. For toll calls, calling card companies that have a traditional toll call business may find it profitable to persuade customers to switch from calling cards to toll calling in the face of a price increase.<sup>85</sup> [ ]<sup>86</sup> [ ] however, commented that calling cards are not a perfect substitute for other calling methods and that [ ]<sup>87</sup>.
131. However, a distributor-agent of calling cards may well be prevented from increasing prices if downstream calling cards were close enough substitutes to Skype and other internet-based options. This is because any increase in the price of calling cards would cause consumers to switch to internet-based options to the detriment, not only of the calling card company, but also the distributor-agent of calling cards.<sup>88</sup>
132. Skype's internet based calling is very low cost to people with the required technology at both ends, as the only additional charge for a consumer is the cost of data usage. However, there are factors other than price that may prevent some calling card customers switching to Skype and other internet-based calling options. Skype's 'free' calling requires both ends of the call to have a fast and reliable internet connection. This may not always be available in a number of countries. Therefore the ability of customers in the downstream market to switch to Skype type options is likely to be limited.
133. If a monopolist distributor-agent increased its price by 5-10% and this was added to the price of calling cards, this would result in a very small price increase for the consumer. The Commission considers that even if a price increase was fully passed through, it is unlikely that sufficient consumers would switch in the downstream market to toll calls or Skype and other internet-based options so as to render an upstream price increase unprofitable. Therefore, the Commission does not consider these other calling options to be part of the market for the purpose of this application.

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<sup>83</sup> Submission from epay to the Commerce Commission (28 March 2012).

<sup>84</sup> Commerce Commission interview with [ ] (16 March 2012).

<sup>85</sup> The Commission notes that if calling card companies used toll specials to entice calling card customers to on-account tolls, they would need to take into account lost revenue from current toll users making the most of toll specials.

<sup>86</sup> Commerce Commission interview with [ ] (16 March 2012).

<sup>87</sup> [ ]

<sup>88</sup> Calling card companies are unlikely to persuade customers to use Skype or other internet-based options in response to a price increase, as they would be unlikely to capture revenue from such a switch.

### Conclusion

134. For the purposes of this application, the Commission has adopted a market for the distribution and in-store payment processing of calling cards in New Zealand (the **in-store mobile top-up market**).

### Gift cards

135. Gift cards are, essentially, pre-paid credit that can be redeemed for goods or services in a retailer. As their name suggests, gift cards are usually purchased by consumers and given to others as a gift. As noted by epay in its application, gift cards have existed in various forms for a long time.<sup>89</sup> Historically, gift cards took the form of paper vouchers or gift certificates. Nowadays, they are more commonly plastic magnetic swipe cards.
136. The Commission understands that there are broadly three different types of gift cards:
- 136.1 “Closed loop” cards, which are specific to a particular retail chain or business and can be redeemed only with that retailer. An example of a closed loop card is the Mitre 10 gift card.
- 136.2 “Open loop” cards, which carry credit that can be redeemed at the majority of retailers. Kiwibank’s Prezzy card is an example of an open loop card.
- 136.3 “Network” cards, which are in between an open loop and closed loop card. An example of a network card is a Westfield gift card, which can be redeemed at any retailer within any Westfield mall.
137. Traditionally, gift cards were “closed loop” and were sold by the relevant retailer in its stores (eg Mitre 10 card purchased in store from Mitre 10). However, the introduction of open loop cards and plastic magnetic swipe cards has widened the ways through which consumers can purchase gift cards. Consumers are now able to purchase gift cards online and via stands of cards that are available in a range of retailers (eg a consumer can purchase a Mitre 10 gift card at the supermarket).
138. Retail chains can contract with third parties to:
- 138.1 manage the retailer’s in-store gift card programs;<sup>90</sup>
- 138.2 distribute the retailer’s gift cards in other retailers’ stores; and/or
- 138.3 provide in the retailer’s store a stand of gift cards (and also digital content cards) for other retailers.
139. epay and Ezi-Pay act as distributor-agents for retailers wishing to distribute their gift cards “out-of-store” to third parties, ie in other retailers’ stores.

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<sup>89</sup> Application, para 8.13.

<sup>90</sup> However, many retail chains manage their in-store gift card programs themselves rather than contracting this out to a third-party.

140. If a hypothetical monopolist distributor-agent of third-party gift cards were to impose a price increase, the question is to what extent content providers would be able to persuade sufficient customers to switch to purchasing that content providers gift card sales in the retailer's own stores to render such a price increase unprofitable.
141. In this respect, epay submitted that the most popular means by which gift cards are sold in New Zealand continues to be "for the retailer to sell cards to consumers at their own retail stores".<sup>91</sup>
142. The evidence obtained by the Commission confirms that consumers normally purchase gift cards in the store where it will be redeemed.<sup>92 93</sup> To illustrate, epay estimated that sales of gift cards directly by retail chains in their own stores are \$[ ] per year, while<sup>94</sup> [ ] estimated those sales to be less at \$[ ] per year.<sup>95</sup> Either way, that level of sales is significantly greater than the sales of gift cards through third parties, which for all distributor-agents totalled only \$[ ] last year.
143. Nevertheless, distribution of gift cards via third parties is increasing in popularity and provides additional sales for content providers. That is, at least a proportion of third-party sales are likely to be new sales that would not otherwise have occurred. In the face of a price increase, it seems that retailers would lack any practical ability to be able to persuade these additional customers to purchase the gift cards within the retailers' own stores. Retailers generally have very little visibility of the customers currently purchasing its cards in third-party stores and therefore no way to target those customers.
144. Therefore the Commission considers the relevant market is the market for the third-party distribution and payment processing of gift cards in New Zealand (the **third-party gift card market**).
145. While we note that the market may be wider than this to include gift cards sold in retailers' own stores rather than just third-party stores, market definition should not be determinative of the competition issues. Even if a wider market were adopted, the majority's conclusion on the competition issues would remain the same.

### Digital content

146. Digital content is any content that is published or distributed in a digital form. This principally includes computer software, music and computer games.
147. Digital content providers can distribute digital content in a number of ways:

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<sup>91</sup> Application, para 8.13.

<sup>92</sup> In the case of [ ], for example, 90% of its gift cards are sold direct in-store and 10% out-of-store. Commerce Commission interview with [ ] (13 February 2012).

<sup>93</sup> This is in contrast to pre-paid mobile phone top-ups or calling cards, where the norm is for content providers to sell to customers via third-party retailers.

<sup>94</sup> Application, para 17.1.

<sup>95</sup> Commerce Commission interview with [ ] (7 February 2012).

- 147.1 Online direct to the consumer.
- 147.2 For certain computer software, content providers can distribute their physical product (eg, CD-ROM) via retailers, although this is becoming less common, as digital content providers switch to other distribution methods.
- 147.3 Through a distributor-agent that distributes digital content cards in various retailers. The digital content card either provides credit that can be used to purchase digital content online or a product code that can be used to activate computer software. This is the service ePay and Ezi-Pay provide.
148. Popular digital content cards include iTunes and gaming cards (eg Xbox, PlayStation, Moshi Monsters, Disney Club Penguin). By purchasing digital content cards in retailers, consumers do not have to use their credit card online. ePay submitted that this “is intended to provide consumers with increased security as well as allowing parents to monitor children’s expenditure”.<sup>96</sup>
149. If a hypothetical monopolist distributor-agent for digital content cards were to impose a price increase, the question is to what extent content providers could shift enough of their sales away to other payment options to render such a price increase unprofitable.
150. In its application, ePay estimates that sales of digital content in New Zealand either online or by physical CD-ROM are in excess of \$[ ] per year.<sup>97</sup> This does not include Apple iTunes, whose online revenues the Commission understands are significant. This total level of digital content sales is much greater than the sales of digital content cards in retailers, which for all distributor-agents totalled only \$[ ] last year.<sup>98</sup>
151. While there is a significant demand for purchasing digital content online, [ ] advised the Commission that there is demand for purchasing digital content cards in retailers.<sup>99</sup> A large portion of consumers do not have credit cards, including children with pocket money to spend. Other consumers want to control their spending and so do not want to set up an iTunes account using their credit card. In addition, there are also impulse purchases and gifting of digital content cards.
152. [ ] advised that sales of iTunes cards are “a very significant part of the iTunes strategy, because that’s where they get all their visibility and awareness with consumers”.<sup>100</sup>

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<sup>96</sup> Application, para 8.18.

<sup>97</sup> Application, para 17.2.

<sup>98</sup> As noted by [ ] most people purchase digital content online. Commerce Commission interview with [ ] (7 February 2012).

<sup>99</sup> Commerce Commission interview with [ ] (2 February 2012) and Commerce Commission interview with [ ] (7 February 2012).

<sup>100</sup> [ ]

153. Therefore, the Commission considers that digital content cards purchased in retailers constitute a separate product market. While digital content providers have other options available to them to distribute content, in-store sales of digital content are generally targeted at a particular type of consumer; in particular consumers who do not have or do not wish to use credit cards and those consumers who buy digital content as a gift and prefer a physical card. The Commission considers that digital content providers would likely find it difficult to persuade sufficient of these additional customers to purchase via other methods in the face of a price increase such as to render the price increase unprofitable.
154. In conclusion, the Commission considers the relevant market to be the market for the distribution and in-store payment processing of digital content in New Zealand (the **in-store digital content market**).

### **Pre-paid electricity**

155. In its application, epay noted that both epay and Ezi-Pay act as distributor-agents for Mercury Energy Limited (Mercury) to distribute and process payments for Mercury's pre-paid electricity service through retailers.<sup>101</sup> epay noted that it considers this is a minor area of overlap.<sup>102</sup>
156. Mercury is the only electricity retailer that uses epay or Ezi-Pay to facilitate payments for pre-paid electricity. Contact Energy Limited (Contact), Meridian Energy Limited (Meridian) and Genesis Energy Limited (Genesis) are also suppliers of pre-pay electricity. How Contact, Meridian and Genesis consumers top-up their pre-paid electricity is discussed below.
157. Applying the SSNIP test, the question is whether a hypothetical monopolist distributor-agent of pre-paid electricity payment services could profitably increase prices to electricity retailers.

### *Pre-pay electricity payment methods*

158. Electricity retailers currently provide the following range of options for customers to make pre-pay electricity payments:
- 158.1 'over the counter' in retailers;
  - 158.2 credit card payments online and over the phone;
  - 158.3 direct debit activated by a phone call;
  - 158.4 automatic payments; and/or
  - 158.5 self-service kiosks.

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<sup>101</sup> Application, para 8.20.

<sup>102</sup> Ibid.

159. Mercury advised the Commission that when selecting a payment network for its Glo-Bug<sup>103</sup> product it also considered internet banking and Snapper.<sup>104 105</sup>
160. Mercury selected distributor-agents through retailers as its primary payment method for Glo-Bug because [ ].<sup>106</sup> [ ]<sup>107</sup> Mercury also introduced online and phone credit card payments as additional payment methods early in 2012.<sup>108</sup> [ ]<sup>109</sup>
161. Contact offers customers a range of payment methods, including distributor-agents, to top-up their accounts. Specifically, Contact uses direct debit, automatic payments, and credit card payments. Contact customers can also top-up at NZ Post shops (via Kiwibank as distributor-agent).
162. Genesis has directly integrated with a small number of retailers in each area that it supplies pre-pay electricity. [ ]<sup>110</sup>
163. Meridian uses self-service kiosks. However, Meridian intends transferring its pre-paid electricity customers to Mercury's Glo-Bug system, as it has found its system of having only 12 top-up locations around Christchurch unsatisfactory following the Christchurch earthquakes.<sup>111</sup>
164. If a hypothetical monopolist distributor-agent for pre-paid electricity were to impose a price increase, the question is to what extent electricity retailers would be able to switch to alternatives payment methods for prepay customers so as to render the price increase unprofitable.
165. It is clear that some electricity retailers are currently successfully using a range of payment options. While Mercury has [ ], the range of payment alternatives currently in use by other electricity retailers appear to be feasible substitutes in that an electricity retailer would be likely to be able to switch

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<sup>103</sup> Glo-Bug is Mercury's pre-pay electricity system. The electricity customer has a display unit inside their home that glows various colours depending on the amount of credit remaining. Customers can top-up their pre-pay electricity at ePay and Ezi-Pay retailers.

<sup>104</sup> Commerce Commission interview with Mercury (10 February 2012).

<sup>105</sup> Snapper is a type of contactless payment system. Snapper card holders can top-up their Snapper cards at a range of retailers. The credit on the cards can then be used instead of cash at select cafes, convenience stores and transport providers.

<sup>106</sup> Commerce Commission interview with Mercury (10 February 2012).

<sup>107</sup> Ibid.

<sup>108</sup> E-mail from Mercury to the Commerce Commission (10 April 2012).

<sup>109</sup> Commerce Commission interview with Mercury (10 February 2012).

<sup>110</sup> E-mail from Genesis to the Commerce Commission (5 April 2012).

<sup>111</sup> Energy News, "Meridian to transfer 7,000 Christchurch pre-pay customers to Mercury" (3 April 2012).

to using one such payment system without significant impact on its downstream customers.

166. In particular, electricity customers have a long history of paying for electricity via automatic payment or direct debit, and, moreover, these are the main payment methods available to customers of Mercury's competitors. As such, Mercury would likely be able to drop the e-pay payment method in face of a price increase without any significant impact on its sales, thus disciplining the profitability of the price increase.

*Are pre-pay and post-pay electricity payments in the same market?*

167. The Commission has also considered whether payment methods for post-pay electricity should be included in the same market. That is, in the face of a price increase could electricity retailers switch enough of their customers to post-pay electricity plans so as to render the hypothetical price increase unprofitable.
168. Customers generally choose pre-pay electricity as opposed to being on a post-pay monthly account because of budgeting and credit issues, rather than because it is the lowest cost option.<sup>112 113</sup> Further, some pre-pay electricity customers are also paying off an existing debt over time through the pre-pay system. The need to pay off the remaining debt before switching may further limit the ability of customers to switch to post-pay if faced with price increases.
169. As a result, the Commission considers that electricity retailers are likely to be unwilling or unable to persuade pre-pay electricity customers to switch in sufficient volumes to post-pay if faced with price increases. However, we note that enquirers have found that electricity retailers have very little information on the switching motivation or behaviour of pre-pay electricity customers in the downstream market.

*Geographic market*

170. Auckland is the only geographic area where electricity retailers use the services of both e-pay and Ezi-Pay for pre-pay electricity. Electricity retailers need to provide payment services to their customers in Auckland, but the payment services available to them are generally available on a national basis. For instance, distributor-agents generally operate nationwide. Other payment options such as direct debits, automatic payments and credit card sales are also available nationwide. Therefore, the Commission considers that the relevant geographic scope is a market in New Zealand.

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<sup>112</sup> For example, [ ]. Commerce Commission interview with Mercury (10 February 2012). Mercury told the Commission that [ ]. E-mail from Mercury to the Commerce Commission (10 April 2012).

<sup>113</sup> [ ] explained that customers choose pre-pay electricity as a tool to budget their power consumption (as it is easier to monitor electricity usage) and also as a way to avoid unexpected bills. [ ]



### *Conclusion on pre-paid electricity market definition*

171. The Commission considers the relevant market for the purpose of this application is the market in New Zealand for the distribution and payment processing of pre-paid electricity (the **pre-paid electricity top-up market**).

## **Factual and counterfactual**

### **Factual**

172. If the proposed acquisition proceeds, epay would acquire Ezi-Pay. Through the proposed acquisition, epay would more than double the size of its retail distribution network. epay would also acquire Ezi-Pay's contracts with New Zealand retail chains to distribute their gift cards out-of-store and epay would distribute a greater range of content through a larger distribution network.
173. The calling card business of Compass is not part of the proposed acquisition. In the factual, Compass and Ezi-Pay will no longer be commonly owned and associated persons. Compass will be in the same situation as other calling card companies in terms of contracting with epay for the distribution of calling cards in retailers. This is discussed further in the competition analysis for calling cards.
174. It is uncertain what will happen to the arrangement between Ezi-Pay and InComm if the acquisition proceeds. [

] <sup>114</sup> <sup>115</sup> epay has been unable to advise the Commission what would happen to the InComm arrangement post-acquisition. The implications of this arrangement are considered further in the competition analysis for digital content.

### **Counterfactual**

175. The Commission considers that if the proposed acquisition does not proceed the likely counterfactual is either the status quo or sale of Ezi-Pay to another party. As such, the difference between the counterfactuals is likely to be negligible.
176. Ezi-Pay advised the Commission that if the proposed sale to epay does not proceed, it would [ ] <sup>116</sup>
177. The majority does not consider it likely that another existing distributor-agent for in-store mobile top-ups will seek to acquire Ezi-Pay. [ ]
178. A possible buyer is [ ]. It was invited along with other parties to bid for the business as part of the sales process that led to the proposed acquisition of Ezi-Pay by epay. [

<sup>114</sup> Commerce Commission interview with [ ] (2 February 2012).

<sup>115</sup> Ezi-Pay expects that the arrangement is [ ] Commerce Commission interview with Ezi-Pay (9 February 2012).

<sup>116</sup> Commerce Commission interview with Ezi-Pay (9 February 2012).

] <sup>117 118</sup>

### Competition analysis – pre-paid mobile phone top-ups

179. epay and Ezi-Pay are the two largest distributor-agents of pre-paid mobile phone top-ups and the closest competitors. Table 4 outlines the existing market shares in in-store mobile top-up market.

**Table 4: Market shares of pre-paid mobile phone top-ups**

	\$ (millions)	%
epay	\$( [ ] )	[ ]%
Ezi-Pay	[ ]	[ ]%
<b>Merged entity</b>	<b>[ ]</b>	<b>[ ]%</b>
SmartPay	[ ]	[ ]%
TopUp NZ	[ ]	[ ]%
Kiwibank	[ ]	[ ]%
Other <sup>119</sup>	[ ]	[ ]%
<b>Total</b>	<b>\$( [ ] )</b>	<b>100%</b>

Source: Estimated from information provided by industry participants. Figures are based on the face value of pre-paid mobile phone top-ups, not commission of the distributor-agent.

180. The proposed acquisition would increase the three firm concentration ratio only slightly from [ ]% to [ ]%. This ratio is outside the Commission’s safe harbours. However an examination of market shares and concentration is only one of a number of factors to be considered in the assessment of competition in a market.

181. Indeed, notwithstanding the very high market share figures in Table 4, epay submitted that the competitive constraint Ezi-Pay provides is “minor” in a relative sense.<sup>120</sup> epay submitted that post-acquisition, mobile phone companies would continue to have “a wealth of credible options with which to threaten to bypass epay/substantially reduce epay’s revenues”<sup>121</sup> and that epay would continue to face constraint from:<sup>122</sup>

181.1 remaining existing competing distributor-agents;

181.2 mobile phone companies persuading consumers to switch to topping up direct or to post-paid plans;

<sup>117</sup> Commerce Commission interview with [ ] (7 February 2012).

<sup>118</sup> [ ]

[ ] E-mail from [ ] to Commerce Commission (22

February 2012).

<sup>119</sup> This includes pre-paid mobile phone top-ups done through a direct integration that Telecom has with The Warehouse Group Limited (The Warehouse) and in 2degrees stores (handled by 2degrees itself).

<sup>120</sup> Submission from epay to the Commerce Commission (16 May 2012).

<sup>121</sup> Ibid.

<sup>122</sup> Application.

- 181.3 mobile phone companies direct integration with large retail chains;
  - 181.4 potential competition from other distributor-agents; and
  - 181.5 the countervailing power of mobile phone companies.
182. epay submitted that none of the “key constraints currently ensuring competitive pricing – will change as a result of the acquisition”.<sup>123</sup> epay submitted:<sup>124</sup>

The test is whether the telcos can credibly threaten to embark on various responses so as to thwart the attempted price increase. They have a large number of credible threats. Even if the Commission took the view that several of the options were not credible, there remain a sufficient number which are. epay does not believe there is any realistic prospect that, when faced with the telco laying out all of these threats, it could in any way discount the prospect of at least some of them would be carried out. The result is that it will be forced to continue to charge competitive margins.

183. In the remainder of this section, the majority has assessed whether it is satisfied that the constraints identified – either alone or in combination – are sufficient to prevent a likely SLC.
184. Before assessing these constraints in turn (and then collectively), the majority first assesses:
- 184.1 the extent of competition between epay and Ezi-Pay today;
  - 184.2 the extent to which epay’s supply contracts with the mobile phone companies will constrain epay’s pricing post-acquisition; and
  - 184.3 epay’s broader submission that post-acquisition prices to mobile phone companies will decrease in a way that they would not do in the counterfactual.

#### **Existing constraint provided by Ezi-Pay**

185. As described above, epay described Ezi-Pay’s constraint as minor in a relative sense and further said:<sup>125</sup>

Not once during margin discussions have the telcos ever threatened to epay that it will rely on the geographic spread of Ezi-Pay. Rather, the telcos will threaten to promote their direct offerings, directly integrate, etc.

186. As Table 4 indicates, epay and Ezi-Pay are the largest distributor-agents by a considerable distance. Each of epay and Ezi-Pay has a nationwide network of retailers through which they act as distributor-agent for pre-paid mobile phone top-ups. [ ] described epay’s network as “different to, but from a location, regional

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<sup>123</sup> Submission from epay to the Commerce Commission (16 May 2012).

<sup>124</sup> Ibid.

<sup>125</sup> Ibid.

perspective largely directly overlapped by Ezi-Pay's".<sup>126</sup> At times, there may only be 100 or less metres between an epay retailer and an Ezi-Pay retailer.

187. epay acknowledged that if it were to upset a mobile phone company, the mobile phone company could constrain epay because of Ezi-Pay's geographic distribution.<sup>127</sup> However, epay submitted that it competes with Ezi-Pay and SmartPay on the service (including pre-paid content) supplied to retailers, rather than commissions.<sup>128</sup>
188. For the mobile phone companies, the quality of the service provided by distributor-agents is important along with price. Vodafone expressed concern that [ ]<sup>129</sup> In particular, [ ] regards the geographic coverage as a very important part of this because if epay has a network outage or other failure, through Ezi-Pay "customers have an alternative with is generally close by".<sup>130</sup>
189. The commissions paid by the mobile phone companies have reduced over time.<sup>131 132 133</sup> Many industry participants commented that margins are very slim and being a distributor-agent for pre-paid mobile phone top-ups is "a high volume, low margin business".<sup>134</sup> This is indicated by Table 5 below, which sets out the commission rates paid by the mobile phone companies to epay [ ].

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<sup>126</sup> [ ]  
<sup>127</sup> Commerce Commission interview with epay (25 May 2012).

<sup>128</sup> Ibid.

<sup>129</sup> Submission from Vodafone to the Commerce Commission (15 February 2012).

<sup>130</sup> [ ]

<sup>131</sup> [ ]

[ ] E-mail from Bell Gully (on behalf of epay) to the Commerce Commission (26 April 2012).  
<sup>132</sup> [ ]

[ ] E-mail from Bell Gully (on behalf of epay) to the Commerce Commission (26 April 2012).  
<sup>133</sup> [ ]

[ ] E-mail from Bell Gully (on behalf of epay) to the Commerce Commission (18 April 2012).  
<sup>134</sup> Commerce Commission interview with [ ] (14 February 2012), Commerce Commission interview with [ ] (10 February 2012), Commerce Commission interview with [ ] (7 February 2012) and Commerce Commission interview with [ ] (2 February 2012).

**Table 5: Commission rates**

Mobile phone company	Share of in-store pre-paid mobile phone top-ups	Commission to epay	Commission to retailer	Total commission
Vodafone	[ ]%	[ ]%	[ ]%	[ ]%
Telecom	[ ]%	[ ]%	[ ]%	[ ]%
2degrees	[ ]%	[ ]%	[ ]%	[ ]%

Source: epay and mobile phone companies.

190. The majority consider that the evidence provided by the mobile phone companies, and commercial commonsense, indicates that existing competition between the two companies has played a significant role in ensuring competitive pricing in the market:

190.1 Mobile phone companies in their negotiations with epay and Ezi-Pay have the threat of discontinuing their relationship with one of the distributor-agents should the price be too high. While this would significantly reduce the number of retailers that a mobile phone company's product was distributed through, epay's and Ezi-Pay's networks are overlapping, so consumers would not have to go too much further to top-up. On the other hand, epay and Ezi-Pay know that if they lose a contract with a mobile phone company the loss would likely undermine its business.

190.2 Vodafone advised that [

] <sup>135</sup> Vodafone further stated that [ <sup>136</sup>

190.3 2degrees commented that [ <sup>137</sup>

190.4 Telecom advised that [ <sup>138</sup>

[

]

191. If the proposed acquisition goes ahead, the existing significant competitive constraint provided by Ezi-Pay will be lost. For the Commission to be satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition sufficient other constraining factors must remain in the market.

<sup>135</sup> Commerce Commission interview with Vodafone (9 February 2012).

<sup>136</sup> Ibid.

<sup>137</sup> Commerce Commission interview with 2degrees (10 February 2012).

<sup>138</sup> Commerce Commission interview with Telecom (9 February 2012).

**Constraint from existing supply contracts**

192. epay submitted that the mobile phone companies “set the margin that epay makes”.<sup>139</sup> epay submitted that post-acquisition, all margins will continue to be set by the mobile phone companies.<sup>140</sup>

193. [

]

194. [

]<sup>141</sup>

195. [

]

196. [

]

197. [

]

**Will prices decrease as a result of the merger?**

198. epay submitted that [ ].<sup>142</sup> epay further noted that it does not set commissions but rather the mobile phone companies do<sup>143</sup>, and cited [ ] negotiations with mobile phone companies as evidence of epay’s lack of market power.<sup>144</sup>

199. As a general point, the majority reiterates that it must determine the likely differences in prices between the factual and the counterfactual.

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<sup>139</sup> Application, paras 8.7 and 25.3.

<sup>140</sup> Commerce Commission interview with epay (4 April 2012).

<sup>141</sup> [ ]

- [

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- [

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- [

]

<sup>142</sup> Submission from epay to the Commerce Commission (28 March 2012).

<sup>143</sup> Application, paras 8.7 and 25.3.

<sup>144</sup> E-mail from Bell Gully (on behalf of epay) to the Commerce Commission (1 June 2012).

200. As noted above, the prices that mobile phone companies pay to distributor-agents have decreased [ ] in recent years.<sup>145</sup> As costs continue to fall for distributor-agents,<sup>146</sup> the majority anticipates that this downward trend in prices is likely to continue.

201. Therefore, the majority considers it possible prices will fall post-merger given downward trends. [ ] But what is relevant to a SLC is whether, in the factual, prices would decline more slowly than they would in the counterfactual.

[ ] 2degrees

202. epay has submitted that [ ] compared to the counterfactual, indicating a lack of post-merger market power.<sup>147</sup>

203. Because prices are generally trending down, [

]

204. [

] <sup>148</sup> <sup>149</sup> [

<sup>151</sup>

] <sup>150</sup>

205. [

] <sup>152</sup> <sup>153</sup>

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<sup>145</sup> epay has also provided evidence to suggest that prices internationally are trending downward. Commerce Commission interview with epay (4 April 2012).

<sup>146</sup> epay submitted that compared to the investment it has incurred, “for a firm looking to enter today, the costs of entry are lower”. E-mail from Bell Gully (on behalf of epay) to the Commerce Commission (27 April 2012).

<sup>147</sup> Submission from epay to the Commerce Commission (16 May 2012).

<sup>148</sup> [ ] attached to e-mail from Bell Gully (on behalf of epay) to the Commerce Commission (13 April 2012).

<sup>149</sup> [

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<sup>150</sup> E-mail from Bell Gully (on behalf of epay) to the Commerce Commission (18 May 2012).

<sup>151</sup> [

]

Commerce Commission interview with 2degrees (14 May 2012) and e-mail from Bell Gully (on behalf of epay) to the Commerce Commission (24 May 2012).

E-mail from Bell Gully (on behalf of epay) to the Commerce Commission (24 May 2012).

<sup>152</sup> E-mail from Bell Gully (on behalf of epay) to the Commerce Commission (11 June 2012).

<sup>153</sup> epay advised that [ ] E-mail from Bell Gully (on behalf of epay) to the Commerce Commission (11 June 2012). epay later advised that [

] E-mail

from Bell Gully (on behalf of epay) to the Commerce Commission (14 June 2012). epay advised that [

] E-mail from Bell Gully (on behalf of epay) to the

Commerce Commission (14 June 2012).

**Table 6: [ ]**

[ ]	[ ] <sup>154</sup>	[ ]	[ ]
[ ]	[ ]	[ ] <sup>155</sup>	[ ]
[ ]	[ ]		[ ]
[ ]	[ ]		[ ]
[ ]	[ ]		[ ]
[ ]	[ ]		[ ]
[ ]	[ ]		[ ]

Source: epay.

206. [ ]

] <sup>156</sup>

207. [ ]

]

208. [ ]

] <sup>157 158</sup> [ ]

]

*Potential price impacts for Telecom and Vodafone*

209. epay submitted that [ ]

] <sup>159</sup>

210. [ ]

] <sup>160 161</sup>

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<sup>154</sup> [ ]

<sup>155</sup> [ ]

<sup>156</sup> 2degrees provided the Commission with [ ]

] E-mail from

<sup>157</sup> 2degrees to the Commerce Commission (18 May 2012).

For example, [ ]

<sup>158</sup> [ ] Commerce Commission interview with epay (25 May 2012).

] E-mail from 2degrees to the Commerce Commission (21 May 2012). [ ]

<sup>159</sup> E-mail from Bell Gully (on behalf of epay) to Commerce Commission (18 May 2012).



**Table 7: [ ]**

[ ]	[ ]	[ ]	[ ]
[ ]	[ ]	[ ]	[ ]
[ ]	[ ] <sup>162</sup>	[ ] <sup>163</sup>	[ ]
[ ]	[ ] <sup>164</sup>	[ ] <sup>165</sup>	[ ]

Source: epay.

211. [ ]

]

212. [ ]

[ ] Vodafone advised that [ ]<sup>166</sup> epay advised that that [ ]<sup>167</sup> When questioned what this meant, epay advised that [ ]<sup>168</sup>. It further stated:<sup>168</sup>

[ ]

]

213. [ ]

]

*Conclusion on impact of the proposed acquisition on prices*

214. The majority has taken account of epay’s [ ]]. In the majority’s view, the evidence seems to show that prices will be lower in the future.

215. However, the majority cannot be satisfied that prices will be lower with the merger than without, [ ]]. Therefore, the majority goes on to fully assess all

<sup>160</sup> E-mail from Bell Gully (on behalf of epay) to Commerce Commission (24 May 2012). epay advised that [ ] E-mail from Bell Gully (on behalf of epay) to Commerce Commission (24 May 2012).

<sup>161</sup> [ ]

[ ] E-mail from Bell Gully (on behalf of epay) to Commerce Commission (24 May 2012).

<sup>162</sup> [ ]

<sup>163</sup> [ ]

<sup>164</sup> [ ]

<sup>165</sup> [ ]

<sup>166</sup> Commerce Commission interview with Vodafone (5 June 2012).

<sup>167</sup> E-mail from Bell Gully (on behalf of epay) to the Commerce Commission (14 June 2012).

<sup>168</sup> Ibid.

the possible constraints in order to determine whether or not it can be satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition.

### **Constraint from existing competition**

216. As shown in Table 4 above, there would only be a few small existing competitors post-acquisition in the in-store mobile top-up market.
217. For the reasons explained below, the majority is not satisfied that existing competitors would not provide sufficient competitive tension in the market to constrain ePAY post-acquisition.

### *SmartPay*

218. SmartPay is currently the third largest distributor-agent for pre-paid mobile phone top-ups. Like ePAY and Ezi-Pay, SmartPay became a distributor-agent for Telecom and Vodafone almost a decade ago when e-vouchers were introduced for in-store pre-paid mobile phone top-ups. SmartPay entered at a time when retailers were still being signed up to distributor-agents.
219. Despite this, SmartPay has only a [ ]% share of the market and has made no material inroads into the market in recent years.
220. A possible reason for SmartPay's small market share is that main business is the supply of EFTPOS terminals not being a distributor-agent for pre-paid mobile phone top-ups.<sup>169</sup>
221. SmartPay's retail network consists of dairies, convenience stores and independent fuel stations and encompasses only [ ]% of the number of retailers that ePAY would have post-acquisition. The number of retailers in SmartPay's pre-paid network is [ ].
222. SmartPay recently recorded a loss of \$12.1 million for the year ended 31 March 2012. SmartPay has advised the Commission that [ ]<sup>170</sup>, and a number of third parties interviewed by the Commission commented that in their view, [ ].<sup>171</sup> The Commission also understands that [ ]<sup>172</sup>
223. SmartPay is in the process of recapitalising its business [ ]

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<sup>169</sup> [ ]

[ ] Commerce Commission interview with [ ] (24 May 2012).

<sup>170</sup> Commerce Commission interview with [ ] (10 February 2012).

<sup>171</sup> [ ]

<sup>172</sup> Commerce Commission interview with [ ] (21 February 2012).

] <sup>173</sup>

224. Based on this evidence, the majority does not consider SmartPay to be a significant competitor, nor one which is likely to be in a position to expand quickly (absent sponsorship from a mobile phone company which, [ ] and, more generally for the reasons discussed later in the decision is unlikely).<sup>174</sup>

*TopUp NZ*

225. TopUp NZ has a [ ]% share of the market. It acts solely as distributor-agent for pre-paid mobile phone top-ups purchased in Telecom stores.

226. [ ] <sup>175</sup>

227. [ ]

] <sup>176</sup>

228. [ ]

] <sup>177</sup>

229. The majority therefore considers that TopUp NZ (as a distributor-agent) is unlikely to expand to such an extent, so as to provide an effective constraint on epay.

*Kiwibank*

230. Kiwibank has a [ ]% share of the market. It solely acts as distributor-agent of pre-paid mobile phone top-ups purchased in NZ Post shops, for all mobile phone companies. While there are 300 NZ Post shops spread throughout New Zealand, NZ Post shops have relatively limited opening hours compared to other retailers, which appears to be a partial explanation for NZ Post's (and hence Kiwibank's) small share of mobile top-ups.<sup>178</sup>

231. [ ]

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<sup>173</sup> Commerce Commission interview with [ ] (7 June 2012).

<sup>174</sup> The majority notes that [ ]

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<sup>175</sup> Commerce Commission interview with [ ] (21 February 2012).

<sup>176</sup> Ibid.

<sup>177</sup> Ibid.

<sup>178</sup> [ ]

]

] <sup>179</sup> [] <sup>180</sup> <sup>181</sup> <sup>182</sup>

232. [

] <sup>183</sup>

233. However, the majority is not satisfied that Kiwibank would be able to significantly expand the extent of pre-paid mobile phone top-ups undertaken in NZ Post shops, given NZ Post's limited opening hours and the limited number of NZ Post shops.
234. To expand beyond NZ Post shops, Kiwibank would need to sign up other retailers and would, therefore, face many of the same issues as a potential entrant. The issues facing a potential entrant are discussed in the potential entry section, the majority is not satisfied that Kiwibank is likely to expand to such an extent so as to on its own, place a significant constraint on epay. However, the possible expansion of Kiwibank in partnership with Blackhawk is considered in the potential entry section.

*Touch*

235. In its application epay lists Touch Holdings Limited (Touch) as a recent entrant into the market. However, currently, Touch is neither present in the New Zealand market or an existing competitor. Touch is considered further in the potential entry section below.

*Conclusion on constraint from existing competition*

236. Existing competitors would consist of only a small proportion of the market post-acquisition – approximately [ ]. As discussed above, the majority is not satisfied that these firms would be able to expand sufficiently to constrain epay.

**Constraints from direct top-ups and post-pay phones**

237. epay submitted that post-pay and direct pre-paid mobile phone top-ups act as major constraints even if the Commission defines them to be outside the relevant market.<sup>184</sup>
238. In terms of direct top-ups, epay submitted that with growth in the use of smart phones, there will be an “increasing number of consumers which can easily top up from their phone direct” using a top up application.<sup>185</sup> It submitted:<sup>186</sup>

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<sup>179</sup> Commerce Commission interview with [ ] (14 February 2012).

<sup>180</sup> [ ] E-mail from 2degrees to the Commerce Commission (3 April 2012).

<sup>181</sup> [ ] E-mail from Telecom to the Commerce Commission (5 April 2012).

<sup>182</sup> [ ]

[ ] E-mail from Vodafone to the Commerce Commission (10 April 2012).

<sup>183</sup> Commerce Commission interview with [ ] (14 February 2012).

<sup>184</sup> Submission from epay to the Commerce Commission (28 March 2012).

The move to the use of Smart Phones for paying for every day items has already begun. It is unrealistic to believe that telcos will be unable to switch their customers to paying for air time over Smart Phones.

239. While the majority considers post-pay mobile phones and direct pre-paid mobile phone top-ups to be outside the relevant market, the majority has also considered the extent to which epay would be constrained by post-pay mobile phones and direct pre-paid mobile phone top-ups.
240. The question is whether over the next two years, mobile phone companies would be able to persuade sufficient additional customers to top-up direct so as to ensure that prices in the factual are not 4-5% higher than they would be in the counterfactual. That is, we are considering the potential constraint from direct top-ups over a longer timeframe than that used in a traditional market definition framework.
241. The majority accepts that direct top-ups would continue to provide some degree of constraint on epay, but considers that post-pay mobile phones are not a significant constraint.
242. In terms of the extent of constraint, while currently [ ]% of pre-paid mobile phone top-ups are undertaken directly with mobile phone companies and the proportion of direct top-ups has increased [ ] over the last five years, it remains the case that the majority ([ ]%) of customers prefer to top-up in-store. Further, as discussed above, what limited evidence there is, suggests that [ ]. This suggests that mobile phone companies currently have a limited ability to expand direct top-ups in response to a price increase.
243. Nevertheless technology and customer habits change and therefore the majority has assessed the extent to which future technological developments may change consumers' preferred method of top-up, and increase mobile phone companies' ability to expand direct top-ups in response to a price increase.

*Possible technological developments*

244. It is possible that new or recently emerged technologies such as applications on smart phones linked directly to consumers' bank accounts will mean that in time fewer people will top-up in-store. The evidence indicates that there are a range of such technologies being developed or which are very new:

244.1 [ ]<sup>187</sup>

244.2 [ ]

] <sup>188</sup> [ ]

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<sup>185</sup> E-mail from Bell Gully (on behalf of epay) to the Commerce Commission (14 February 2012).

<sup>186</sup> Submission from epay to the Commerce Commission (16 May 2012).

<sup>187</sup> [ ]

<sup>188</sup> Commerce Commission interview with [ ] (21 February 2012).

] <sup>189</sup>

244.3 [

] <sup>190</sup> [] <sup>191</sup>

244.4 The launch of near field communications (NFC), enabling payments using mobile phones is a possibility in the future.<sup>192</sup> epay submitted that the mobile phone companies “could tie pre-pay top-up services to such hardware, thus by-passing epay”.<sup>193</sup> [

] <sup>194</sup> [] <sup>195</sup>

245. The increasing uptake of smart phones is likely to facilitate the development of these technologies. However, at present smart phones account for less than [ ]% of all pre-paid mobile phones, although the Commission has been advised by industry participants that smart phones are expected to make up a significantly greater proportion of the market in the future.<sup>196 197</sup> [
246. Nevertheless, even when smart phones become more widely used by pre-paid mobile phone users, this will not necessarily mean that all issues in respect of changing consumer habits and overcoming some consumers’ reluctance to register their phones and bank accounts would be overcome.

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<sup>189</sup> Commerce Commission interview with [ ] (7 June 2012). [

<sup>190</sup> [ ]

<sup>191</sup> Commerce Commission interview with [ ] (3 May 2012).

<sup>192</sup> It is called near field communication, because radio or wireless communication can occur when a smart phone is in close proximity (near) to a payment terminal or NFC device.

<sup>193</sup> Submission from epay to the Commerce Commission (28 March 2012).

<sup>194</sup> [ ]

<sup>195</sup> Commerce Commission interview with [ ] (7 June 2012).

<sup>196</sup> Vodafone estimates that the proportion of its pre-pay customers with a smart phone will be [ ] E-mail from Vodafone to Commerce Commission (26 March 2012).

<sup>197</sup> Telecom indicated that it expected that [ ]. Commerce Commission interview with Telecom (19 March 2012).

*Impact of such developments on customers topping-up direct*

247. The mobile phone companies were sceptical that such technological developments would significantly shift consumers from in-store to direct top-ups.<sup>198 199 200</sup>

248. Conversely, other industry participants expect direct top-ups to increase significantly in the future. However, how quickly this will occur is uncertain.

248.1 [

] <sup>201</sup>

248.2 [

] <sup>202</sup>

248.3 [

] <sup>203</sup>

248.4 [

] <sup>204</sup>

249. epay has also commented to the Commission that it would be [ ] years before in-store pre-paid mobile phone top-ups, as a channel, was dead.<sup>205</sup> Although, in epay's [

] <sup>206</sup>

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<sup>198</sup> Vodafone advised that [

] Commerce

Commission interview with Vodafone (16 March 2012).

<sup>199</sup> Telecom considered that new technologies might make the experience of topping up direct easier or better for consumers, but is unlikely to result in a "step change" in the number of direct pre-paid mobile phone top-ups. Commerce Commission interview with Telecom (19 March 2012).

<sup>200</sup> Similarly, 2degrees [

] Commerce

Commission interview with 2degrees (20 March 2012).

<sup>201</sup> Commerce Commission interview with [ ] (14 February 2012).

<sup>202</sup> [ ]

<sup>203</sup> Commerce Commission interview with [ ] (24 May 2012).

<sup>204</sup> Commerce Commission interview with [ ] (7 June 2012).

<sup>205</sup> Commerce Commission interview with epay (25 May 2012).

<sup>206</sup> [

] Both spreadsheet

and presentation were attached to e-mail from Bell Gully (on behalf of epay) to the Commerce Commission (28 February 2012).

*Conclusion on constraints from direct-top ups and post-pay mobile phones*

250. While the majority acknowledges the existence of at least some degree of constraint from direct top-ups, in the majority's view, at present and with the present suite of direct top-up options this constraint is not significant.<sup>207</sup>
251. Over time, greater penetration of smart phones and the introduction of new top-up technologies may further increase the proportion of direct pre-paid mobile phone top-ups and increase the ability of mobile companies to persuade consumers to switch top-up method.
252. However, even with continued migration away from in-store top-ups, it does not follow that direct top-ups will constrain price increases for in-store top-ups. If a price increase in in-store payment processing does not speed up the process of switching to direct payment methods, it still may be profit-maximising for epay to raise the price of direct top-ups.
253. In any event, it is difficult to predict the rate at which these technologies will gain a foothold such that they change consumers' preferred method of top-up and cause consumers to migrate away from topping-up in-store.
254. Indeed, while the majority considers that the uptake of smart phones and developments in technology could, in five years time, have significantly increased the proportion of customers topping up direct, the majority considers that there is insufficient evidence such a threat from direct top-ups will be realised within a two year time frame.
255. This means that while the majority recognises that the advent of emergent top-up and mobile technologies poses a real risk to the long-term viability of epay's top-up business, the majority is not satisfied that within the next two years this is likely to act as a significant constraint on its pricing.

**Direct integration with large retailers**

256. epay submitted that it will be constrained post-acquisition by the credible threat of mobile phone companies' directly integrating with large retailers.<sup>208 209</sup>
257. The questions for the Commission are:
- 257.1 Whether the threat of direct integration with large retailers is "credible". This necessarily involves an objective assessment of how likely direct integration is to occur. If, objectively, it is not likely, then the threat of direct integration is unlikely to be credible and hence will not constrain epay.

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<sup>207</sup> As described above at para 241, the majority considers the constraint from post-pay mobile phones to not be significant.

<sup>208</sup> Submission from epay to the Commerce Commission (28 March 2012).

<sup>209</sup> epay said it is "frequently made aware by both the telcos and the large retailers that one option for them is to bypass epay and set up a direct link". Application, para 25.



257.2 If the threat is credible, would the threat of direct integration with large retailers also constrain epay in relation to distribution through smaller retailers?

*epay's submissions on the likelihood of direct integration in the future*

258. epay submitted that direct integration was a credible threat particularly given the direct integration that occurred in Australia in 2011 and that [ ]<sup>210</sup>.

259. While epay acknowledged that there had been only one example of direct integration, direct integration with the supermarket chains or major fuel companies would likely occur post-acquisition if the merged entity sought to raise commissions.<sup>211</sup> epay submitted that [ ]<sup>212</sup>.

260. epay also submitted that [ ]<sup>213</sup>

Likelihood of direct integration

261. In relation to likelihood of direct integration, epay provided [ ]<sup>214</sup> epay advised the Commission that [ ]<sup>215</sup>.

262. In the pay-back analysis provided to the Commission, epay assumed:<sup>216</sup>

262.1 [ ];

262.2 [ ];

262.3 [ ],<sup>217</sup>

262.4 [ ]

],<sup>218 219</sup> and

<sup>210</sup> E-mail from Bell Gully (on behalf of epay) to the Commerce Commission (15 February 2012).

<sup>211</sup> Commerce Commission interview with epay (4 April 2012).

<sup>212</sup> Ibid.

<sup>213</sup> Submission from epay to the Commerce Commission (28 March 2012).

<sup>214</sup> Ibid.

<sup>215</sup> Submission from epay to the Commerce Commission (16 May 2012).

<sup>216</sup> Submission from epay to the Commerce Commission (28 March 2012).

<sup>217</sup> [ ]  
epay advised that [ ] Commerce  
Commission interview with epay (4 April 2012).

<sup>218</sup> This is because retail chains would want a higher margin to directly integrate. Commerce Commission interview with epay (4 April 2012).

262.5 [ ]

263. [ ]<sup>220</sup>

263.1 [ ]

263.2 [ ]

264. [ ]

264.1 [ ]<sup>221</sup> However, as described, the majority considers that prices will more likely decline from current levels rather than increase.

264.2 [ ]

[ ]<sup>222</sup> epay estimated that, depending on a retailer's POS system, the cost of this method of integration would be below \$[ ]<sup>223</sup>. However, evidence from [ ] indicates that [ ]

]

Extent of constraint: critical loss analysis

265. epay submitted that [ ]<sup>224</sup>

265.1 [ ]

]

265.2 epay submitted that [ ]

[ ]<sup>225</sup> [ ]

]

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<sup>219</sup> [ ]

<sup>220</sup> Submission from epay to the Commerce Commission (16 May 2012).

<sup>221</sup> Submission from epay to the Commerce Commission (28 March 2012).

<sup>222</sup> Submission from epay to the Commerce Commission (16 May 2012).

<sup>223</sup> Ibid.

<sup>224</sup> E-mail from Bell Gully (on behalf of epay) to the Commerce Commission (18 April 2012).

<sup>225</sup> [ ]

266. epay further submitted that [ ]<sup>226</sup>

*Existing direct integration*

267. Currently, there is only one instance of direct integration with a retailer in New Zealand. Telecom is directly integrated with The Warehouse.
268. The majority acknowledges that Vodafone and 2degrees are both directly integrated with Kiwibank, which itself is interconnected with NZ Post shops, but does not consider this to be “direct integration” per se.<sup>227</sup> This integration has occurred because Kiwibank has established itself as a competing distributor-agent, not because the mobile phone companies have elected to bypass the distributor-agent services of epay or Ezi-Pay and directly integrate into NZ Post shops.
269. Telecom’s direct integration with The Warehouse was established some years ago at a time when The Warehouse was re-selling numerous Telecom pre paid phones. This relationship made it worth Telecom investing in direct integration.<sup>228</sup>
270. Being directly integrated with The Warehouse [ ]<sup>229</sup> – and it [ ]<sup>230 231</sup>
271. Aside from The Warehouse example, there has not been an instance of direct integration by mobile phone companies in the past, even though both in-store pre-paid mobile top-up transaction volumes and the total commissions were higher in the past than they are today. Such higher commissions and volumes should have been more conducive to direct integration (although the majority acknowledges that historical costs of direct integration may have been higher).
272. That said, the majority must consider whether direct integration is likely in the future. In this respect, epay submitted that the “fact that the telcos are not all currently directly integrating could be for a number of reasons, including simply that they have higher project priorities”.<sup>232</sup>
273. In the majority’s view, evidence of past conduct (ie the general lack of direct integration), while not determinative, is relevant to an assessment of what is likely to

<sup>226</sup> Submission from epay to the Commerce Commission (16 May 2012).

<sup>227</sup> Unlike other distributor-agents, Kiwibank is also vertically integrated and (through its parent NZ Post), has its own retailers, namely NZ Post shops. At this point in time, Kiwibank’s retail network for the distribution of mobile top-ups is limited to NZ Post shops.

<sup>228</sup> Commerce Commission interview with Telecom (9 February 2012).

<sup>229</sup> Commerce Commission interview with Telecom (19 March 2012).

<sup>230</sup> [ ] Commerce Commission interview with [ ] (17 February 2012).

<sup>231</sup> Telecom advised the Commission that [ ] Commerce Commission interview with Telecom (19 March 2012).

<sup>232</sup> Submission from epay to the Commerce Commission (16 May 2012).

happen in the future. This is particularly the case given the majority expects commission rates to keep falling.

*Commission’s analysis of the likelihood of direct integration*

274. As indicated, whether the threat of direct integration with large retailers is “credible” necessarily involves an objective assessment of how likely direct integration is to occur. If, objectively, it is not likely, then the threat of direct integration is unlikely to be credible and hence will not constrain the merged entity.

Retailers that may justify direct integration

275. The evidence before the Commission indicates that because direct integration involves significant costs for both mobile phone companies and retailers, direct integration only makes financial sense when the relevant retailer handles a large volume of pre-paid mobile phone top-ups.

276. This has been the experience in Australia where direct integration has occurred with the supermarket chains, Woolworths and Coles.<sup>233</sup>

277. Table 8 disaggregates the in-store pre-paid mobile phone top-ups by store type.

**Table 8: Estimated proportion of in-store mobile phone top-up sales**

Store type	% of in-store top-ups by value	Face value of in-store top-ups
Dairies/convenience stores <sup>234</sup>	[ ]%	[\$ [ ]]
Supermarket chains		
- Foodstuffs	[ ]%	[\$ [ ]]
- Progressive	[ ]%	[\$ [ ]]
<b>Total supermarkets</b>	<b>[ ]%</b>	<b>[\$ [ ]]</b>
Petrol stations	[ ]%	[\$ [ ]]
[ ]	[ ]%	[\$ [ ]]
Other retailers	[ ]%	[\$ [ ]]

Source: epay, Ezi-Pay SmartPay and mobile phone companies. Note that in the data provided a small proportion independent fuel stations are also included in dairy/convenience.

278. Table 8 illustrates that the supermarket chains (Foodstuffs and Progressive) both handle significant values of pre-paid mobile phone top-ups, although Foodstuffs figures represent volumes across all three co-operatives. The majority understands that [

<sup>233</sup> [ ] similarly advised, in respect of the direct integration [

] Letter from [ ] to

the Commerce Commission (18 May 2012).

<sup>234</sup> There are close to 6,000 such retailers across New Zealand that provide pre-paid mobile phone top-ups. Whilst in total they account for a significant proportion of in-store pre-paid mobile phone top-ups, the volumes of top-ups undertaken by each of these retailers is considerably less than that done by a single supermarket.

]. The volumes through each of Foodstuffs (Wellington) Co-operative Society Limited (Foodstuffs Wellington) Foodstuffs Auckland Limited (Foodstuffs Auckland) and Foodstuffs South Island Limited (Foodstuffs SI) would be much lower and are likely to be more concentrated around Foodstuffs Auckland given population demographics.

279. The next biggest retail chain, in terms of top-ups, is [ ] stores. Similar to Foodstuffs, assuming an even split across the four major fuel companies, each handles around \$[ ] (or [ ]%) of in-store pre-paid mobile phone top-ups per annum. After these companies, [ ] is the next biggest retail chain [ ]. It handles in total [ ]% of in-store pre-paid mobile phone top-ups – \$[ ].
280. Based on these figures, the majority considers that the supermarket chains are the retailers that are the most plausible direct integrators due to their significant volumes. However, even these retailers have significantly lower volumes than the supermarkets in Australia.<sup>235</sup>
281. In any event, even if the supermarkets did directly integrate, Table 8 shows that the remaining retailers would represent the majority of the market.
282. The Commission explored with mobile phone companies and large retailers the likelihood of direct integration with large retailers and this evidence is summarised below.

#### Evidence from retail chains on likelihood of direct integration

283. In summary, the large retail chains to whom the Commission spoke advised the Commission that they would need a bigger margin to justify direct integration with mobile phone companies so as to compensate them for the costs they would incur (including direct costs, indirect costs and the costs of maintaining an additional supplier relationship).
284. As discussed above, The Warehouse is already directly integrated with Telecom. [ ]<sup>236</sup>

285. In relation to [ ]:

285.1 [ ]

] <sup>237</sup> [ ]

] <sup>238 239</sup> [ ]

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<sup>235</sup> [ ] Commerce Commission

interview with [ ] (1 May 2012)

<sup>236</sup> Commerce Commission interview with [ ] (17 February 2012).

<sup>237</sup> Commerce Commission interview with [ ] (10 February 2012).

<sup>238</sup> Ibid.

] <sup>240</sup>

285.2 [

] <sup>241</sup>

285.3 [

] <sup>242</sup>

285.3.1 [ ]

285.3.2 [ ]

285.3.3 [ ]

285.3.4 [ ]

285.3.5 [

]

286. Woolworths is directly linked with Telstra and Optus in Australia and has been since mid-2011. <sup>243</sup> [

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<sup>239</sup> [ ]

<sup>240</sup> Commerce Commission interview with [ ] (10 February 2012).

<sup>241</sup> Commerce Commission interview with [ ] (3 February 2012).

<sup>242</sup> Commerce Commission interview with [ ] (24 May 2012) and e-mail from [ ] to the Commerce Commission (24 May 2012).

<sup>243</sup> Woolworths directly integrated following the collapse of Bill Express Limited (Bill Express), a distributor-agent in Australia for in-store pre-paid mobile phone top-ups (the other two distributor-agents being epay and Touch, which is considerably smaller than epay). [

interview with [ ] (1 May 2012). [ ] Commerce Commission  
Commerce Commission interview with [ ] (3 May 2012). ]

] <sup>244</sup>

287. [

] <sup>245</sup> [

] <sup>246</sup>

288. [

] <sup>247</sup> [

] <sup>248</sup>

289. [

] <sup>249</sup>

Evidence from mobile phone companies on likelihood of direct integration

290. The views of each mobile phone company are considered in detail below.

2degrees

291. 2degrees advised the Commission that [

] <sup>250</sup> [

] <sup>251</sup>

292. 2degrees also advised the Commission that [

] <sup>252</sup> 2degrees [

] <sup>253</sup>

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<sup>244</sup> Commerce Commission interview with [ ] (1 May 2012). [

] Letter from [ ]

to the Commerce Commission (18 May 2012).

<sup>245</sup> Commerce Commission interview with [ ] (13 February 2012).

<sup>246</sup> Ibid.

<sup>247</sup> Ibid.

<sup>248</sup> Commerce Commission interview with [ ] (1 May 2012).

<sup>249</sup> Commerce Commission interview with [ ] (13 February 2012).

<sup>250</sup> E-mail from 2degrees to Commerce Commission (4 April 2012).

<sup>251</sup> Commerce Commission interview with 2degrees (10 February 2012).

<sup>252</sup> Ibid.

<sup>253</sup> Ibid.

293. As a result, 2degrees advised that [

] <sup>254</sup>

294. From 2degrees' perspective, [

] <sup>255</sup>

295. 2degrees has [

] <sup>256</sup> However, 2degrees advised [

] <sup>257</sup>

296. However, 2degrees has:

296.1 stated [

]; <sup>258</sup> and

296.2 [

] <sup>259</sup>

297. 2degrees [

] <sup>260</sup>

297.1 [

]

297.2 [

]

297.3 [

]

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<sup>254</sup> Ibid.

<sup>255</sup> Commerce Commission interview with 2degrees (14 May 2012).

<sup>256</sup> Commerce Commission interview with 2degrees (14 May 2012).

<sup>257</sup> Ibid.

<sup>258</sup> E-mail from 2degrees to the Commerce Commission (25 May 2012).

<sup>259</sup> Ibid.

<sup>260</sup> [ ], attached to e-mail from 2degrees to the Commerce Commission (23 May 2012) and Commerce Commission interview with 2degrees (24 May 2012).



298. [

] <sup>261</sup>

299. 2degrees advised that [

] <sup>262</sup>

[

]

300. 2degrees advised that [

] <sup>263 264</sup>

301. [

] <sup>265</sup> 2degrees advised that [

] <sup>266</sup> 2degrees stated that [

] <sup>267</sup> This is because 2degrees advised [

] <sup>268</sup>

302. 2degrees commented to the Commission that [

] <sup>269</sup> [

] <sup>270</sup>

303. [

] 2degrees advised that [

] <sup>271</sup>

<sup>261</sup>

Ibid.

<sup>262</sup>

Commerce Commission interview with 2degrees (20 March 2012).

<sup>263</sup>

Commerce Commission interview with 2degrees (14 May 2012).

<sup>264</sup>

2degrees had earlier advised the Commission that [

] Commerce Commission interview with

2degrees (14 May 2012).

<sup>265</sup>

Commerce Commission interview with 2degrees (20 March 2012).

<sup>266</sup>

Commerce Commission interview with 2degrees (14 May 2012).

<sup>267</sup>

Ibid.

<sup>268</sup>

[ ].

<sup>269</sup>

Commerce Commission interview with 2degrees (20 March 2012).

<sup>270</sup>

[ ].

<sup>271</sup>

Commerce Commission interview with 2degrees (14 May 2012).

304. If epay were to raise commissions post-acquisition, 2degrees advised that it [

] <sup>272</sup>

Telecom

305. Telecom advised that [ <sup>273</sup> but commented that [

] <sup>274</sup> Telecom also said that [

] <sup>275</sup>

306. As noted, Telecom is already directly integrated with The Warehouse. Telecom advised the Commission that [

] <sup>276</sup>

307. More generally, Telecom said [ <sup>277 278</sup> Telecom submitted: <sup>279</sup>

The costs to establish and maintain a direct retailer relationship are not insignificant. These relationships can take time to establish and there are IT development and integration costs for both the retailer and Telecom as the telecommunications provider. [

]

308. Telecom advised that, rather than direct integration with retailers, its preference and goal was to have more customers top-up direct. <sup>280</sup>

309. Nevertheless, Telecom confirmed that [

] <sup>281</sup> and said that if epay

sought to raise commissions post-acquisition, [

] <sup>282</sup> However, Telecom also

said [ <sup>283</sup>.

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<sup>272</sup> Commerce Commission interview with 2degrees (20 March 2012).

<sup>273</sup> E-mail from Telecom to the Commerce Commission (5 April 2012).

<sup>274</sup> Commerce Commission interview with Telecom (19 March 2012).

<sup>275</sup> Ibid.

<sup>276</sup> Commerce Commission interview with Telecom (9 February 2012).

<sup>277</sup> Commerce Commission interview with Telecom (6 June 2012).

<sup>278</sup> Telecom said [

] Commerce Commission interview with Telecom (9 February 2012).

<sup>279</sup> E-mail from Telecom to Commerce Commission (29 February 2012).

<sup>280</sup> Commerce Commission interview with Telecom (6 June 2012).

<sup>281</sup> Commerce Commission interview with Telecom (9 February 2012).

<sup>282</sup> Commerce Commission interview with Telecom (6 June 2012).

<sup>283</sup> Commerce Commission interview with Telecom (9 February 2012).

310. That said, [ ]  
Telecom customers topping up in NZ Post outlets are still issued with physical mobile-top cards. [ ]

[ ]<sup>284</sup>  
311. [ ] Telecom.<sup>285</sup>  
311.1 advised that [ ];  
311.2 would [ ]  
[ ];  
311.3 expects that [ ]

Vodafone

312. Vodafone advised that [ ]  
[ ]<sup>286</sup>  
313. Vodafone also said [ ]<sup>287</sup> and [ ]  
[ ]<sup>288</sup>  
314. [ ]  
[ ] Vodafone advised the Commission that [ ]  
[ ]<sup>289</sup> Vodafone also advised that [ ]  
[ ]<sup>290</sup>

315. Vodafone said [ ]  
[ ]<sup>291</sup>

<sup>284</sup> Commerce Commission interview with Telecom (19 March 2012).

<sup>285</sup> Commerce Commission interview with Telecom (9 February 2012).

<sup>286</sup> E-mail from Vodafone to the Commerce Commission (10 April 2012).

<sup>287</sup> Commerce Commission interview with Vodafone (5 June 2012).

<sup>288</sup> Commerce Commission interview with Vodafone (16 March 2012).

<sup>289</sup> Commerce Commission interview with Vodafone (9 February 2012).

<sup>290</sup> Ibid.

<sup>291</sup> Ibid.

316. Vodafone [

] <sup>292</sup>

317. Vodafone summarised its position by submitting that [

] <sup>293</sup>

318. If epay were to raise commissions significantly post-acquisition, Vodafone advised that [ <sup>294</sup> However, it commented that [ <sup>295</sup> and that [ <sup>296</sup>

319. [

] <sup>297</sup>

#### Majority's conclusion on likelihood of direct integration

320. It seems accepted that direct integration is unlikely for smaller retailers (eg, dairies), as such outlets do not have sufficient volumes to justify the cost of integration.

321. However, as illustrated by the preceding discussion, the majority is faced with conflicting evidence on the likelihood of direct integration for larger retailers and the extent to which the threat of direct integration is used as a constraint.

322. Hence, the majority has considered to what degree direct integration is likely to occur if epay should seek to maintain prices at a higher level in the factual compared to the counterfactual (but not necessarily higher than current prices).

323. The majority considers that direct integration is possible with supermarkets, but is not satisfied that direct integration with the supermarkets is likely and hence it is not satisfied that direct integration is likely to constrain the merged entity. This is because the cost of integration, including the costs of inducing supermarkets to bear the cost of switching, are high relative even at current prices.

324. [

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<sup>292</sup> Commerce Commission interview with Vodafone (16 March 2012).

<sup>293</sup> Ibid.

<sup>294</sup> Ibid.

<sup>295</sup> Commerce Commission interview with Vodafone (9 February 2012).

<sup>296</sup> Commerce Commission interview with Vodafone (16 March 2012)

<sup>297</sup> Commerce Commission interview with Vodafone (5 June 2012).

325. Moreover, even if the prospect of direct integration with supermarkets was likely, this would not necessarily constrain epay from increasing prices for volumes sold via other smaller retailers.

*Price discrimination*

326. The merged entity's ability to charge different prices to mobile phone companies depending on which retail channel their products are distributed through means that even if a mobile phone company directly integrated with some retailers (or an entrant entered one part of the market) successfully, this may not be sufficient in extent to constrain epay. That is, epay could charge higher prices for volumes through smaller retailers, if it thought direct integration would only likely occur via large retailers.
327. In relation to whether epay would be able to successfully charge different prices for volumes distributed through different retailers ("price discrimination"), epay submitted:<sup>298</sup>

Integration with retailers or a potential entrant's ability to readily sign up retailers would constrain epay because if epay did attempt to raise its prices via a price discrimination strategy it would result in the telco ensuring that it lost a substantial portion of its business. This means that any profitable price discrimination strategy that epay attempts to employ would be quickly and easily undermined.

Even if epay offered to reduce the margin it charged the telco for sales to Progressive (for example), if at the same time it was seeking to increase the margin payable for sales made via smaller retailers, the telco would still be incentivised to threaten to directly integrate into Progressive if it felt that were needed in order to constrain epay's pricing across the board. An offer by epay to reduce margin for Progressive sales would not change that.

328. The majority accepts that [ ]

329. However, [ ]

] <sup>299</sup>

330. Indeed, [ ] Furthermore, some interested parties have advised the Commission that more subtle forms of price discrimination may also already take place through the use of rebates and other incentives. [ ] commented to the Commission that "there's nothing contractually

<sup>298</sup> Submission from epay to the Commerce Commission (16 May 2012).

<sup>299</sup> For instance, if a mobile phone company sought to directly integrate with the supermarkets (or an entrant only looked to target small firms, such as dairies), epay could charge the mobile phone companies lower margins for the 'at-risk' retailers while charging higher margins for products distributed via other retailers which have less ability to switch.

stopping them {epay} from imposing other fees or charges on the retailer”.<sup>300</sup> Having said that, epay submitted that it “does not use rebates to price discriminate”.

331. The majority considers that price discrimination is likely to be feasible for epay. The potential for price discrimination increases the risk that prices for product distributed through retailers other than the supermarkets would increase.
332. In this respect, the majority’s estimates that epay would increase its profits if it lost the volumes from supermarkets (about [ ]% of total volumes) provided it was able to increase prices by [ ]% to all other retailers.<sup>301</sup> Similarly, a [ ]% price increase would be profitable if only [ ]% of volumes were lost. In practical terms, epay may be able to increase profits by increasing prices [ ]% even if it lost Progressive and/or one of Foodstuffs Auckland, Foodstuffs Wellington or Foodstuffs SI.
333. Whether epay could achieve such price increases for other retailers is dependent on the other constraints epay will face, such as the threat of entry and the countervailing power of mobile phone companies. These issues are explored further below.

#### **Potential competition**

334. An acquisition is unlikely to result in a SLC in a market if the businesses in that market continue to be subject to real constraints from the threat of market entry.<sup>302</sup>
335. The Commission considers whether viable entry is likely, timely and on sufficient scale so as to prevent any SLC in the factual. The Commission analyses whether any businesses, incentivised by price rises by epay, would enter the relevant market and thereafter expand.
336. The likely effectiveness of entry is determined by the nature and effect of the aggregate conditions of entry and expansion into the relevant market.<sup>303</sup> Hence the Commission examines entry conditions, together with any impediments to entry and expansion that entrants would face.<sup>304</sup>
337. In order for market entry to be a sufficient constraint, entry of new participants in response to a price increase or other manifestation of market power must be:
- 337.1 likely in commercial terms;
- 337.2 sufficient in extent to cause market participants to react in a significant manner; and
- 337.3 timely, that is, feasible within two years from the point at which market power is first exercised.

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<sup>300</sup> [ ]

<sup>301</sup> See Attachment A for further detail on the Commission’s critical loss analysis.

<sup>302</sup> *Mergers and Acquisitions Guidelines*, above n11, at p 27.

<sup>303</sup> *Commerce Commission v Southern Cross Medical Care Society (CA)* above n6 at para 73.

<sup>304</sup> Natural, regulatory and strategic barriers to entry are discussed on p 28 of the Commission’s *Mergers and Acquisitions Guidelines*.

338. For the reasons explained below, the majority is not satisfied that entry is likely to occur to a sufficient extent within a sufficiently timely period so as to constrain entry.

*Is entry likely?*

339. In order to be a constraint, entry must be likely in commercial terms.
340. An economically rational firm will be unlikely to enter a market unless it has a reasonable prospect of achieving a satisfactory return on investment, including an allowance for any risks involved.

Requirements for entry

341. At an aggregate level, there are three requirements an entrant must meet before it can enter the market, namely:
- 341.1 Establishing – and demonstrating to customers<sup>305 306</sup> – the technical capability necessary to process large numbers of transactions via retailers (eg software (including testing), an agreement with one of the EFTPOS payment switch networks (EFTPOS NZ or Paymark)).
- 341.2 Establishing supply contracts with mobile phone companies. The willingness of a mobile phone company to contract with a new supplier will depend on a number of factors. For example, mobile phone companies would incur costs by integrating with a new entrant and therefore, an entrant would need to convince the phone company that it has at least a realistic prospect of developing a retail network through which the mobile phone companies' payments can be completed.<sup>307 308 309</sup> This creates a 'chicken and egg' problem<sup>310</sup> as the entrant will also need to sign up retailers, the third requirement for entry. Nevertheless, the majority considers that in the factual, mobile companies are likely to be more willing to contract with an

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<sup>305</sup> For example, because of the risk of contracting with a new entrant [ ] advised that it would "want to be absolutely sure that they have got the proper systems in place". [ ]

<sup>306</sup> [ ]

]

<sup>307</sup> 2degrees advised that [ ]

[ ] As such 2degrees advised that [ ]

Commerce Commission interview with 2degrees (20 March 2012).

<sup>308</sup> Vodafone submitted that [ ] Vodafone also submitted that [ ] Submission from Vodafone to the Commerce Commission (15 February 2012).

<sup>309</sup> Telecom commented that [ ] Commerce Commission interview with Telecom (19 March 2012).

<sup>310</sup> [ ] described the scenario as "very much chicken and egg, because without the distribution it can sometimes be a challenge to get the product providers on board. And without product providers it is sometimes challenging to get distribution." [ ]

additional provider if they consider that this will place competitive constraint on epay.<sup>311 312 313</sup>

- 341.3 Establishing supply contracts with retailers. For larger retailers, switching costs may be significant (as discussed below), while more generally retailers may be unwilling to sign up with a new entrant unless that new entrant can provide mobile top-ups for the three mobile phone companies (and potentially other content providers).<sup>314</sup>
342. epay submitted that there are a number of parties that already meet some of the above requirements for entry, “many of whom need only receive content rights from the telcos in order to enter the market”.<sup>315</sup>
343. Because the majority considers that the issues relating to overcoming the first requirement (technical ) and third requirement (ability to sign retailers), differ according to whether an entrant is targeting large retailers (supermarket, petrol stations etc) or smaller retailers, the majority has separately considered each type of entry strategy below.
344. The majority acknowledges that potential entrants may in fact target both large and small retailers. Indeed, given the possibility of price discrimination discussed above, entry would need to be in both parts of the market for entry by itself to fully constrain epay.

#### Likelihood of entry via large retailers

345. Compared to an entrant targeting smaller retailers, an entrant targeting a few large retailers would need to contract with fewer retailers before it reached a minimum scale. For example, the largest individual supermarket customer (Progressive) represents as much as [ ]% of the market.<sup>316</sup>
346. However, there are other requirements that may be more acute for an entrant targeting smaller retailers, particularly switching costs.

#### Influence of switching costs for larger retailers

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<sup>311</sup> Vodafone has advised that, [ ] Commerce Commission interview with Vodafone (9 February 2012).

<sup>312</sup> Telecom stated that [ ] Commerce Commission interview with Telecom (9 February 2012).

<sup>313</sup> 2degrees advised that [ ] Commerce Commission interview with 2degrees (20 March 2012).

<sup>314</sup> If retailers are signed up to exclusive arrangements with epay (particularly, arrangements that are exclusive across a bundle of pre-paid products), this may hinder a potential entrants’ ability to gain significant market share to constrain epay in the factual. However, the majority has found that exclusive contacts with retailers are not pervasive in this market

<sup>315</sup> Submission from epay to the Commerce Commission (16 May 2012).

<sup>316</sup> While the three Foodstuffs co-operatives as a group represent [ ]%, each cooperative company represents only a portion of this total.



- 347. Larger stores generally have larger switching costs due to the costs of integrating with existing POS infrastructure.<sup>317</sup> Although, epay submitted that for large retailers, “the costs of switching are off-set by the large potential revenues available to payment processing services providers”.<sup>318</sup>
- 348. Since top-up products are essentially identical (putting aside broader portfolio effects), the majority considers that a new entrant would likely need to compensate the retailer for its switching costs or provide some other benefits/incentives. Evidence received by the Commission indicates that retailers may be unwilling to switch unless the entrant covers the switching costs incurred or otherwise provides a better product. The majority has assessed the extent of these switching costs.
- 349. While epay submitted that integration with a supplier of POS software would cost \$[ ],<sup>319</sup> the Commission requested details of direct integration costs from a number of parties, which are included in Table 9.
- 350. As is evident, the estimated costs vary widely, with a large part of that variation likely due to how the companies account for their internal costs and the degree to which retailers’ internal costs are compensated. Costs also depend on the particular IT and POS systems that parties have. Costs may be higher where retailers have their own in-house customised POS systems and lower where retailers use an “off-the-shelf” POS system (purchased from a supplier of POS software).

**Table 9: Examples of integration costs by distributor-agents**

Companies	Costs	Detail
[ ]	[ ]	[ ]
[ ]	[ ]	[ ]
[ ]	[ ]	[ ]
[ ]	[ ]	[ ]
[ ]	[ ]	[ ]

<sup>317</sup> Note that this is not necessarily the case for Progressive which is already with Blackhawk and InComm, two potential entrants.

<sup>318</sup> Submission from epay to the Commerce Commission (28 March 2012).

<sup>319</sup> Ibid.

Companies	Costs	Detail
[ ]	[ ]	[ ]
[ ]	[ ]	[ ] <sup>320</sup>
[ ]	[ ]	[ ] <sup>321</sup>
[ ]	[ ]	[ ] <sup>322</sup>
[ ]	[ ]	[ ] <sup>323</sup>
[ ]	[ ]	[ ] <sup>324</sup>

Source: Industry participants. Note that Blackhawk and InComm do not currently provide pre-paid mobile phone top-ups, rather they do gift cards and digital content. However, we understand that the integration costs are similar.

351. The data in Table 9 indicate varying – but in all cases substantial – switching costs (both direct and internal time costs) for large retailers. The higher switching costs are or are likely to be, the lower the likelihood of retailers actually switching and hence the more difficult it would be for an entrant to sign up retailers.
352. The fact that switching costs are high appears to be reflected in the fact that there have been only six examples of large retailers switching between distributor-agents in the last six years.<sup>325</sup> Moreover, of the six examples given it appears that two were primarily driven by changes in the retailer’s company ownership or structure.<sup>326</sup> The largest scale switch was [ ]<sup>327</sup>.

<sup>320</sup> E-mail from [ ] to the Commerce Commission (29 February 2012).

<sup>321</sup> E-mail from [ ] to the Commerce Commission (22 February 2012).

<sup>322</sup> Ibid.

<sup>323</sup> E-mail from [ ] to the Commerce Commission (23 February 2012) and e-mail from [ ] to the Commerce Commission (23 February 2012).

<sup>324</sup> Commerce Commission interview with [ ] (7 February 2012).

<sup>325</sup> E-mail from Bell Gully (on behalf of epay) to Commerce Commission (27 March 2012).

<sup>326</sup> [ ]

<sup>327</sup> [ ] Commerce Commission interview with epay (4 April 2012). [ ]

[ ] E-mail from [ ] to the Commerce Commission (16 April 2012).

353. [ ] submitted.<sup>328</sup>

Retailers tend to stay with their usual equipment provider/voucher supplier and switching rates are believed to be low. Retailers typically see technical and customer disruption as something inherent in a changeover process, and also see risk in changing supplier if their current equipment has been working reliably. [

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354. The majority expects that a new entrant would face the same challenges post-acquisition and would likely have to compensate retailers for the switching costs that retailers incur. The majority recognises that an entrant may be more willing to incur a retailer's switching costs if retailers were willing to enter into longer-term contracts. However, an entrant may find it difficult to persuade retailers to enter longer-term contracts unless retailers are confident that the entrant will have a successful network. We now turn to this issue.

Network effects – a successful network and the ability to offer a broad range of content

355. Entry into markets with switching costs can be made more difficult when such markets are characterised by network effects.<sup>329</sup> Network effects arise where a customer benefits from other customers also acquiring the product.

356. The majority considers that such network effects are present in this market because most (although not all)<sup>330</sup> large retailers prefer distributor-agents who have a breadth of content on offer. This is because it can reduce the retailer's transaction costs. However, a distributor-agent is better positioned to attract a breadth of content if it has a large retail network.

357. These network effects mean that if large retailers are to switch to an entrant, they will likely require a certain degree of confidence that the entrant will be successful in the future and, in particular, be able to provide a full range of products, including the apparently expanding consumer demand areas of gift cards and digital content.

358. This means an entrant is likely to need to attract – or demonstrate the potential to attract – additional content providers to their network before large retailers commit to switch.

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<sup>328</sup> [ ]

<sup>329</sup> Farrell and Klemperer, *Coordination and lock-in: Competition with switching costs and network effects*, Handbook of Industrial Organisation v3, p 2005

<sup>330</sup> For example, epay is Progressive's main distributor-agent, providing it with pre-paid mobile phone top-ups and calling cards. But Progressive has separately introduced a stand in its stores with gift and digital content cards. [

] Commerce Commission interview with [ ] (13 February 2012).

359. While epay submitted that “a new entrant or existing player wishing to grow its network would have no difficulty attracting content providers”,<sup>331</sup> this seems incongruous with its stated commercial rationale for the transaction.<sup>332</sup>
360. Indeed, some potential entrants, such as Blackhawk / Kiwibank and InComm, already have access to other pre-paid content, which would ameliorate any network effects for them.
361. In contrast to epay’s submission, the majority considers that any other new entrant would face difficulties in attracting (or demonstrating an ability to attract) sufficient high quality content providers over the next two years because:
- 361.1 The most desirable local gift card content providers are already signed up to, primarily, Ezi-Pay<sup>333</sup> and this may limit the number of “new” content providers that an entrant could sign up, unless epay was to increase prices charged to gift card content providers.
- 361.2 As indicated in Table 9, there is a cost associated with content providers integrating with a distributor-agent for some products. As such, content providers may be unwilling to use more than one distributor-agent unless fully compensated for these costs or unless that other content is highly desired by the retailer.
- 361.3 There may be value in content providers waiting, rather than bearing the risk of being one of the first to switch.

#### Conclusion on whether entry is likely for large retailers

362. While epay cited a number of possible entrants, the majority considers that Blackhawk / Kiwibank or InComm are the best placed to enter by targeting larger retailers.
363. This is because they are already integrated with some major retailers for gift cards and digital content,<sup>334</sup> and both have experience overseas being distributor-agents for pre-paid mobile phone top-ups. That is, they meet the “technical capability” requirement of entry and face low switching costs for some retailers.
364. However, the question is whether the Commission is satisfied that entry is commercially likely.
365. In that regard, [

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<sup>331</sup> Submission from epay to the Commerce Commission (28 March 2012).

<sup>332</sup> [

], attached to e-mail from Bell Gully (on behalf of epay) to the Commerce Commission (28 February 2012).

<sup>333</sup> As detailed later in the competition analysis of gift cards, epay has only a small direct presence in gift cards, but has an arrangement with Ezi-Pay to on-distribute some of its gift card content.

<sup>334</sup> Namely, Progressive, Dick Smith, [ ]

] <sup>335</sup>

366. [

] <sup>336</sup>

367. [

] <sup>337</sup>

368. [

] <sup>338</sup>

[

]

369. [

] <sup>339</sup>

[

]

370. Since Blackhawk / Kiwibank and InComm are already integrated with some retailers, the most significant being Progressive, if Blackhawk / Kiwibank or InComm contracted with the mobile phone companies, the switching costs for contracting with Progressive for pre-paid mobile phone top-ups as well, would be low. This suggests that Blackhawk / Kiwibank and Incomm may be likely entrants in terms of these retailers. The majority is satisfied that Blackhawk / Kiwibank is a likely entrant in terms of the retailers it is already integrated with, but the majority is not satisfied

<sup>335</sup> Commerce Commission interview with [ ] (7 February 2012).

<sup>336</sup> Ibid.

<sup>337</sup> E-mail from [ ] to the Commerce Commission (28 April 2012).

<sup>338</sup> Commerce Commission interview with [ ] (2 February 2012).

<sup>339</sup> E-mail from [ ] to the Commerce Commission (22 February 2012).

that InComm is in fact a likely entrant for such retailers [ ]<sup>340</sup>

371. In terms of likelihood of wider expansion into those retailers that are not already integrated with Blackhawk / Kiwibank and InComm, the majority considers that the switching costs are likely to be significant for most retailers. This finding is consistent with the lack of switching evident in the market.
372. While the majority acknowledges that entry is possible, even at current prices, [ ].
373. Given this evidence combined with the evidence on switching costs and network effects, the majority cannot be satisfied that potential expansion via larger retail chains meets the “likely” element of the LET test.

#### Likelihood of entry via smaller retailers

374. As already discussed, the issues associated with entry via smaller retailers differ from those in respect of entry via larger retailers.
375. As indicated in Table 8, around [ ]% of in-store pre-paid mobile phone top-up revenue is generated through the close to 6,000 dairies or convenience stores throughout New Zealand.
376. In contrast to switching costs for large retailers, the majority considers switching costs for these smaller retailers are likely to be low. As noted earlier, smaller retailers tend to use discrete terminals rather than a direct interface. These terminals are usually rented by the retailer, and could easily and quickly be exchanged should an entrant provide a better offer. Alternatively, an entrant could provide top-ups over a retailers’ pre-existing EFTPOS terminal.<sup>341 342</sup>
377. Further, network effects are unlikely to be an issue for an entrant focussing on these smaller retailers. Smaller retailers mainly sell only pre-paid mobile phone top-ups and calling cards, and hence an entrant into this segment would not need the same breadth of product offering as an entrant into the large retailer segment.
378. Evidence of these lower switching costs and smaller network effects is provided by switching/past practice: epay advised that around [ ] (or [ ]%) of small retailers have

<sup>340</sup> Commerce Commission interview with [ ] (2 February 2012).

<sup>341</sup> An entrant would need to develop software that worked over a particular type of EFTPOS terminal and negotiate with EFTPOS terminal suppliers to be able to install that software on their terminals. Software would need to be installed on a retailers’ EFTPOS terminal. However, the software could be downloaded and activated remotely. Commerce Commission interview with [ ] (24 May 2012).

<sup>342</sup> [ ]

[ ] Commerce Commission interview with [ ] (24 May 2012).

switched annually between epay, SmartPay and Ezi-Pay over the last 3 to 4 years.<sup>343</sup>  
<sup>344</sup> Nevertheless while switching costs and network effects may be lower, an entrant would need to sign up a greater number of retailers in order to create a viable base. An entrant distributor-agent would have to convince retailers to contract with it (use its services) to provide pre-paid mobile phone top-ups before installing any software over terminals.

379. The process of signing up smaller retailers may take significant time, and may require a different business model such as a sales force and, perhaps, advertising (with the associated costs).

380. This may, to a limited extent, be mitigated by the ability to sign up wholesalers or chains of convenience stores.<sup>345</sup> Touch, for example, advised that [ ]<sup>346</sup> For example, Red Circle is a wholesale supplier to [ ] convenience stores and independent fuel stations. [ ]

[ ]<sup>347</sup> However, wholesalers are a limited part of the market currently: epay informed the Commission that [ ]% of the independent dairies it is distributor-agent for are supplied directly by epay.<sup>348</sup>

381. Further, [ ]

[ ]<sup>349</sup> Given this, dairies may be willing and incentivised to sign up with a new entrant.

382. In terms of possible entrants, the majority considers that Touch is the best placed to enter. Touch is already active in the Australian market in the same segment.

383. Touch advised the Commission [ ]

[ ]<sup>350</sup>

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<sup>343</sup> E-mail from Bell Gully (on behalf of epay) to Commerce Commission (27 March 2012).

<sup>344</sup> In terms of switching costs for small retailers, epay further submitted “switching costs for small retailers are extremely low and, it is epay’s experience that switching occurs on a regular basis. Further, there is nothing stopping any small retailer from having dual providers of payment processing services. The administrative and logistical costs associated with switching are also minimal in that it generally takes epay only 48 hours to switch a customer”. Submission from epay to the Commerce Commission (28 March 2012).

<sup>345</sup> Examples of chains of convenience stores include City Star Convenience, City Stop, FiX and Night ‘n Day.

<sup>346</sup> Commerce Commission interview with Touch (12 April 2012).

<sup>347</sup> Commerce Commission interview with [ ] (20 March 2012).

<sup>348</sup> E-mail from Bell Gully (on behalf of epay) to Commerce Commission (27 March 2012).

<sup>349</sup> E-mail from [ ] to the Commerce Commission (15 March 2012).

<sup>350</sup> Commerce Commission interview with Touch (13 February 2012).

384. [

] <sup>351</sup>

385. [

] <sup>352 353</sup>

386. Touch also advised that [

] <sup>354</sup> [

] <sup>355</sup>

387. [

] <sup>356</sup>

[

]

388. In terms of the likelihood of mobile phone companies contracting with Touch, [

] <sup>357</sup>

389. In summary [

]

390. Therefore, while the majority recognises that Touch may possibly enter, the majority is not satisfied that its entry meets the “likely” element of the LET test.

Is a mobile phone company (or a group of them) likely to sponsor entry?

391. The majority’s conclusions on the likelihood of entry above focussed on an entrant unilaterally making a decision to enter the market and compete for business.

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<sup>351</sup> Ibid.

<sup>352</sup> Ibid.

<sup>353</sup> [

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<sup>354</sup> Commerce Commission interview with Touch (12 April 2012).

<sup>355</sup> E-mail from [ ] to the Commerce Commission (26 April 2012).

<sup>356</sup> E-mail from [ ] to the Commerce Commission (1 June 2012).

<sup>357</sup> [ ]



However, epay submitted that mobile phone companies could ‘sponsor’ a new entrant into the market.

392. epay submitted that mobile phone companies could empower a new entrant (or an existing provider) in a number of ways, including “offering them exclusive contracts or greater margins”,<sup>358</sup> or “simply granting a new entrant exclusivity or guaranteeing the entrant a sufficient volume of top-ups for an initial start up period”.<sup>359</sup> epay referred to examples of mobile phone companies sponsoring entry in the United States, South America and Spain.<sup>360</sup>

393. The majority [  
 ],<sup>361 362 363</sup>

394. As such, the Commission asked the mobile phone companies for their views on sponsoring entry or guaranteeing minimum volumes to an entrant.

395. 2degrees advised that [  
 ]<sup>364</sup>  
 [  
 ]

396. Vodafone submitted that [  
 ]<sup>365</sup>

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<sup>358</sup> Submission from epay to the Commerce Commission (16 May 2012).

<sup>359</sup> Ibid.

<sup>360</sup> Submission from epay to the Commerce Commission (28 March 2012).

<sup>361</sup> [  
 ]

<sup>362</sup> ] Electronic System Distribution Agreement between Vodafone and epay (11 December 2002), Prepaid Recharge Supply and Distribution Agreement between 2degrees and epay (2009), and Electronic System Distribution between Telecom and epay (31 March 2005).

However, to grant exclusive access or guarantee minimum volumes to an entrant, a mobile phone company may need to terminate its contract with epay and switch top-ups through specific retailers to the new entrant. [  
 ]

<sup>363</sup> Vodafone advised that [  
 ]

<sup>364</sup> ] Commerce Commission  
 interview with Vodafone (16 March 2012).

<sup>364</sup> E-mail from 2degrees to the Commerce Commission (25 May 2012).

<sup>365</sup> Letter from Vodafone to the Commerce Commission (25 May 2012).

[

]

397. Vodafone further advised the Commission, that [

that [ majority notes that [

]<sup>366</sup> The majority considers ] However, the

]

398. Telecom advised that [

]<sup>367</sup>

[

]

399. On sponsoring the expansion of an existing distributor-agent, Telecom advised:<sup>368</sup>

[

] We would have to evaluate any proposal carefully to ensure it aligns with our overall cost objectives, distribution efficiencies, customer needs and other factors. [

]

400. Based on these submissions, the majority considers that while exclusive contracts or minimum volumes would be technically possible, they are commercially unlikely because:

400.1 it would likely require coordination across the mobile phone companies or otherwise it would risk placing the initiating mobile phone company at a competitive disadvantage;

400.2 turning off a channel in one fell swoop is commercially high risk; and

400.3 sponsorship would be costly.

401. Another way the mobile phone companies could facilitate entry is by switching top-ups through their own stores to an entrant distributor-agent. Vodafone advised that

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<sup>366</sup> Ibid.

<sup>367</sup> E-mail from Telecom to the Commerce Commission (1 June 2012).

<sup>368</sup> Ibid.

[

] <sup>369</sup> The majority considers this is possible and accepts this might facilitate entry to some extent. However, the majority is mindful of [

] <sup>370</sup> Moreover, as previously noted, the majority is not satisfied that an entrant could rely on sponsorship from a mobile phone company and hence the majority is not satisfied that sponsorship makes entry any more likely.

#### Self-provision by a mobile phone company in its own stores

402. Another form of entry option would be a mobile phone company self-providing in its own stores. 2degrees has already done this, <sup>371</sup> and epay advised the Commission that Vodafone [ ] <sup>372</sup>.

403. When asked about this, Vodafone advised the Commission that [

] <sup>373</sup>

404. A mobile phone company could in theory also go even further and distribute pre-paid mobile phone top-ups through retailers itself. [

] <sup>374</sup> The majority has not, however, been made aware of other examples of this occurring in New Zealand or elsewhere around the world.

405. In summary, while the majority considers it possible that Vodafone and Telecom could self-supply in their own stores, it is not satisfied that this meets the “likely” element of the LET test.

#### Conclusion on likelihood of entry

406. For the reasons explained, the majority:

406.1 is satisfied that Blackhawk / Kiwibank meets the “likely” element of the LET test for retailers which they are already integrated with;

406.2 is not satisfied that the potential entry of Blackhawk / Kiwibank (or any other person) via other larger retailers meets the “likely” element of the LET test; and

406.3 is not satisfied that entry by Touch (or any other person) via smaller retailers meets the “likely” element of the LET test.

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<sup>369</sup> Commerce Commission interview with [ ] (16 March 2012).

<sup>370</sup> Commerce Commission interview with [ ] (21 February 2012).

<sup>371</sup> Submission from epay to the Commerce Commission (28 March 2012).

<sup>372</sup> Ibid.

<sup>373</sup> Commerce Commission interview with Vodafone (5 June 2012).

<sup>374</sup> Commerce Commission interview with [ ] (24 May 2012).

*Extent of entry required*

- 407. Generally, a potential entrant may be able to constrain epay even if it is only able to acquire part of the market, if the loss of that proportion of the market renders a price increase by epay unprofitable.
- 408. In respect of entry via large retailers that are already directly connected to Blackhawk / Kiwibank, while the majority considers this meets the “likely” threshold, the majority is not satisfied that such entry would be sufficient to constrain epay.
- 409. Based on the Commission’s critical loss analysis, a [ ]% price increase in respect of all volumes distributed through all other retailers would be profitable for epay even if this resulted in an entrant entering the market by providing mobile top-ups distributed through Progressive for all mobile phone companies.
- 410. In relation to smaller retailers, while the majority is not satisfied that Touch’s entry is “likely”, the majority has considered whether if entry did occur, it would be sufficient in extent to constrain epay.
- 411. [ ]

] <sup>375</sup> <sup>376</sup> [ ]  
 ] <sup>377</sup> [ ]  
 [ ]

412. [ ] are set out in Table 10.

**Table 10:** [ ]

	Year 1	Year 2	Year 3
[ ]	[ ]%	[ ]%	[ ]%
[ ]	[ ]%	[ ]%	[ ]%

[ ]

413. As evidenced by Table 10, [ ]

<sup>375</sup> E-mail from [ ] to the Commerce Commission (22 February 2012).

<sup>376</sup> epay advised the Commission that [ ]

[ ] Commerce Commission

interview with epay (4 April 2012).

<sup>377</sup> E-mail from [ ] to the Commerce Commission (22 February 2012).

]

Timeliness of entry

414. The majority acknowledges that entry by Blackhawk / Kiwibank expanding in relation to retailers with which they are already integrated, could occur quickly.
415. In relation to entry via smaller retailers, the majority recognises that there is some prospect for entry. The majority consider that if that entry occurred via primarily contracting with smaller retailers, then the timeliness of that entry may also be of concern.
416. epay submitted that “effective entry could be achieved within 3-6 months”.<sup>378</sup> [ ] advised that this was an unrealistic timeframe for a party to enter with an effective footprint of retailers. There would not be a “reallocation of market share” on entry, instead an entrant would take a long time (a number of years) to attract retailers and content providers.<sup>379</sup>
417. While equipping itself to compete in the market may be a relatively quick process, [ ]<sup>380</sup>  
Other potential entrants would likely face a similar lead in period.

Modelling of entry

418. Although not specifically addressing questions of likelihood, extent or timeliness of entry, the Commission has estimated the profitability of entry into the in-store mobile phone top-up market to help inform the Commission’s assessment of the constraint that epay may face from potential competition.
419. Modelling entry in such a market is particularly challenging due to the need to estimate an entrant’s potential market share or yearly transactions, as well as costs and unit revenue. As opposed to, say, a factory where capacity is usually fixed within certain bounds, market share or transaction volumes in this instance depend on how many retailers an entrant can contract with.
420. As described above, the majority considers that a distributor-agent entrant is more likely to rely on existing terminals and existing POS systems, rather than investing in replicating such infrastructure.<sup>381</sup> This view appears consistent with epay’s views.<sup>382</sup> Therefore, the Commission has modelled entry on the basis of the ‘lower cost’ entry model that relies substantively on existing infrastructure and systems.

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<sup>378</sup> Application, para 20.2.

<sup>379</sup> [ ]

<sup>380</sup> E-mail from [ ] to the Commerce Commission (22 February 2012).

<sup>381</sup> Although we note that bespoke integration into large retailers’ POS systems may still be required.

<sup>382</sup> E-mail from Bell Gully (on behalf of epay) to the Commerce Commission (27 April 2012).

421. The Commission has developed a 10-year NPV model based on information gathered throughout its investigation.<sup>383</sup>
422. The model suggests that entry could be profitable at current prices given the following main assumptions:
- 422.1 Initial capital investment of \$[ ], which is significantly lower than Ezi-Pay's historic \$[ ] investment in assets.<sup>384</sup> It is also significantly lower than epay's proposed purchase price for Ezi-Pay of \$[ ].<sup>385 386</sup>
- 422.2 Overheads of \$[ ] per year, with additional staff costs as the number of contracted retailers grows. Those additional costs are \$[ ] sales staff costs per [ ] extra retailers and an additional \$[ ] support staff costs per additional [ ] retailers. epay has submitted that each additional sales and administration staff person can deal with around [ ] outlets.<sup>387</sup>
- 422.3 An entrant contracting with 500 small retailers in the first year, 1,500 retailers by year two, 2,500 by year three, 3,000 retailers by year four and an additional 100 retailers in each of the remaining years. This would mean that by year five, the entrant would likely account for about half of the in-store transaction in the market. epay has advised that on average small retailers process about [ ] transactions per year.<sup>388</sup>
- 422.4 An entrant would contract with one large retailer, two large retailers by year two, and three large retailers for years 3-10. epay has advised that on average large retailers process about [ ] transactions per year.<sup>389</sup>
- 422.5 Based on these assumptions, an entrant would process 1,444,500 transactions in year one, 4,305,500 transactions in year two and 7,162,500 transactions in year three. The model therefore produces a market share for the entrant of about 34% by year three.<sup>390</sup> These projected transactions are [ ] when compared to [ ]<sup>391</sup> That is, [ ]% market share by year three.

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<sup>383</sup> [ ]  
<sup>384</sup> epay also submitted that Ezi-Pay's historic investment is "not a reasonable approximation of the likely capital expenditure to be incurred by a new entrant", primarily due to the lower investment into actual hardware. epay has submitted that [ ]. Submission from epay to the Commerce Commission (16 May 2012).

<sup>385</sup> [ ]  
<sup>386</sup> However, epay has submitted that its "business model is a different model to the one that epay presented to the Commission as a model that a potential entrant would enter on". Submission from epay to the Commerce Commission (16 May 2012).

<sup>387</sup> Submission from epay to the Commerce Commission (16 May 2012).

<sup>388</sup> E-mail from Bell Gully (on behalf of epay) to the Commerce Commission (11 June 2012).

<sup>389</sup> Submission from epay to the Commerce Commission (16 May 2012).

<sup>390</sup> This assumes that the total number of transactions in the market is stable over the next three years.

<sup>391</sup> E-mail from [ ] to the Commerce Commission (22 February 2012).

422.6 An average margin for the entrant of between [ ]%. This range encompasses [ ] estimated margin<sup>392</sup> – [ ] – and epay’s estimated current average margin – [ ]].

423. The results of this modelling suggest that entry could be barely profitable for an entrant with an average margin of [ ]% and low start up costs if it could reasonably quickly sign up a significant number of retailers, both smaller retailers and some larger retailers. The profitability of entry would increase significantly if an entrant could achieve average margins of [ ]%, the upper end of the range and above the commissions currently earned by distributor-agents.

424. These results indicate that an entrant would need to have confidence that it could quickly grow market share for it to have confidence that entry would be profitable. For the reasons explained above, the majority is not satisfied that a new entrant would be able to achieve the requisite level of market share and hence this modelling highlights the majority’s concerns about the likelihood of entry.

#### *Conclusion on LET test*

425. For the reasons explained the majority is not satisfied that entry is likely to occur to a sufficient extent to constrain epay within a two-year period.

#### *Conclusion on potential competition*

426. For the reasons explained, the majority is not satisfied that potential entry would be a sufficient competitive constraint post-acquisition.

#### **Countervailing power**

427. In some circumstances the potential for epay to exercise market power may be sufficiently constrained by a buyer or supplier to eliminate concerns that an acquisition may lead to a SLC.

428. epay submitted that post-acquisition the mobile phone companies “will continue to have substantial countervailing power” and that this will constrain epay’s pricing.<sup>393</sup>

[ ]

429. epay has also submitted that the revenues of epay as distributor-agent for in-store pre-paid mobile phone top-ups “are dwarfed by each of the three main telcos’ revenues”, arguing that this size alone gives them countervailing power.<sup>394</sup> The mobile phone companies being large in relation to epay is only one factor relevant to assessing whether the potential for epay to exercise market power may be

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<sup>392</sup> [ ]

<sup>393</sup> E-mail from Bell Gully (on behalf of epay) to the Commerce Commission (15 February 2012).

<sup>394</sup> E-mail from Bell Gully (on behalf of epay) to Commerce Commission (18 April 2012).

sufficiently constrained by countervailing power. The mobile phone companies also need to be “well informed about alternative sources of supply, readily able to switch from one supplier to another, and able to foster new supply (including own supply)”.<sup>395</sup>

430. Post-acquisition, the leverage that the mobile companies have would likely be reduced as a result of the loss of the existing significant competitive constraint provided by Ezi-Pay.

431. In this regard, [ ] has submitted:<sup>396</sup>

Although [ ], any countervailing power will be nullified after the takeover – there would be no credible alternative provider available. Being a large customer itself is not sufficient – countervailing power is unable to be effectively exercised unless there is a credible threat of switching away from the supplier.

432. epay submitted that, if the mobile phone companies are at risk post-acquisition, “they will respond” and a lack of switching to date was not indicative of behaviour post-acquisition.<sup>397</sup> epay further submitted that mobile phone companies could exercise countervailing power to empower (short of sponsorship) another distributor-agent by:<sup>398</sup>

432.1 [

]

432.2 [

]

433. epay also submitted that, in response to a price rise post-acquisition, “2degrees and Vodafone could credibly threaten to print scratch cards to bypass epay and Telecom could credibly threaten to increase its distribution of scratch cards”.<sup>399</sup> epay submitted that, following the collapse of Bill Express in Australia, “both Optus and Telstra launched physical scratch cards into the market for prepay within one month”.<sup>400</sup>

434. Scratch cards were historically the way all pre-paid mobile phone users topped up their phones. Telecom and Vodafone printed physical top-up cards (on cardboard) in

<sup>395</sup> *Mergers and Acquisitions Guidelines*, above n11, at p 31.

<sup>396</sup> [ ]

<sup>397</sup> Commerce Commission interview with epay (4 April 2012).

<sup>398</sup> Submission from epay to the Commerce Commission (28 March 2012).

<sup>399</sup> E-mail from Bell Gully (on behalf of epay) to Commerce Commission (18 April 2012).

<sup>400</sup> Submission from epay to the Commerce Commission (16 May 2012).



specific fixed denominations and distributed them direct to retailers. Consumers would purchase a top-up card, scratch off a panel to reveal a PIN number, and then call up and enter the number to activate the top-up. However, for retailers, scratch cards were easily stolen and retailers had to themselves pre-pay for card stocks before they sold them. In light of the issues with scratch cards, the mobile phone companies sought an electronic solution, which led in 2003 to both the creation of Ezi-Pay and the entry of epay into New Zealand. Currently, scratch cards are only used by Telecom customers topping up in NZ Post outlets, [

]. The majority considers it unlikely that mobile phone companies would want to revert to using scratch cards for in-store pre-paid mobile phone top-ups.

435. Overall, the majority recognises that the mobile phone companies have some degree of countervailing power. They are large customers of epay, which relies on their ongoing business. However, for countervailing power to be sufficient to constrain an entity, customers must have alternatives. As outlined earlier, the majority has doubts as to whether direct integration and new entry will be viable commercial alternatives for the mobile phone companies. [ ] and switching their own-brand stores to a new entrant may ease an entrant's pathway to some extent. epay will also be keen to grow other revenue streams with mobile phone companies, such as [ ].
436. The removal of Ezi-Pay as a current competitor however, suggests that mobile phone companies' countervailing power will be reduced should the merger go ahead, as it would remove their main alternative to epay.

### **The constraints taken together**

437. epay submitted it is critical to assess the cumulative effect of the various options mobile companies have to discipline a price increase.<sup>401</sup>
438. The majority acknowledges that, even if not one of the individual constraints by itself is sufficient to prevent a likely SLC, taken together as a suite, they may provide a sufficient constraint. This could occur when the individual constraints are likely and are indeed cumulative.
439. As an initial point, the majority does not consider that all of the key constraints identified by epay (even if they were likely) are necessarily cumulative.
440. The distribution of mobile top-ups through large retailers is a particular example of this. Direct integration is most likely to happen for large retailers, but if direct integration occurs, new entry into these retailers is less likely to occur.
441. More generally, the majority considers that for constraints to have a cumulative effect, they must first be likely to constrain to some extent. In other words, the "accumulation" of constraints is a question of quantum or extent, not likelihood.

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<sup>401</sup> Ibid.

442. Logically, adding a series of unlikely constraints together does not transform them into a likely constraint, although adding a series of likely but insufficient constraints together may transform the group into a collective sufficient constraint. For example if entry were likely in the large and small retailer segments but neither involved sufficient volumes to constrain epay, then it may be appropriate to add the potential volume losses together to assess whether taken together that likely volume loss would constrain epay.
443. However, that is not the position here in relation to many of the constraints, as the majority is not satisfied that:
- 443.1 direct integration is likely;
- 443.2 entry into the large retailer segment (other than for retailers already integrated with Blackhawk / Kiwibank) is likely;
- 443.3 entry into the smaller retailer segment is likely; and/or
- 443.4 self-supply is likely.
444. In that circumstance, there is no reason to think that adding these unlikely constraints together would translate those constraints into a collectively likely constraint.
445. The majority accepts that the constraint provided by direct top-ups should be added to the other “likely” constraints. However, the majority is not satisfied that this constraint when added to these other constraints is sufficient to allay the majority’s concerns about a likely SLC.

### Efficiencies

446. epay expects to derive some scale efficiencies from the acquisition of Ezi-Pay that will allow epay to reduce its costs.<sup>402</sup> In its internal presentation on the proposed acquisition of Ezi-Pay, epay identifies cost synergies arising from the merger of US\$[ ]<sup>403</sup>.

447. epay further submitted that [ ]

In this respect, epay submitted that it [ ]<sup>404</sup> [ ]<sup>405</sup> [ ]

]

<sup>402</sup> Application, para 28.1.

<sup>403</sup> [ ], attached to e-mail from Bell Gully (on behalf of epay) to the Commerce Commission (28 February 2012).

<sup>404</sup> E-mail from Bell Gully (on behalf of epay) to Commerce Commission (18 April 2012).

<sup>405</sup> Based on 2011 figures.

448. As explained earlier, to the extent that efficiencies are relevant under the clearance regime, efficiency gains of the required magnitude and credibility will very rarely be sufficient to satisfy the Commission that competition would not be substantially lessened.
449. On the basis of the information provided by epay, the majority is not satisfied that the efficiencies claimed would be likely to be sufficient to ensure that competition would not be substantially lessened.
450. However, the majority notes that the efficiencies claimed could be considered as part of an authorisation application.<sup>406</sup>

### Conclusion

451. Based on the evidence and information provided, the majority cannot be satisfied that the acquisition will not have, or would not be likely to have, the effect of a SLC in the in-store mobile top-up market.

### Competition analysis – calling cards

452. Table 11 outlines the market shares in the in-store calling card market.

**Table 11: Market shares of calling cards**

	\$ (millions)	%
epay	\$[ ]	[ ]%
Ezi-Pay	[ ]	[ ]%
<b>Merged entity</b>	[ ]	[ ]%
Self-supply by calling card companies	[ ]	[ ]%
Other <sup>407</sup>	[ ]	[ ]%
<b>Total</b>	<b>\$[ ]</b>	<b>100%</b>

Source: Estimated from information provided by industry participants. Figures are based on the face value of calling card sales and recharges, not commission of the distributor-agent.

453. Table 11 shows that post acquisition epay would have a market share of [ ]%. However, direct supply of pre-loaded cards by calling card companies make up a significant portion of in-store calling card sales, approximately [ ]%
454. epay submitted that post-acquisition, it would continue to face constraint from:
- 454.1 calling card companies<sup>408</sup> selling pre-loaded calling cards direct to retailers,<sup>409 410</sup>

<sup>406</sup> When assessing an authorisation application, the Commission would consider the overall loss of total welfare. That is, to the extent that they do not reduce efficiency or reduce society's total welfare, transfers of wealth between New Zealanders are generally not considered as a detriment in an authorisation setting.

<sup>407</sup> This includes calling card sales and recharges done through a direct integration that Telecom has with The Warehouse, by TopUp NZ in Telecom stores, and by Kiwibank in NZ Post shops.

<sup>408</sup> There are four main calling card providers in New Zealand. They are CardCall [ ]%, Compass [ ]%, Telecom [ ]% and TelstraClear [ ]%.

- 454.2 calling card companies selling online and over the phone (as noted earlier, we consider online and phone sales to be outside the relevant market);<sup>411</sup>
- 454.3 existing competitors including NZ Post, SmartPay, and TopUp NZ;<sup>412</sup>
- 454.4 the potential for direct integration by calling card companies with retailers;<sup>413</sup> and
- 454.5 the potential for new distributor-agents to enter the market.<sup>414</sup>

### **Constraint from pre-loaded calling card sales**

455. While the information set out in the market definition section shows that [ ], the Commission considers that pre-loaded cards are close enough substitutes so as to be in the same market as cards distributed and activated by distributor-agents.
456. [ ]
457. The Commission considers that direct in-store sales by calling card companies would be likely to constrain epay from raising prices. Calling card companies have direct control as to whether they supply a retailer with pre-loaded cards or supply their cards for charging via a distributor-agent. While there would likely be some retailers that would be reluctant to switch to pre-loaded cards, calling card companies would only need to switch sufficient volumes away from epay to constrain a price increase.
458. While the Commission acknowledges calling card companies' concerns in relation to the additional costs of the pre-loaded card sales channel, [ ]. All four calling card companies already supply some type of pre-loaded card directly and all have the ability to expand this model further if incentivised by a proposed price increase by epay.
459. [ ]<sup>415</sup>

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<sup>409</sup> TelstraClear's retailer direct model [ ]

<sup>410</sup> Submission from epay to the Commerce Commission (28 March 2012), para 11.1.

<sup>411</sup> Submission from epay to the Commerce Commission (28 March 2012), para 11.1 and para 2.5(a).

<sup>412</sup> Application, para 16.3.

<sup>413</sup> Submission from epay to the Commerce Commission (28 March 2012), para 11.1.

<sup>414</sup> Application, para 20.5.

<sup>415</sup> Submission from [ ] to Commerce Commission (1 March 2012).

460. [

] <sup>416</sup>

461. However, as discussed above at para 173, Ezi-Pay has a common ownership with Compass. As such, Ezi-Pay may currently have the incentive to restrict other calling card companies' abilities to market and merchandise their products directly with retailers in order to elevate Compass's calling card offering. Post-acquisition Compass would not have any association with epay, removing this incentive.

#### **Constraint from Smartpay, TopUp NZ and Kiwibank**

462. The Commission considers that Smartpay, TopUp NZ and Kiwibank are unlikely to provide any significant constraint on epay.

463. SmartPay's position is discussed above in relation to pre-paid mobile phone top-ups at paras 218-224. These considerations are also relevant to calling cards. Therefore the Commission concludes that SmartPay is unlikely to expand to place any significant constraint on epay.

464. Similarly, TopUp NZ is also discussed above at paras 225-229 in relation to pre-paid mobile phone top-ups. TopUp NZ's calling cards sales account for approximately [ ]% of in-store calling card sales and is limited to sales of Telecom calling cards in Telecom stores. The Commission concludes that TopUp NZ is unlikely to expand to place any significant constraint on epay.

465. KiwiBank sells pre-loaded calling cards through NZ Post stores. [

] <sup>417</sup> Like pre-paid mobile phone top-ups, the Commission considers that Kiwibank is unlikely to expand its calling card sales to such an extent as to place a significant constraint on epay.

#### **Conclusion**

466. The Commission is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in the in-store calling card market due to the presence of existing competition from calling card suppliers supplying direct to the market.

#### **Competition analysis – gift cards**

467. Table 12 provides an estimate of the existing market shares in the third-party gift card market. Note that the on-distribution of Ezi-Pay gift card content by epay is shown in epay's market share.

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<sup>416</sup> Ibid.

<sup>417</sup> Commerce Commission interview with [ ] (14 February 2012).

**Table 12: Market shares of gift cards**

	\$ (millions)	%
epay	\$[ ]	[ ]%
Ezi-Pay	[ ]	[ ]%
<b>Merged entity</b>	<b>[ ]</b>	<b>[ ]%</b>
Blackhawk / Kiwibank	[ ]	[ ]%
<b>Total</b>	<b>\$[ ]</b>	<b>100%</b>

Source: Estimated from information provided by industry participants. Figures are based on the face value of gift cards, not commission of the distributor-agent.

468. Table 12 shows that post-acquisition epay would have an estimated market share of [ ]% but that because of epay's limited presence in gift cards, the aggregation in market share is very small.
469. epay submitted that that there is little difference between the factual and counterfactual and that post-acquisition, it would continue to face constraint in gift cards from:<sup>418</sup>
- 469.1 existing competing distributor-agents;
  - 469.2 retail chains selling their gift cards direct to consumers in their stores;
  - 469.3 potential competition from other distributor-agents; and
  - 469.4 the countervailing power of content providers.
470. While epay would have a large share in the market as defined, as already noted under market definition, sales of gift cards out-of-store currently account for only a very small proportion of all gift card sales in New Zealand. Most gift cards are sold directly in-store by the content provider. The Commission expects in-store sales to continue to provide some degree of constraint.
471. As indicated in Table 12, there are only three distributor-agents of gift cards out-of-store, being epay, Ezi-Pay and Blackhawk / Kiwibank. As well as distributing gift cards out-of-store, epay and Ezi-Pay are also involved in the management of in-store gift card programs for certain content providers that choose not to do these themselves.
472. Ezi-Pay is the largest distributor-agent of gift cards out-of-store in New Zealand and significantly bigger than epay and Blackhawk / Kiwibank. Ezi-Pay introduced the concept of gift card stands into New Zealand and was distributing gift cards out-of-store for a period before the entry of epay and Blackhawk / Kiwibank. Ezi-Pay, as a result, secured the rights to distribute gift cards out-of-store for many of New Zealand's leading retail chains.
473. epay, in contrast, has only a very small presence in gift cards. [

<sup>418</sup> Application, paras 16.4, 20.8-20.10 and 25.

] However, prior to the proposed acquisition, epay negotiated to on-distribute the top eight gift cards distributed by Ezi-Pay. Notwithstanding this, epay submitted that it would, in gift cards, [ ].<sup>419</sup> Accordingly, epay submitted that change in the competitive landscape in gift cards from the proposed acquisition is comparatively low.<sup>420</sup>

- 474. The Commission accepts that there is little change in the competitive dynamics in this market as between the factual and the counterfactual. While epay submitted that [ ]<sup>421</sup>, the Commission accepts epay’s submission that it [ ]
- 475. Moreover, the Commission considers the existing competition from Blackhawk / Kiwibank which is larger than epay today, would be likely to continue to provide sufficient competitive constraint to offset any little change between the factual and the counterfactual.
- 476. For these reasons, the Commission is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in the third-party gift card market.

**Competition analysis – digital content**

477. Table 13 provides an estimate of the existing market shares. Note that the on-distribution of epay and InComm digital card content by Ezi-Pay is shown in Ezi-Pay’s market share.

**Table 13: Market shares of digital content**

	\$ (millions)	%
epay	[\$ ]	[ ]%
Ezi-Pay	[ ]	[ ]%
<b>Merged entity</b>	<b>[ ]</b>	<b>[ ]%</b>
Blackhawk / Kiwibank	[ ]	[ ]%
InComm	[ ]	[ ]%
Direct by content providers	[ ]	[ ]%
<b>Total</b>	<b>[\$ ]</b>	<b>100%</b>

Source: Estimated from information provided by industry participants. Direct by content providers is estimate only. Figures are based on the face value of digital content cards, not commission of the distributor-agent.

478. Table 13 shows that post-acquisition epay would have an estimated market share of [ ]%.

<sup>419</sup> Application, para 20.10.

<sup>420</sup> Ibid.

<sup>421</sup> [ ]

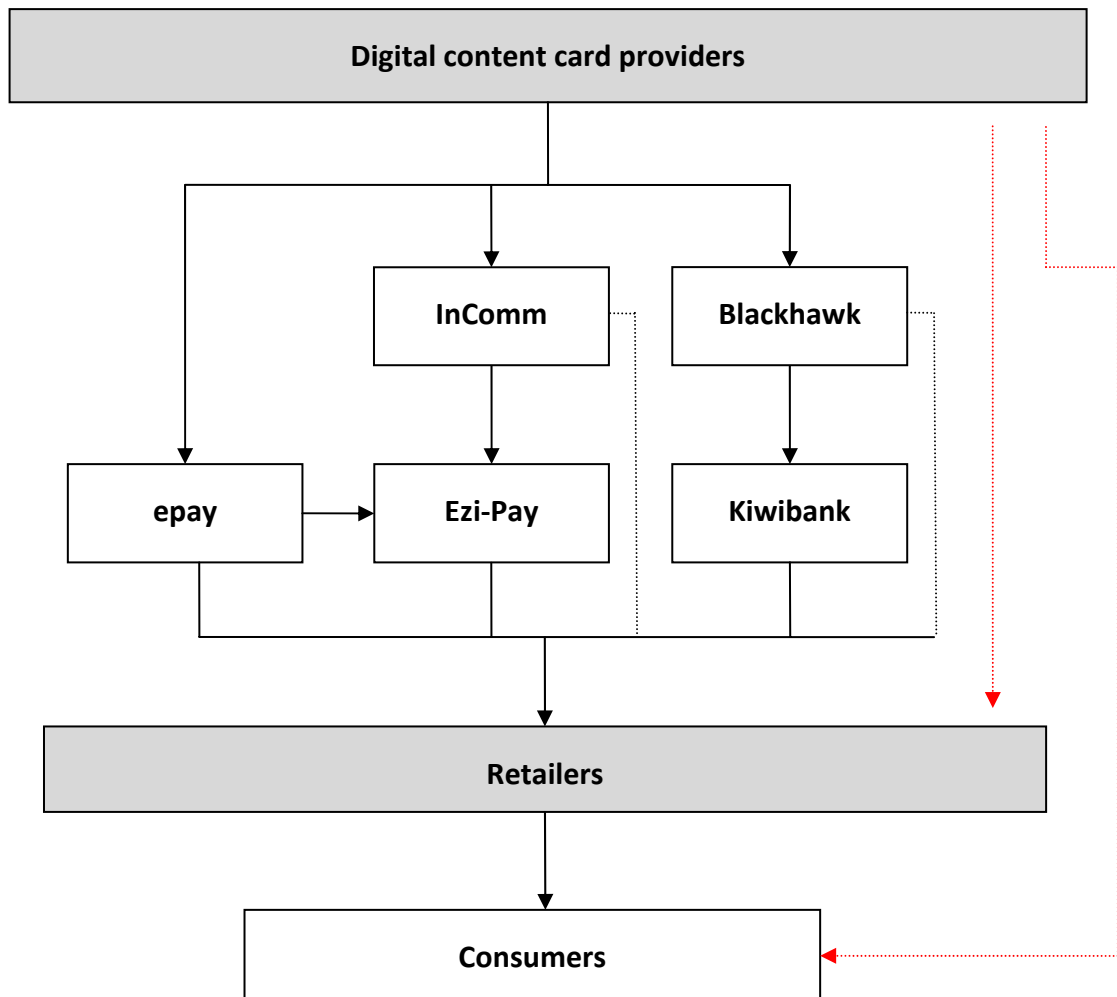
] Application, para 5.3.

479. Notwithstanding this high market share, epay submitted that post-acquisition, it would continue to face constraint in digital content from:<sup>422</sup>
- 479.1 existing competing distributor-agents;
  - 479.2 digital content providers selling content direct to consumers online and directly into retailers;
  - 479.3 potential competition from other distributor-agents; and
  - 479.4 the countervailing power of content providers.
480. There are only four distributor-agents of digital content cards, being epay, Ezi-Pay, InComm and Blackhawk / Kiwibank. In contrast to gift cards, there is less differentiation in content between the distributor-agents.
481. epay is the largest distributor-agent of digital content cards in New Zealand. But, due to the size of its retail distribution network, Ezi-Pay is also a significant distributor-agent of digital content cards, even though (as discussed below) it does not have direct access to content.
482. In the distribution of digital content cards, there are some arrangements amongst the competing distributor-agents to on-distribute certain cards where they do not otherwise have access to content, as set out in Figure 5.

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<sup>422</sup> Application, paras 16.5, 20.11-20.12 and 25.



**Figure 5: Inter-relationships in terms of digital content cards**

483. As indicated in Figure 5, while ePay, InComm and Blackhawk all have rights to distribute iTunes cards and other digital content, Ezi-Pay does not itself have any rights to distribute digital content. Instead, Ezi-Pay has arrangements with both ePay and InComm to enable Ezi-Pay to on-distribute digital content through its retailers. Similarly, Blackhawk on-distributes certain digital content through its partnership with Kiwibank.
484. Inter-relationships between distributor-agents appear to exist in the market for two reasons:
- 484.1 Because one distributor-agent holds the exclusive rights to distribute certain content, or for some other reason a distributor-agent is unable to secure the rights to distribute content directly themselves.
- 484.2 A distributor-agent holds the exclusive rights to distribute certain content, but it or a retailer cannot justify the costs of direct integration, so as to distribute the content in that retailer, because “that’s expensive”.<sup>423</sup> [ ] advised that in the case of a small number of cards, it is not worth getting

<sup>423</sup> Commerce Commission interview with [ ] (9 February 2012).

them directly from second distributor-agents.<sup>424</sup> [ ]  
 advised that it might be worth dealing directly with a second distributor-agent if they offered improved margins.<sup>425</sup>

### *Blackhawk and Kiwibank*

485. As already discussed, Blackhawk entered New Zealand around two years ago. Its business in New Zealand is currently limited to the distribution of gift cards and digital content cards. While it distributes some content direct to a few retail chains, on the back of international relationships, otherwise its distribution of gift cards and digital content in New Zealand is through its partnership with Kiwibank.

486. The revenue of Blackhawk / Kiwibank from the distribution of digital content is [ ]. Blackhawk's total digital content card sales, direct and through Kiwibank, currently constitute [ ]% of the market.

487. As noted earlier, [

] <sup>426</sup>

488. [ ] <sup>427</sup>

489. Blackhawk / Kiwibank have had limited success since entering. [ ] <sup>428</sup> [

] <sup>429</sup> This appears to be for the following reasons:

489.1 Ezi-Pay got into the market first and holds the rights to distribute gift cards out-of-store for many of New Zealand's leading retail chains. In contrast, Blackhawk's gift card content is very Australian-oriented. A number of industry participants commented to the Commission that the Blackhawk gift card content is currently not very attractive to retailers with stands of cards in-store.<sup>430</sup> Although, Blackhawk does have a comprehensive range of digital content.

489.2 Blackhawk does not currently offer a wide range of pre-paid products, in particular pre-paid mobile phone top-ups. This means that Blackhawk / Kiwibank need to convince or incentivise a retailer to be integrated with a second distributor-agent in order to stock Blackhawk / Kiwibank cards. A

<sup>424</sup> Commerce Commission interview with [ ] (17 February 2012).

<sup>425</sup> Commerce Commission interview with [ ] (10 February 2012).

<sup>426</sup> Commerce Commission interview with [ ] (7 February 2012) and Commerce Commission interview with [ ] (14 February 2012).

<sup>427</sup> Commerce Commission interview with [ ] (7 February 2012)

<sup>428</sup> Commerce Commission interview with [ ] (14 February 2012)

<sup>429</sup> Commerce Commission interview with [ ] (7 February 2012).

<sup>430</sup> Commerce Commission interview with [ ] (10 February 2012).

retailer is only likely to do so if it wants to offer a wide or greater range of content.<sup>431</sup>

490. As discussed earlier, [

] <sup>432</sup>

491. epay submitted that, in the short-to-medium term, the gift card market “is likely to attract much greater attention from the large international players such as Blackhawk, Incomm, etc”.<sup>433</sup> epay further submitted that, if it were to seek to reduce service levels or otherwise act less competitively post-acquisition that would “only provide these competitors with the scope to expand faster”.<sup>434</sup> [

] <sup>435</sup>

492. It is possible that Blackhawk / Kiwibank may be able to expand distribution of digital content cards in New Zealand by a combination of the following:

492.1 Contracting with additional digital content providers to distribute through its current contracted retailers.

492.2 Convincing those retailers who wish to stock a wide range of pre-paid card content to stock Blackhawk / Kiwibank digital content cards in addition to any pre-paid products already supplied by another distributor-agent. Blackhawk has already successfully done this with Progressive.

492.3 Blackhawk / Kiwibank securing more attractive gift card content, which together with its existing digital content, will be a more appealing stand of cards to retailers, that they may want to stock instead of an epay stand. Blackhawk has recently won distribution of the [ ] cards from Ezi-Pay.

493. The Commission considers that Blackhawk / Kiwibank provides some constraint in the market for distributing digital content and is likely to have some ability to expand both the scope and scale of its operations so as to be a greater constraint on epay in the future. The Commission considers that some expansion by Blackhawk / Kiwibank via any of the methods mentioned above is more likely to occur than de novo entry by Blackhawk into the in-store mobile top-up market.

#### *InComm*

494. InComm entered New Zealand in 2010. As already noted, its business in New Zealand is currently limited to the distribution of digital content cards. Like Blackhawk, InComm distributes some content direct to a few retail chains, on the back of

<sup>431</sup> Commerce Commission interview with [ ] (13 February 2012).

<sup>432</sup> Commerce Commission interview with [ ] (7 February 2012).

<sup>433</sup> Application, para 10.5.

<sup>434</sup> Application, para 21.1.

<sup>435</sup> Commerce Commission interview with [ ] (14 February 2012).

international relationships. Otherwise, its distribution of digital content in New Zealand is through its partnership with Ezi-Pay. Its direct gift card sales outside of its partnership with Ezi-Pay constitute only [ ]% of the market. Around [ ]% of InComm's total New Zealand sales are through Ezi-Pay.

495. [

] <sup>436</sup> [

] <sup>437</sup>

496. As noted earlier, it is uncertain what will happen to the partnership between Ezi-Pay and InComm if the acquisition proceeds. [

] <sup>438</sup>

497. [

] <sup>439</sup>

498. While the Commission acknowledges that InComm currently provides some constraint, the Commission considers that InComm is unlikely to expand to such an extent so as to place a significant constraint on epay in the factual.

*Countervailing power of large digital content providers*

499. Apple and Microsoft are significant providers of digital content in respect of iTunes, Microsoft software and Xbox gaming content. The Commission contacted Apple and Microsoft as part of its investigation of the proposed acquisition.

500. [

] <sup>440</sup>

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<sup>436</sup> Commerce Commission interview with [ ] (9 February 2012).

<sup>437</sup> Commerce Commission interview with [ ] (2 February 2012).

<sup>438</sup> Ibid.

<sup>439</sup> Commerce Commission interview with [ ] (2 February 2012) and Commerce Commission interview with [ ] (17 February 2012).

<sup>440</sup> Commerce Commission interview with [ ] (24 February 2012).

501. [

] <sup>441</sup>

502. In response to attempts by the epay post-acquisition to increase commissions, large content providers like Apple and Microsoft could exercise countervailing power by no longer using epay as distributor-agent (within New Zealand, but perhaps also overseas). Because Apple and Microsoft have sought after digital content, retailers that currently get such content via epay would likely look to get it from other distributor-agents instead. This may in turn aid the ability of existing competitors to expand.
503. The Commission considers the potential for epay to exercise market power in the market for the distribution and in-store payment processing of digital content in New Zealand would likely be sufficiently constrained by large digital content providers.

### Conclusion

504. Due to the countervailing power of content providers and the constraint from existing competitors, the Commission is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in the in-store digital content market.

### Competition analysis – pre-paid electricity

505. Table 14 outlines the market shares in the market for pre-paid electricity top-ups.

**Table 14: Market shares of pre-paid electricity**

	\$ (million)	%
epay	[\$ ]	[ ]%
Ezi-Pay	[ ]	[ ]%
<b>Merged entity</b>	<b>[ ]</b>	<b>[ ]%</b>
Kiwibank	[ ]	[ ]%
Self supply by electricity retailers	[ ]	[ ]%
<b>Total</b>	<b>[\$ ]</b>	<b>100%</b>

Source: Estimated from information provided by industry participants. Figures are based on the face value of pre-paid electricity, not commission or fee of the distributor-agent.

506. As discussed in the market definition section, while a number of major electricity retailers offer pre-pay electricity, only Mercury (Mighty River Power) uses a distributor-agent. Other retailers offer a range of top-up options. The above market share table shows that the majority ([ ]%) of pre-pay electricity payments are made via methods that do not involve distributor-agents.
507. epay submitted that pre-pay electricity is minor area of overlap and that pre-pay electricity would be less than 10% of Mercury's total revenue and a much smaller

<sup>441</sup> E-mail from [ ] to Commerce Commission (7 March 2012).

portion of the overall retail market.<sup>442</sup> epay also submitted that “switching by customers would almost certainly defeat any proposed price increase”.<sup>443</sup>

508. The Commission considers that in the event that epay attempted to increase prices, Mercury would have the ability to persuade customers to use alternative payment methods.
509. Contact provides the widest range of payments options to pre-pay electricity customers. Table 15 below sets out the breakdown between payments types for Contact customers.

**Table 15: Contact’s prepay customers’ top-ups by channel**

	%
Kiwibank	[ ]%
Credit card	[ ]%
Direct debit	[ ]%
Automatic payments	[ ]%
<b>Total</b>	<b>100%</b>

Source: Estimated from information provided from Contact. Percentages based on face value of sales.

510. In general, the use by Contact of a number of top-up options for pre-pay customers, none of which include topping up through a distributor-agent, suggests that Mercury, too, could cut out the use of epay in face of a price increase without a significant impact on its sales.
511. Mercury currently uses only one of Contact’s payment methods, namely credit cards. However, Mercury’s levels of credit card top-up, available both over the phone or online, are currently very low in comparison to Contact’s. This is likely in part attributable to the credit card option only being introduced in February 2012. For Contact, in contrast, as indicated in Table 15, credit card top-ups make up [ ] of all Contact customers’ pre-pay electricity top-ups.
512. While Mercury submitted that [ ],<sup>444</sup> the Commission is satisfied that the ability of Mercury to credibly threaten to switch to these types of payments methods would be sufficient to constrain epay from raising prices. [ ] Contact told the Commission that:<sup>445</sup>

[

]

<sup>442</sup> Application, para 8.20.

<sup>443</sup> Submission from epay to the Commerce Commission (28 March 2012).

<sup>444</sup> Commerce Commission interview with Mercury (10 February 2012).

<sup>445</sup> E-mail from Contact to Commerce Commission (20 April 2012).

513. While Contact offers a number of top-up options to pre-pay customers, the figures in Table 15 show that most of Contact's customers top-up via Kiwibank/NZ Post. Other electricity retailers have developed self-supply options that provide top-ups for pre-paid electricity through retailers, but by-pass distributor-agents:

513.1 As noted above at para 162, [

] This method is the only way in which Genesis's pre-pay electricity customers can top-up and it makes up [ ]% of the market in New Zealand for the distribution and payment processing of pre-paid electricity.

513.2 Similarly, Meridian pre-pay electricity customers have a limited number<sup>446</sup> of self-service kiosks they can use to top-up. Meridian explained that [

].<sup>447</sup> The transactions made through these retailers makes up [ ]% of the total market in New Zealand for the distribution and payment processing of pre-paid electricity.

514. Genesis' and Meridian's experience indicates that switching to self-supply through retailers is a real alternative for electricity retailers, if faced with a price increase.

515. The Commission therefore concludes that the range of self supply options available to electricity retailers is sufficient to constrain epay from raising prices.

516. We also note that Mercury has in the past signed term agreements with epay. In April, Mercury renewed its contract with epay, with pricing agreed as follows:<sup>448</sup>

516.1 [ ]; and

516.2 [

]

517. This agreement will further protect Mercury from being exposed to price increases by epay.

518. For these reasons, the Commission is satisfied that the proposed acquisition will not have, or would not be likely to have the effect of substantially lessening competition in the market for pre-paid electricity top-ups.

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<sup>446</sup> Twelve outlets in Christchurch, seven in Whangarei, and three in the Hawke's Bay.

<sup>447</sup> E-mail from Meridian to Commerce Commission (20 April 2012).

<sup>448</sup> Commerce Commission interview with Mercury (10 February 2012) and e-mail from Mercury to Commerce Commission (11 June 2012).

### **Determination on Notice of Clearance**

519. Pursuant to s 66(3)(b) of the Commerce Act 1986, the majority of the Division of the Commission determines to decline to give clearance for the proposed acquisition.

520. Gowan Pickering has dissented from the majority decision and his opinion follows.

Dated 15 June 2012

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Dr Mark Berry  
Chair



## Attachment A: Critical Loss Analysis

- A1. Critical loss analysis balances the additional profit from an increase in price with the loss in profit from reduced volumes following an increase in price. In this instance, the analysis considers what price increase epay would have to achieve for a given decrease in volumes for its total profits to remain unchanged. That is, it calculates the margins on the volumes lost and equates that to the additional margin on the remaining volumes.
- A2. To calculate the proportion of customers epay would need to lose we use the following formula: critical loss (volume) = price increase/(price increase + gross margin percentage). In this instance [ ]% = [ ]%/( [ ]%+[ ]%). That is, if epay earned an additional [ ]% on its commission for its remaining sales, this would approximately equal the lost commission on [ ]% of its current sales.
- A3. The gross margin percentage is epay's gross margin as a proportion of the price it receives, which we estimate to be [ ]%.
- A4. We consider the relevant price to be epay's total commission – the average of this is about [ ]%<sup>449</sup> – including both the retailer commission and the commission retained by epay. The retailers' commission cost is a variable cost, akin to costs of goods sold, that is incurred for every additional unit sold. The gross commission is therefore the total commission minus the retailer commission (a variable cost) minus other variable costs.
- A5. epay has argued that its contribution margin is [ ]%.<sup>450</sup> In its calculation, epay has used its net commission as the relevant price (i.e. the total commission minus the retailers' commission). The Commission has estimated this net commission to be [ ]% on average. The net commission does not include the retailers' commission, and consequently variable costs are lower and gross margins are higher.
- A6. The two approaches to price should not, theoretically, impact the outcome of a comprehensive competition analysis. This is because the actual gross margin that epay earns as a dollar amount is the same in both cases.
- A7. The critical loss figures (i.e. how much volumes epay would need to lose for a given price increase) is only one half of the analysis. The other half is the actual loss, which is what volumes epay would *actually* lose if prices increased by a certain amount. This reality would not change as a result the different approaches to price taken by the Commission and epay.
- A8. For instance, consider the situation where epay could hypothetically increase mobile phone companies cost from [ ]% to [ ]% (a change of [ ]%) before inciting entry or vertical integration.

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<sup>449</sup> [ ]  
<sup>450</sup> Submission from epay to the Commerce Commission (16 May 2012). ]

- A9. That would be about an [ ]% increase on epay's price.<sup>451</sup> Conversely, using the Commission's approach, it would be about a [ ]% increase in price.<sup>452</sup>
- A10. Regardless of which approach to price is taken, the *actual* impact on epay and customers remains the same. epay will earn more margin on the volumes it keeps, but lose a certain amount of volumes. The mobile phone companies would, in this example, face a cost increase for in-store top-ups equivalent to [ ]% of revenue.

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<sup>451</sup> [ ]  
<sup>452</sup> [ ]

## Dissenting opinion of Gowan Pickering

1. For the reasons given by the majority, I am satisfied that epay's acquisition of the assets or shares of Ezi-Pay will not have, or would not be likely to have, the effect of substantially lessening competition in the in-store calling card, third-party gift card, in-store digital content market and pre-paid electricity top-up markets (as the majority has defined those markets).<sup>1</sup>
2. However for the reasons I explain below, unlike the majority, I am also satisfied that the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in the market in which epay and Ezi-Pay supply pre-paid mobile top-up services to mobile phone companies.
3. Accordingly, I would give clearance for epay to acquire the assets or shares of Ezi-Pay.

### Market definition

4. I disagree with the majority's market definition. While I agree that the potential to switch to post-pay mobiles falls outside the relevant market, my view is that the relevant market includes direct top-ups.
5. The Act defines a market as:<sup>2</sup>

a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them.
6. In my view the evidence demonstrates that direct top-ups and in-store top-ups are substitutes as a matter of fact and commercial common sense. This can be seen by examining the data in Table 1 of the majority's decision.<sup>3</sup> This data illustrates that:
  - 6.1 in 2011, nearly [ ] out of every [ ] top-up transactions ([ ]%), was a direct top-up transaction that completely by-passed epay and Ezi-Pay; and
  - 6.2 in the five year period from 2007 to 2011 the value of direct top-ups has [ ], increasing from \$[ ] (or [ ]% of all top-ups) to \$150 million. Over the same period, in-store top-ups have declined in value from \$[ ] to \$[ ].
7. Telecom and Vodafone are the only mobile phone companies that have been operating for this entire period. For those companies:
  - 7.1 Vodafone's direct top-ups increased from \$[ ] in 2007 to \$[ ] in 2011, a growth of [ ]% over this period. At the same time, in-store top-ups declined from \$[ ] to \$[ ].

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<sup>1</sup> Majority reasons, para 53.

<sup>2</sup> Section 3(1A) of the Act.

<sup>3</sup> Majority reasons, p 34.

- 7.2 Telecom's direct top-ups increased from \$[ ] in 2007 to \$[ ] in 2011, a growth of [ ]% over this period. At the same time, in-store top-ups declined from \$[ ] to \$[ ].
8. No doubt some of the reduction in Vodafone's and Telecom's in-store top-ups has been as a result of 2degrees' entry into the mobile market in 2009. However, in contrast to in-store top-ups, Vodafone's and Telecom's direct top-ups have continued to increase for Vodafone and Telecom, despite 2degrees' entry. In my view, this data reflects the increasing importance of direct top-ups in the market. This growth is also hard to reconcile with the mobile phone companies' submissions that [ ]<sup>4</sup>
9. The majority's decision to exclude direct top-ups from the relevant market is premised on the notion that telecommunications companies would not be able to convince additional customers to switch their direct top-up payment methods to defeat a price increase. Specifically the majority says:
- 9.1 There is a limit to the set of pre-paid customers that may switch to topping up directly.<sup>5</sup>
- 9.2 The [ ]<sup>6</sup>
- 9.3 A price increase has little incremental impact on the incentive and the ability of the mobile phone companies to induce their customers to switch to topping up directly.<sup>7</sup>
10. I do not agree that telecommunications companies would be unable to switch sufficient customers to top-up direct over a sufficiently short time frame to constrain a price increase.

*A limited set of customers?*

11. The majority suggests that the proportion of customers that are currently able to directly top-up is limited, particularly by the number of persons who do not hold credit cards.<sup>8</sup> I accept that most direct top-ups currently occur by way of credit card and that most of the direct top-ups require use of a credit card. I also accept that those who cannot obtain a credit card for whatever reason find it more difficult to top-up directly.
12. However, there are still some in-store top-ups that are conducted via credit card and which it would seem could be easily switched to direct top-ups. The only evidence the Commission has on this is the evidence from [ ] that [ ]% of top-ups in its stores are made via credit card.<sup>9</sup> If that number is reflective across retailers, [ ]%

<sup>4</sup> Commerce Commission interview with Vodafone (9 February 2012).

<sup>5</sup> Majority reasons, para 102.

<sup>6</sup> Majority reasons, para 105.

<sup>7</sup> Majority reasons, paras 94-95.

<sup>8</sup> Majority reasons, paras 102-103.

<sup>9</sup> [ ]

represents nearly \$[ ] in in-store top-ups. Mobile companies could switch some of these top-ups to direct top-ups relatively easily.

13. In any event, credit cards are not the only method by which direct top-ups can occur. Further, interested parties seem united in their view that the range of non-credit card direct top-up options will increase in the future, although there were different views as to the impact this growth would have on in-store top-ups. For example, and as highlighted in the majority's decision:

13.1 [ ]<sup>10</sup>

13.2 [ ]<sup>11</sup> (I acknowledge that some of these handset transactions will involve payment via credit card).

14. [ ]<sup>12</sup>

15. That said, as the figures on the growth of direct top-ups show, there is already strong growth in direct top-ups and new technology may simply enable this trend to continue for longer than it otherwise would.

16. My view is that the range of top-up options will increase over time and that this will significantly expand the number of customers that will be able to top-up direct. I expect this growth to be much quicker than the majority, particularly given the general rise of e-commerce, and the concurrent demand by consumers for methods of paying for goods and services online or via electronic channels using non-credit card methods of payment.

17. The range of options either available or which are likely to become available include:

17.1 Scheme debit cards such as Visa Debit or MasterCard debit which can be used in the same way as eftpos cards. [ ] informed the Commission that it had seen significant growth recently in the use of debit cards;<sup>13</sup> greater use and wider acceptance of debit cards as a means of online payment increases the proportion of customers able to top-up direct as more people are able to obtain a debit card more easily.<sup>14</sup>

17.2 Enabling top-ups to be paid for directly from a customer's bank account:

<sup>10</sup> Commerce Commission interview with [ ] (14 February 2012).

<sup>11</sup> [ ]

<sup>12</sup> [ ]

<sup>13</sup> Commerce Commission interview with [ ] (24 May 2012).

<sup>14</sup> For example, ASB and Kiwibank each offer Visa Debit cards to customers over 15, and ASB offers Visa Debit to customers between 13 and 15 with parental or guardian consent.

17.2.1 This already occurs in other markets. Air New Zealand, for example, offers customers the ability to pay for airline tickets using PoLi.<sup>15</sup> The PoLi system is supported by all the major New Zealand trading banks.<sup>16</sup>

17.2.2 It is also already supported via Vodafone’s “Hotlink” which allows direct payment from ASB, BNZ and TSB bank accounts,<sup>17</sup> and Telecom’s “M top-up” which allows direct payment from ASB, Kiwibank and TSB.<sup>18</sup>

17.2.3 [ ]<sup>19</sup>

17.2.4 [ ]<sup>20</sup>

17.2.5 [ ]<sup>21</sup>

17.2.6 By using ATMs: currently, ASB, BNZ and Westpac ATMs are enabled to allow Vodafone customers to top-up directly. epay has highlighted the entry of white label ATM providers which are connected to all the major trading banks as an avenue whereby mobile phone companies could extend ATM top-up distribution.<sup>22</sup>

17.3 The ability to top-up via smart phones directly linked to bank accounts (or credit or debit cards): as noted in the majority decision,<sup>23</sup> the level of smart phone penetration is expected to increase [ ]. Vodafone estimates that the proportion of its pre-pay customers with a smart phone will be [ ].<sup>24</sup> Telecom indicated that it expected that [ ].<sup>25</sup> I agree with epay that “It is unrealistic to believe that telcos will be unable to switch their customers to paying for air time over smart phones”.<sup>26</sup>

17.4 NFC, or similar technology, is likely to be rolled out in the medium term. [ ]

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<sup>15</sup> [ ]  
<sup>16</sup> See [https://airnz.custhelp.com/app/answers/detail/a\\_id/2422/related/1](https://airnz.custhelp.com/app/answers/detail/a_id/2422/related/1) (last accessed 1 June 2012).  
<sup>17</sup> See <http://www.vodafone.co.nz/phones-plans/paying-your-bill/hotlink/> (last accessed 6 June 2012).  
<sup>18</sup> Commerce Commission interview with Telecom (9 February 2012).  
<sup>19</sup> [ ]  
<sup>20</sup> Commerce Commission interview with [ ] (21 February 2012).  
<sup>21</sup> [ ]  
<sup>22</sup> Submission from epay to the Commerce Commission (16 May 2012). See also <http://www.vodafone.co.nz/phones-plans/prepay/etopup/> (last accessed 6 June 2012).  
<sup>23</sup> Majority reasons, para 244.  
<sup>24</sup> E-mail from Vodafone to the Commerce Commission (26 March 2012).  
<sup>25</sup> Commerce Commission interview with Telecom (19 March 2012).  
<sup>26</sup> Submission from epay to the Commerce Commission (16 May 2012).

] <sup>27</sup> epay has submitted that the mobile phone companies have already undergone the back-end integration with Paymark for the NFC project, Paymark being the processor of [ ]% of all New Zealand's electronic transactions.<sup>28</sup>

18. Given that in-store top-ups are an expensive distribution channel for the mobile phone companies, they will have every incentive to develop and promote these alternative top-up methods and I believe that they will do so.

*Will only a small number of customers switch?*

19. I do not agree with the majority that mobile phone companies would not be able to switch sufficient customers over a sufficiently short time-frame to constrain epay from imposing a price increase.

20. Indeed, the evidence indicates that the mobile phone companies have been successful in growing the number of people topping-up direct.

21. The majority's decision is based in large part on evidence from Vodafone that the proportion of people topping up direct during [ ] specific price promotions increased by only around [ ].<sup>29</sup> Vodafone commented that:<sup>30</sup>

[

]

22. From this, the majority reason that Vodafone will not be able to shift consumers to topping up direct in response to a price increase. I do not think the evidence provided supports such a conclusion (particularly given [ ]).

23. On its face, the fact that Vodafone has run specific promotions suggests that Vodafone does believe it can influence customers to switch to direct top-ups. It is also notable that [ ], the proportion of Vodafone customers topping-up direct increased from [ ]% to [ ]%.

24. However, this represents only limited evidence. Telecom, for example, has not run any specific promotions designed to promote customers to top-up direct. epay also informed us that [ ].<sup>31</sup>

25. Accordingly, I think it is dangerous to generalise from Vodafone's limited experience to hold that all specific promotions, or promotions more generally, will not succeed.

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<sup>27</sup> [ ]

<sup>28</sup> Submission from epay to the Commerce Commission (16 May 2012).

<sup>29</sup> E-mail from Vodafone to Commerce Commission (26 March 2012).

<sup>30</sup> Ibid.

<sup>31</sup> Submission from epay to the Commerce Commission (28 March 2012).

26. In any event, the growth in Vodafone’s direct top-ups [ ] illustrates that mobile phone companies can promote direct top-ups in ways that extend beyond merely targeted sales promotions, such as a general or targeted marketing campaign.<sup>32</sup>
27. This conclusion is consistent with comments that epay has said [ ]. epay advised the Commission that [ ]<sup>33</sup> epay provided [ ]<sup>34</sup> [ ]
28. This indicates a willingness by [ ] to drive direct top-ups transactions, something which is reflected in the growth of direct top-ups. It also shows [ ] is aware of the options at its disposal to drive switching to direct top-ups.
29. Telecom’s experience appears to be similar. While Telecom has not run specific “promotions”, like Vodafone, it is actively trying to move people to the direct channel [ ]<sup>35</sup> As the figures highlighted above show, [ ]% over five years, [ ]
30. In my view, this trend towards direct top-ups is likely to continue; simply introducing new ways of topping up, and educating consumers, is likely to increase direct top-ups. Education or other promotional materials can be targeted to particular customers.<sup>36</sup>
31. The majority concludes that any increased incentive to promote direct top-ups would be negligible.<sup>37</sup> However, my view is that a 5% or 10% cost increase is likely to

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<sup>32</sup> epay has provided a list of strategies which it says mobile phone companies could adopt to promote direct top-ups, many of which involve non-price based promotions. Submission from epay to the Commerce Commission (16 May 2012).

<sup>33</sup> E-mail from Bell Gully (on behalf of epay) to the Commerce Commission (1 June 2012).

<sup>34</sup> [ ] attached to e-mail from Bell Gully (on behalf of epay) to the Commerce Commission (1 June 2012).

<sup>35</sup> Commerce Commission interview with Telecom (9 February 2012).

<sup>36</sup> As indicated in the majority decision, subject to the Unsolicited Electronic Messages Act 2007, at least some of the telecommunications companies can target customers by top-up method. Majority reasons, para 99.

<sup>37</sup> Majority reasons, paras 89-100.



be more than “negligible” and would prompt mobile phone companies to accelerate their promotion of direct top-ups.

32. For reasons I have explained, I consider there will be an increasing pool of consumers that the mobile phone companies can target as the methods of directly topping-up continue to expand.

#### *Conclusion on market definition*

33. As I explained, the Act directs that the market be defined based on fact and commercial common sense. This is a matter of judgement, bearing in mind that the objective is to define a market which highlights the competition issues but does not predetermine them.<sup>38</sup>
34. The evidence of the extent to which direct top-ups are currently used, their growth over the last few years and the reduction in the use of in-store top-ups indicates that direct top-ups and in-store top-ups are substitutes as a matter of fact and commercial common sense.<sup>39</sup> In other words, I consider that mobile phone companies would be able to defeat a price increase through the use of direct top-ups.
35. While I have reached a different view to the majority on the relevant market definition, I agree with the majority that even if direct top-ups are not in the relevant market, the extent to which they constrain e-pay must still be assessed. I address that issue now.

#### **Constraint from direct top-ups**

36. As is apparent from my views on market definition, I consider that direct top-ups are a much closer substitute for in-store top-ups (on the demand side) than recognised by the majority.
37. I consider direct top-ups to be analogous to a competitor in the market. Characterised in that way, the question for the Commission is whether that “competitor” would be able to expand its sales sufficiently to mitigate any potential SLC.
38. The majority concludes that direct top-ups do not provide a sufficient constraint.<sup>40</sup> As with their market definition, the majority’s conclusion is premised on the view that mobile phone companies would not be able to increase the level of direct top-ups within a two-year period so as to defeat a price increase.
39. For the reasons I have already explained my view is that mobile phone companies would have the incentive and ability to increase the number of direct top-up

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<sup>38</sup> See Sumpter *New Zealand Competition Law and Policy*, p 403.

<sup>39</sup> This is particularly so when considered in light of the fact that commissions have been falling over this period.

<sup>40</sup> Majority reasons, paras 250-255.

transactions relatively quickly and that this would be likely to constrain epay within the relevant two-year timeframe.

40. I expect the mobile phone companies to focus on increasing direct top-ups as their reaction to any exercise of market power by epay. This is because direct top-ups are the lowest cost form of distribution.
41. Accordingly, I consider that mobile phone companies' ability to expand and to threaten to expand direct top-ups will nullify any increase in bargaining power epay may gain as a result of the merger. I consider this threat to be sufficient to constrain epay and I am therefore satisfied there would not be a SLC.

### **Constraint from direct integration**

42. epay has submitted that the threat of mobile phone companies directly integrating with retailers is a credible one that would constrain epay's pricing post merger.<sup>41</sup>
43. While I consider that the threat of direct integration is plausible for supermarkets and would provide some degree of constraint in relation to distribution through supermarkets, I am not satisfied that that the threat of direct integration will be sufficient in itself to constrain epay.

### *Is direct integration a credible threat currently?*

44. There are already examples in New Zealand where mobile phone companies have directly integrated with retailers. Telecom is directly integrated with The Warehouse while [ ]<sup>42</sup>
45. These examples of direct integration suggest that further direct integration in some instances is at least plausible.
46. However, the Commission received conflicting evidence on whether further direct integration has been used as a threat by mobile phone companies:

46.1 epay told the Commission that it is "frequently made aware by both the telcos and the large retailers that one option for them is to bypass epay and set up a direct link".<sup>43</sup> epay also referred to threats in relation to direct integration.<sup>44</sup>

46.2 [ ]<sup>45</sup>

46.3 [ ]

] <sup>46</sup>

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<sup>41</sup> Submission from epay to the Commerce Commission (28 March 2012).

<sup>42</sup> Submission from epay to the Commerce Commission (16 May 2012).

<sup>43</sup> Application, para 25.

<sup>44</sup> E-mail from Bell Gully (on behalf of epay) to the Commerce Commission (1 June 2012).

<sup>45</sup> [ ]

47. [

] <sup>47</sup>

48. [ ] While the information of whether such a threat has been raised in the past is conflicting, even if such a threat has not been raised in the past, this does not mean it may not be used in the future.

49. The questions we must answer are:

49.1 Is the likelihood of direct integration sufficiently high that the threat of direct integration will provide a credible threat for epay?

49.2 If direct integration is a credible threat, will that be sufficient to constrain epay?

*Likelihood of direct integration*

50. I agree with the majority (for the same reasons) that mobile phone companies are unlikely to establish direct links with the thousands of independent dairies and convenience stores across New Zealand.

51. In my view, the only realistic prospect of direct integration is with the supermarket chains (Foodstuffs and Progressive), which together account for [ ]% of all in-store top-ups in New Zealand. I consider the potential for top-ups through smaller retailers such as the petrol companies (combined [ ]% of in-store top-ups) to be a more remote prospect.

52. As outlined in the majority decision, [

] <sup>48 49</sup>

53. [

] <sup>50</sup>

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<sup>46</sup> [ ]  
<sup>47</sup> [ ]  
<sup>48</sup> [ ]  
<sup>49</sup> More specifically:  
• [ ]  
• [ ]  
• [ ]  
• [ ]  
<sup>50</sup> [ ]

54. [ ]<sup>51</sup> [ ]

55. [ ]<sup>52</sup> [ ]<sup>53</sup>

56. I agree with the majority that direct integration would have to make financial sense in order for a mobile company to contemplate it and for it to be a credible threat.<sup>54</sup> I now assess whether direct integration is commercially likely.

*Would direct integration make financial sense?*

57. As described by the majority, epay presented to the Commission [ ]<sup>55</sup>

58. [ ]

59. epay's analysis and the assumptions behind it are explained fully in the majority's decision.<sup>56</sup> [ ]

59.1 [ ]

59.2 [ ]

60. Self-evidently such analysis is dependent on the quality of the assumptions used. In this respect I note that:

60.1 epay has said the [ ]<sup>57</sup>, although there is no documentary evidence to support that assumed cost.

60.2 As the majority explains, [ ]

] epay submitted that "this could happen for

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<sup>51</sup> Ibid.

<sup>52</sup> [ ]

<sup>53</sup> Ibid.

<sup>54</sup> Majority reasons, para 274-275.

<sup>55</sup> Submission from epay to the Commerce Commission (28 March 2012).

<sup>56</sup> Majority reasons, paras 261-264.

<sup>57</sup> Commerce Commission interview with epay (4 April 2012).

below \$[ ]".<sup>58</sup> While that might be possible, [ ]

60.3 [ ]

for epay's integration costs. ]<sup>59</sup> This provides some support

60.4 [ ]  
For example:

60.4.1 [ ]

] <sup>60</sup>

60.4.2 [ ] <sup>61</sup>

60.4.3 [ ].

61. I consider that the pay-back analysis shows that direct integration is plausible for the supermarkets. [ ]<sup>62</sup>
62. The costs in epay's analysis seem sensible, although I acknowledge that they are only epay's estimates. The fact is that the returns implied by epay's analysis have not resulted in direct integration to date. Of course the question is what happens if the merged entity sought to increase prices above counterfactual levels. In this respect my experience is that significant projects (such as direct integration would be) are risky projects and firms making such investment decisions will factor in the IT, cost, time, and business continuity risks when deciding whether to invest.
63. This means that the mobile phone companies and supermarkets are likely to be reluctant and perhaps slow to directly integrate even in the face of a price increase above counterfactual levels (particularly if prices are otherwise declining). However, epay will not know where the trigger point is and so the possibility of direct integration will remain a factor in its pricing decisions.
64. So, in summary, while I consider that direct integration will provide some degree of constraint for distribution through the supermarkets, I do not consider it sufficient in itself to satisfy me that direct integration would be likely to prevent any SLC, even for top-ups distributed through supermarkets.

<sup>58</sup> Commerce Commission interview with epay (25 May 2012).

<sup>59</sup> Commerce Commission interview with [ ] (1 May 2012).

<sup>60</sup> [ ]

<sup>61</sup> Majority reasons, Table 9, p 85.

<sup>62</sup> [ ]

65. For other retailers with lower volumes, I do not consider direct integration is likely to happen quickly in response to a price increase given the risks and costs associated with direct integration.

*Is the threat sufficient to constrain?*

66. Even if the threat is so credible for distribution through supermarkets such that prices charged to mobile phone companies for distribution through supermarkets will not increase, the question remains whether this threat is sufficient by itself to constrain epay across the remainder of the market.
67. For reasons given by the majority, I am not satisfied that the prospect of this occurring is sufficient to constrain the market as a whole.

*Conclusion*

68. I am satisfied that the threat of direct integration will provide some degree of constraint in relation to supermarket distribution. However, I am not satisfied that this degree of constraint is sufficient in itself to prevent a likely SLC even for top-ups distributed through supermarkets.

**Constraint from new entry**

69. I agree with the majority that there are a number of hurdles a new entrant would have to overcome in order for that entrant to be able to enter the market in a way that would constrain epay.
70. I also agree that the conditions for entry for an entrant targeting larger chain retailers (supermarkets, petrol companies etc) are different to the conditions of entry that would face an entrant seeking to enter and expand by targeting the smaller retailers (dairies and convenience stores etc).
71. However, in either case, my view is that entry (and expansion) by anyone other than Blackhawk / Kiwibank (and possibly InComm)<sup>63</sup> in the larger retailer segment, or by Touch in the small retailer segment, is unlikely. I deal with each of these scenarios below.

*Entry by Blackhawk / Kiwibank*

72. Blackhawk is already integrated with a number of retailers to provide digital content and gift cards. This includes Progressive which accounts for [ ]% of the in-store top-ups. Blackhawk also has a distribution relationship with Kiwibank.
73. In relation to Blackhawk / Kiwibank, I agree with the majority that it would be relatively simple for Blackhawk / Kiwibank to expand to provide mobile top-ups in Progressive stores (and other stores where Blackhawk has infrastructure) and that switching costs for retailers would be low. Accordingly, I consider the mobile phone

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<sup>63</sup> While integrated with some retailers, [

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companies could potentially utilise Blackhawk / Kiwibank to provide mobile top-ups to its existing retailers. This would constrain epay in relation to distribution via Progressive stores (and other stores where Blackhawk / Kiwibank has infrastructure).

74. In principle the majority's conclusion in respect of digital content (with which I agree) that Blackhawk / Kiwibank "is likely to have some ability to expand both the scope and scale of its operations so as to be a greater constraint on epay"<sup>64</sup> is also relevant to the mobile top-up market. However, in terms of commercial likelihoods:
- 75.1 I do not consider it likely that Blackhawk / Kiwibank would expand beyond its current footprint into smaller retailers; and
- 75.2 I am not satisfied that Blackhawk / Kiwibank would be likely to expand its footprint to service other large retailers.
75. Accordingly, while I am satisfied that the threat of Blackhawk / Kiwibank's expansion would be a sufficient constraint on epay in relation to distribution via Progressive stores (and other stores where Blackhawk / Kiwibank has infrastructure), I am not satisfied that this would constrain epay where Blackhawk / Kiwibank does not have an existing presence.
76. Hence I am not satisfied that the constraint provided by Blackhawk / Kiwibank expansion is sufficient in itself to prevent any likelihood of a SLC.

#### *Entry by Touch*

77. As noted in the majority decision<sup>65</sup>, Touch is the potential entrant most likely to target the non-major retailer segment, which sells around [ ]% of in-store pre-paid mobile phone top-ups.

#### Touch's business model

78. Touch is a credible provider. It has a [ ]% share of the Australian market, primarily providing top-ups in 7-eleven stores.<sup>66</sup> Touch has [

] <sup>67</sup>

79. The Touch model involves rolling out software to terminals over the existing EFTPOS terminals. [ ] has confirmed that this software roll out can occur remotely.<sup>68</sup> [

] <sup>69</sup>

80. This means that Touch would have the ability to compete for all retailers with EFTPOS terminal capability without the need for a retailer to install new equipment.

<sup>64</sup> Majority reasons, para 493.

<sup>65</sup> Majority reasons, paras 382-390.

<sup>66</sup> Commerce Commission interview with Touch (12 April 2012).

<sup>67</sup> Ibid.

<sup>68</sup> Commerce Commission interview with [ ] (24 May 2012).

<sup>69</sup> Commerce Commission interview with Touch (12 April 2012).

81. Indeed, there already appears to be some examples of a similar expansion model in other markets. As the majority explain in relation to pre-paid electricity, [ ]<sup>70</sup>

Is Touch likely to enter?

82. My concern is whether there is a commercial likelihood that Touch would enter.

83. Touch has said [ ]<sup>71</sup> and it has looked at the New Zealand market before. However, [ ]<sup>72</sup>

84. In April Touch told the Commission that [ ]<sup>73</sup>  
[ ]<sup>74</sup>  
[ ]  
[ ]

85. I also consider that if Touch were to enter, the mobile phone companies would have an incentive to enter into agreements with Touch which enable Touch to distribute mobile top-ups.<sup>75 76 77</sup>

86. This is particularly the case given that [ ]

87. The Commission’s entry modelling (which is described in the majority decision) suggests that entry would be profitable at current prices for an entrant such as [ ], provided that an entrant could sign up a number of retailers reasonably quickly. In terms of Touch specifically, the model does not incorporate Touch’s potential to sell other value added services in time.

88. Moreover, epay suggested various ways in which a mobile phone company could facilitate Touch’s entry, ranging from exclusivity to guaranteed minimum top-up volumes.

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<sup>70</sup> Majority reasons, para 162.

<sup>71</sup> Commerce Commission interview with Touch (12 April 2012).

<sup>72</sup> E-mail from [ ] to the Commerce Commission (26 April 2012).

<sup>73</sup> Commerce Commission interview with Touch (12 April 2012).

<sup>74</sup> E-mail from [ ] to the Commerce Commission (1 June 2012).

<sup>75</sup> 2degrees advised that [ ]

[ ] Commerce Commission interview with 2degrees (10 February 2012).

<sup>76</sup> Vodafone has advised that, [ ] Commerce Commission interview with Vodafone (9 February 2012).

<sup>77</sup> Telecom stated that [ ] Commerce Commission interview with Telecom (9 February 2012).



89. [ ]
90. In relation to exclusivity, there are examples of mobile phone companies entering into exclusive contracts with providers. For example, [ ]<sup>78</sup> However, as I indicated the evidence from mobile phone companies is [ ]
91. In relation to guaranteed minimum volumes, the mobile phone companies indicated [ ] However, a mobile phone company could switch top-ups through its own stores to an entrant distributor-agent.<sup>79 80</sup>
92. For Vodafone at least such a strategy would provide a [ ] minimum volume. Around [ ]% of all Vodafone in-store mobile top-ups<sup>81</sup> are made in Vodafone's own stores.<sup>82</sup> This would ameliorate to a considerable extent the problem of establishing a retailer base.<sup>83</sup>
93. However, the fact is that the New Zealand market is a small market by international standards and Touch [ ]
94. While I consider that entry by Touch is possible, I am not satisfied that this prospect is sufficient to meet the "likely" element of the LET test. This is because I consider it more likely (or at least as likely) that Touch [ ]
95. However, as with direct integration, the question is the extent to which epay can push things before prompting entry. While I am satisfied the threat of entry would provide some degree of constraint on epay I do not consider it is sufficient in itself to prevent a SLC.

Would Touch's entry be of sufficient extent, and be sufficiently timely, to constrain epay?

96. In my view, were Touch to enter, it would constrain epay more quickly than the majority conclude. This is particularly so given [ ]

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<sup>78</sup> Commerce Commission interview with epay (25 May 2012).

<sup>79</sup> [ ]

[ ] (16 March 2012).]

<sup>80</sup> Alternatively, the mobile phone company could switch to self-supply for top-ups in their own stores, such as 2degrees has done.

<sup>81</sup> [ ]

<sup>82</sup> [ ]

<sup>83</sup> It is possible Vodafone might insist in exclusivity in exchange for such a contract, [ ]

97. In this respect I do not agree with the emphasis placed by the majority on [ ]
98. Once in the market, Touch would be able to compete for retailers against epay in the same way that Ezi-Pay does today, particularly if a mobile phone company supported entry. As noted by the majority<sup>84</sup>, churn in the market stands at about [ ]% in any event.<sup>85</sup> Touch has also said [ ]<sup>86</sup>
99. There are also other examples of successful entry by parties providing similar services. epay refer to the example of Snapper which signed up over 500 retailers in six months.<sup>87</sup>

#### Conclusion on Touch

100. For the reasons explained, I am not satisfied that entry by Touch would be likely to constrain epay in and of itself. However, as with the possibility of direct integration, I do consider that the possibility of entry would provide some degree of constraint on epay.

#### **Countervailing power**

101. epay submitted strongly that the mobile phone companies would continue to have substantial market power which would constrain epay's pricing post merger. I agree with this submission for the reasons I explain below.

#### *Current contracts prevent price increases*

102. As the majority explain, [ ]<sup>88</sup> Further, [ ]

103. [ ]

104. In this respect while I agree with the majority that the size of Vodafone, Telecom and 2degrees does not give those companies countervailing power, the size and financial strength of these companies is relevant to my assessment of whether these companies would be able to effectively utilise options to prevent epay increasing prices.

<sup>84</sup> Majority reasons, para 378.

<sup>85</sup> E-mail from Bell Gully (on behalf of epay) to Commerce Commission (27 March 2012).

<sup>86</sup> Commerce Commission interview with Touch (12 April 2012).

<sup>87</sup> Submission from epay to the Commerce Commission (16 May 2012).

<sup>88</sup> Majority reasons, para 193.

105. For the reasons I have already explained, I consider the mobile phone companies retain a number of options to by-pass epay were it to seek to increase prices.
106. In particular, I see the trend towards direct top-ups continuing. If epay sought to increase prices, my view is that mobile phone companies will have an increased incentive to increase the rate by which direct top-ups are growing. I consider this will be the first initiative which mobile phone companies adopt and this in itself will constrain epay.
107. In saying this I am also cognisant that [
- ] <sup>89</sup>
108. I see a similar situation evolving with the service epay provides. Mobile phone companies have the ability and incentive to drive the continued growth of direct top-ups. This growth will place providers such as epay under increasing pressure to reduce prices and indicate the ways in which they can add value for mobile phone companies.
109. In this respect it is also relevant that epay has informed us that it is focussed on developing new ways to add value for mobile phone companies. Given the continued decline in demand for epay’s core services, epay would not want to jeopardise its opportunity to provide other ‘added value’ services to mobile phone companies in the future, which a price increasing strategy may do.<sup>90</sup>
110. While I think that mobile phone companies would firstly look to drive direct top-ups in response to epay increasing prices, I consider that the options of direct integration and supporting entry provide additional ways in which the mobile phone companies would be able to exert a degree of countervailing power on epay.
111. My confidence in the countervailing power of the mobile phone companies is confirmed by the evidence from epay in relation to its [

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<sup>89</sup> [ ]

<sup>90</sup> E-mail from Bell Gully (on behalf of epay) to Commerce Commission (14 June 2012).

<sup>91</sup> [ ] E-mail from Bell Gully (on behalf of epay) to Commerce Commission (14 June 2012).

**Overall conclusion**

112. I am satisfied that the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition. This is principally because of the ability for mobile phone companies to increase the growth of direct top-ups.
113. While I am not satisfied that either the potential for direct integration or entry is likely to constrain epay sufficiently by itself, I do take further comfort from these constraints. I consider that the possibility of these occurring is sufficient to at least cause epay to pause, and carefully consider these threats before taking any action.
114. Similarly, given the likely decline in demand for epay's services, epay would not want to jeopardise its opportunity to provide other 'added value' services for mobile phone companies in the future, which a price increasing strategy may do.