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The Registrar
Commerce Commission
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Ingenico/Paymark: submission from Verifone on the Statement of Preliminary Issues

1. Thank you for the opportunity to make a submission on the Commerce Commission's Statement of Preliminary Issues on Ingenico Group SA's application for clearance to acquire 100% of the shares in Paymark Limited (the **clearance application**).

Introduction and summary of submission

2. Verifone submits that there is a very real risk that the proposed transaction will substantially lessen competition in the national market for the wholesale supply of payment terminals and terminal connectivity to resellers (the **wholesale terminal market**), the regional markets for the resale supply of payments terminals and terminal connectivity to merchants (the **retail terminal markets**), and the national market for the provision of digital payment services (the **digital payment market**). The merged entity will have the ability and the incentive to use its position in the national market for the provision of payment switching and processing services for electronic transactions (the **switching market**) to foreclose its competitors in the wholesale terminal market, the retail terminal markets, and the digital payment market.

3. Paymark already has the ability to foreclose competition in the switching market, the wholesale terminal market, the retail terminal markets (together, the **terminal markets**), and the digital payment market. We submit that Paymark also already has the incentive to foreclose competition in the switching market – and has in fact already engaged in conduct that is consistent with a foreclosure strategy.

4. The proposed transaction is likely to substantially lessen competition because the vertically integrated nature of the merged entity will give it the incentive that Paymark does not currently have to engage in foreclosure strategies in the terminal markets and the digital payment market. In addition, the merged entity will have an increased ability and stronger incentives to restrict competition in the switching market, as doing so will bolster foreclosure strategies in the terminal markets and the digital payment market.

5. The clearance application filed by Ingenico completely ignores the extent to which Paymark's competitors in the switching market (including Verifone and DPS Payments Express) rely on access to Paymark's switching infrastructure to provide their own switching services. In particular:

   (a) Paymark has an effective monopoly on all switch to issuer (**S2I**) transactions, which account for approximately 65% of all processed transactions; and

   (b) Paymark has a substantial degree of market power for the remaining 35% of transactions. Although Verifone is able to process switch to acquirer (**S2A**) transactions for merchants whose acquirer is ANZ, Paymark controls the processing for almost all S2A transactions acquired by ASB, BNZ, and Westpac.

6. The other fundamental error in the competition analysis contained in the clearance application relates to the ability and incentive the vendor banks will have to exercise countervailing power over the merged entity. The barriers to entry and expansion in the switching market mean that the banks in fact have very little countervailing power over Paymark, as the banks can offer their merchants no real choice of providers of switching services.

7. In addition, the clearance application very briefly refers to ancillary agreements. Verifone understands that the ancillary agreements include strong financial incentives for the vendor banks to encourage their merchants to continue to connect to Paymark's switch, and strong disincentives for banks to do anything that might result in merchants moving away from Paymark's switch. Verifone is concerned that the ancillary agreements conditional on the proposed transaction contain provisions that at best entrench the status quo, and are likely to create even more barriers to entry and expansion on the switching market than already exist.

8. Any reduction in competition in the switching market, the terminal markets, or the digital payment market is likely to result in higher costs for merchants and consumers. We submit that the Commission should decline clearance.

Outline of submission

9. In this submission, we:

   (a) outline who we are;

   (b) identify our view of the state of competition in the relevant markets without the proposed transaction, and the features of the proposed transaction that are likely to result in a change in the competitive dynamics;

   (c) explain the limited constraint that competitors such as Verifone and DPS Payment Express are able to provide in the switching market, and Paymark's ability to control the extent of the constraint they provide;

   (d) explain how the proposed transaction will substantially lessen competition by increasing Paymark's ability and incentive to restrict competition in the switching market; and

   (e) explain how the proposed transaction will substantially lessen competition by giving the merged entity the ability and incentive to foreclose competitors in:

      (i) the terminal markets; and

(ii) the digital payment market.

About Verifone: who we are

10. Verifone is a global payments company listed on the NYSE (PAY) and headquartered in San Jose, California.

    Verifone's presence in the New Zealand payments market is a function of two local acquisitions made in 2013:

    (a) The purchase of EFTPOS New Zealand Limited from ANZ Bank New Zealand; and

    (b) The purchase of Sektor Payments Limited from Sektor Limited.

11. As a result of these acquisitions, Verifone operates a vertically integrated payments business with key operations as follows:

    (a) we provide full service payments switching and processing services to ANZ and its acquired merchants. This includes full S2A and S2I processing. However, we outsource the processing of all of our S2I transactions, other than those where the issuer is ANZ, to Paymark under a wholesale switching agreement. Our switch provides both card present and card not present (digital) transaction processing services, but only for ANZ Bank acquired merchants. Our switch also operates as a front-end 'terminal handler' where we can deploy terminals connected to our switch for non-ANZ acquired merchants. However, in that scenario, we route all traffic to Paymark under an aggregation agreement, and Paymark remains the switch or processor for those transactions;

    (b) in the wholesale terminal market, we bring Verifone manufactured devices into NZ, and provide payment application software development services to allow those terminals to connect to both the Paymark and Verifone switches. We sell those terminals to a wide range of resellers and other entities active in retail terminal markets. We also provide full software and hardware support, maintenance and repairs services for those terminals; and

    (c) we operate in retail terminal markets under the EFTPOS New Zealand brand to supply terminal solutions directly to merchants (usually under a subscription model). We offer merchants a full service nationwide terminal offering that includes a broad range of payment options to suit merchant requirements, with comprehensive support, compliance management, repairs and maintenance, and nationwide field service and install.

The likely state of competition without the proposed transaction, and features of the proposed transaction that will change the competitive dynamics

The likely state of competition without the proposed transaction

12. The Commission is required to compare the state of competition in each likely scenario without the proposed transaction, with the likely state of competition with the proposed transaction. If the Commission cannot be satisfied that proposed transaction will not substantially lessen competition compared with any one of the likely "without" scenarios, the Commission must decline clearance.[1]

[1] *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128 (HC) and *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA).

13. The clearance application identifies three possible counterfactuals:[2]

    (a) Paymark is purchased by an alternative purchaser that does not have a presence in the terminal markets or the digital payment market;

    (b) Paymark is purchased by an alternative purchaser with a presence in the terminal markets and/or the digital payment market (similar to the factual); or

    (c) the vendor banks do not sell Paymark. Paymark submits that this is the most likely counterfactual.

14. The Commission's *Mergers and Acquisitions Guidelines* state that the Commission usually focuses its analysis on the likely scenario without the proposed transaction that the Commission considers the most competitive.

15. We submit that the appropriate "without" scenario on which the Commission should focus its analysis is that Paymark is purchased by an alternative purchaser that does not have a presence in the terminal markets or the digital payment market. That is because such a scenario:

    (a) is likely without the proposed transaction. Verifone understands that Cuscal Limited was one of four shortlisted potential purchasers of Paymark. Cuscal is a global provider of switching services. Cuscal does not participate in the terminal markets, or the digital payment market in New Zealand, and to Verifone's knowledge, has no particular terminal or digital payment capability. Cuscal is not currently participating in the switching market in New Zealand. The fact that Cuscal was shortlisted as a potential purchaser of Verifone indicates that, without the proposed transaction, there is a real chance that Cuscal would be acceptable to the vendor banks as an alternative purchaser; and

    (b) would be the most competitive of the three possible counterfactuals. It would not result in any aggregation in the switching market, and would not result in any vertical integration.

16. We understand that the revised services agreements containing the volume targets referred to in paragraph 45 of the clearance application include financial incentives (through significant reductions in price) for the vendor banks to meet those volume targets. We submit that the appropriate counterfactual would not involve Paymark and the vendor banks entering into revised services agreements with those volume targets and incentives. This is because, as outlined later in this submission, there is a real chance that those volume targets will raise competition concerns[3] by creating new barriers to entry and expansion in the switching market. We submit that an alternative transaction would be likely to proceed even if Paymark and the vendor banks do not agree volume targets and associated incentives.

Features of the proposed transaction that are likely to change competitive dynamics, compared with if the proposed transaction did not go ahead

17. As we explain in the next section of our submission, Paymark already has the ability to restrict competition in the switching market. Paymark's market power in the switching market also gives it the ability to foreclose competition in the terminal markets and the digital payment market. That is

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[2] Paragraphs 89-93 of the clearance application.

[3] The Commission has stated in its *Mergers and Acquisitions Guidelines* that, if purchase by an alternative buyer might give rise to competition concerns, the Commission is unlikely to adopt that scenario as the without scenario.

because, in most cases, a condition of entry and expansion in the terminal markets and the digital payment market is access to switching services. Merchants use terminals and digital payment services to process payments – which almost always requires access to a switch. However, Paymark does not currently have any incentive to foreclose competition in the terminal markets or the digital payment market.

18. We are concerned that the proposed transaction will substantially lessen competition because:

    (a) **the merged entity will have incentives to foreclose competition in the terminal markets and the digital payment market, that Paymark would not have without the proposed transaction.** Without the proposed transaction, Paymark will not have any stake in the terminal markets or in the digital payment market. The proposed transaction will produce a vertically integrated entity that will seek to maximise its revenue across the switching market, the terminal markets, and the digital payment market. As discussed later in our submission, there is no real constraint on Paymark in the switching market. The merged entity will have the ability and incentive to maximise its revenue across all of the relevant markets by using its market power in the switching market to foreclose competition in the terminal markets and the digital payment market;

    (b) **the merged entity will have stronger incentives to restrict competition in the switching market than Paymark would have without the proposed transaction**, in order to secure the success of a foreclosure strategy targeting the terminal markets or the digital payment market;

    (c) **the revised services agreements contain volume targets that will substantially lessen the prospect of increased competition in the switching market, and are contingent on the proposed transaction taking place**. We have not seen the terms of the revised services agreements, but we understand that they create strong financial incentives for the vendor banks to encourage their merchants to continue to contract with Paymark for switching services. In particular, we understand that the switching fees the vendor banks are required to pay Paymark will reduce if those targets are met. This is likely to have the effect of:

        (i) the vendor banks taking steps to encourage merchants to remain with Paymark by, for example, offering lower fees to merchants that contract with Paymark (as opposed to, for example, Verifone or DPS Payment Express) as their switch. Banks recover their costs from their customers, including merchants. Paymark previously had a rebate arrangement in place with the vendor banks, under which Paymark paid the vendor banks rebates for meeting volume targets. We understand that the vendor banks were able to channel those rebates back to merchants by offering merchants lower fees. When that rebate structure was removed, we observed that a significant number of merchants began to consider contracting with another switch. We expect that the volume targets in the revised services agreements will have a similar effect to the former rebate structure, and make merchants who currently contract with Paymark more "sticky". This will make it more difficult for alternative providers of switching services to compete;

(ii) discouraging the vendor banks from doing anything that might reduce the volume of payments Paymark processes. For example, if an alternative provider of switching services sought to build links to any of the vendor banks to process S2A transactions in order to provide a partial switching service (similar to Verifone's links with ANZ, which are the product of ANZ itself building and later selling those links), the vendor banks would be less inclined to allow that to occur because it would reduce the volume of payments processed by Paymark, and therefore the volume-based discounts; and

(d) **the vendor banks will no longer be able to constrain Paymark as shareholders:** as the largest issuers, the vendor banks have the most exposure to switching fees for S2I transactions. Paymark is currently the only provider of switching services for S2I transactions, meaning that there is no competitive constraint on Paymark for those services. Paymark is currently partially constrained by the fact that, if Paymark substantially increases its fees for S2I or S2A transactions, the vendor banks could take action against Paymark (such as by changing the composition of Paymark's Board). If the increases were sufficiently high, the vendor banks would have the incentive to take such action, as they would not necessarily receive all of those increased fees through dividends or rebate payments. The proposed transaction would remove that constraint.

The constraints on Paymark in the switching market are limited, and are largely controlled by Paymark

19. The clearance application claims that Verifone and DPS Payment Express provide a significant competitive constraint on Paymark[4] that would prevent the merged entity from engaging in any type of foreclosure strategy. In particular, the clearance application claims that the merged entity could not engage in a foreclosure strategy because any affected competitors in the terminal markets or the digital payment markets could decide to use another switch, and any affected merchants could choose to use the merged entity's competitors in the switching market, the terminal markets, or the digital payment markets. According to the clearance application, such a strategy could not be profitable for the merged entity, and the merged entity would have neither the ability or incentive to engage in a foreclosure strategy.

20. However, contrary to the statements in the clearance application, Paymark is the only switch provider with full capabilities. Both Verifone and DPS Payment Express rely on access to Paymark's switch in order to provide switching services to customers. Paymark has the ability to control the level of constraint we and DPS Payment Express provide through the terms on which it grants us access to its switch. If the merged entity did engage in a foreclosure strategy, the barriers to entry and expansion in the switching market mean that new entry or expansion in the switching market would not be sufficiently likely, sufficient in extent, or sufficiently timely to effectively constrain Paymark.

21. We also disagree with the submission in the clearance application that Paymark is constrained by the countervailing power of banks in the switching market.

[4] See, for example, paragraph 64, paragraph 134 and paragraphs 1-12 of Appendix 3 of the clearance application.

22. We discuss those matters below. Our concerns are consistent with the fact that, over the last 30 years, market shares in the switching market have remained relatively unchanged.

Verifone and DPS Payment Express are not full capability providers of switching services, and rely on access to Paymark's switch

23. Paymark is the only switch capable of processing S2I transactions, and all other providers of switching services in New Zealand rely on Paymark giving them access to that capability.

24. We are able to process S2A transactions independently of Paymark for merchants whose acquirer is ANZ. We can also process S2I transactions independently of Paymark if:

    (a) the merchant is connected to our switch. This means that the merchant must bank with ANZ; and

    (b) the issuer for the transaction is ANZ.

25. However, we rely on access to Paymark's switch under the terms of our wholesale switching agreement with Paymark in order to process all other S2I transactions for our merchants. We are also unable to provide any switching services to merchants whose acquirer is not ANZ.

26. DPS Payment Express's ability to provide switching services also relies on access to Paymark's switch. DPS has its own links to a number of acquirers, including direct links to card schemes. DPS Payment Express is able to process:

    (a) card present and card not present S2A transactions for BNZ and ANZ acquired merchants;

    (b) card not present S2A transactions for ASB and Westpac acquired merchants.

    (c) card present and card not present S2A transactions for its self-acquired service

27. However, merchants generally also require their switch to process S2I transactions. We have an arrangement with DPS Payment Express that allows DPS Payment Express to provide that capability to merchants through our access to Paymark's switch.

As a consequence, Paymark is able to control the extent to which it is constrained by Verifone and DPS Payment Express

28. As a result of our inability to process S2I transactions or card present transactions for ASB and Westpac acquired merchants on our own, Paymark is able to control the extent to which we and DPS Payment Express can act as a competitive constraint on Paymark in the switching market. Paymark is able to, and does, limit our ability to compete through:

    (a) its decisions about whether or not to provide access to its switch; and

    (b) if Paymark does provide access to its switch, the terms on which it provides that access.

29. We are aware of at least two instances where Paymark has used its monopoly on the switching of S2I transactions to limit the constraint that we and DPS Payment Express are able to provide.

30. First, as the Commission will be aware, around 2015/2016, DPS Payment Express sought to provide switching services to a number of new merchants. This was around the same time that Paymark ended the scheme under which it paid volume-based rebates to the vendor banks. That

increased the price that merchants paid for Paymark's switching services, providing the opportunity for DPS Payment Express to win new merchants.

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

32. **[REDACTED]**

33. **[REDACTED]**

34. We refused to engage with Paymark on those negotiations, and DPS Payment Express was able to win significant transaction volume from Paymark. **[REDACTED]**

35. **[REDACTED]**

    (a) **[REDACTED]**

    (b) **[REDACTED]**

36. **[REDACTED]**

37. **[REDACTED]**

New entry or expansion in the switching market is not sufficiently likely, unlikely to be sufficient in extent, and unlikely to be sufficiently timely to constrain Paymark

38. The clearance application states that the merged entity will be constrained by the prospect of new entry in the switching market, an existing participant (such as Verifone or DPS) investing in building

new infrastructure, or an existing participant negotiating with Paymark to use Paymark's infrastructure.

39. None of those prospects provide a realistic constraint on Paymark, and there is no reason to think that they will provide a realistic constraint on the merged entity.

40. It is extremely unlikely that a new entrant or an existing participant would be able to build new infrastructure that could constrain the merged entity. Even if they could, it is extremely unlikely that they could do so quickly enough to thwart any foreclosure strategy. In terms of new entry, the clearance application acknowledges that a new entrant to the switching market would need to build a greenfield switch by investing in switching assets, and building a connectivity network to all issuing and acquiring banks.[5] Similarly, if we or DPS Payment Express were to build a complete connectivity network, that would involve building links to all issuing banks (as Paymark is currently the only switch able to process S2I transactions), and any acquiring banks to which links are not already in place.

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

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

    (b) in order to provide any real constraint on Paymark, it would be necessary to build links to all 29 issuers in New Zealand, amounting to a total cost of at least $15 million. This is because:

        (i) building fewer links than that would result in continued reliance on Paymark to provide switching services to merchants;

        (ii) in Verifone's case, our wholesale switching agreement with Paymark requires us to send all transactions we receive (other than ANZ-acquired S2A transactions) through Paymark's switch. This means that, in practice, we would be unable to use any new links until we have built links to all issuers in New Zealand; and

    (c) the small scale of the New Zealand market makes it extremely difficult to achieve scale, making it difficult to recover the costs of building a connectivity network.

42. There are also other significant barriers to building a complete connectivity network, including:

    (a) building new bilateral links requires the cooperation of the counterparties of those links (ie, the issuers), including to test the links. Given the need to build bilateral links to each issuer in New Zealand, the risk that any one of those issuers might refuse to cooperate increases the risk associated with building a connectivity network, and decreased the likelihood of a new entrant or existing participant recovering their costs. This barrier is more significant with the proposed transaction than without. That is because the volume targets and associated financial incentives that we understand the revised services agreements (which are contingent on the proposed transaction) provide for would increase the risk that a vendor bank might refuse to cooperate;

[5] Paragraph 103 of the clearance application.

(b) the time required to build a connectivity network. We estimate that it would take a number of years to build a full connectivity network. By that time, a foreclosure strategy could be well underway or even fully implemented.

43. In relation to the clearance application's contention that the merged entity will be constrained by the ability of an existing participant to "cherry-pick" the processing of higher value transactions and negotiate with Paymark for access to Paymark's infrastructure for other transactions,[6] the clearance application refers to DPS Payment Express as an example of a participant that could provide such a constraint. In our view, there is no real prospect of that happening at all – **[**

REDACTED

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Paymark is not constrained by the countervailing power of banks in the switching market

44. The clearance application contends that the banks have countervailing power in the switching market, because they make up a large proportion of any switch's transaction volume. The clearance application also argues that the banks have, and will continue to have, an incentive to ensure that the price of switching services remains low, and that, accordingly, the banks have the ability and incentive to constrain Paymark.[7]

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

46. We submit that, in order for the banks to have any countervailing power over Paymark or the merged entity, the banks need to be able to credibly threaten to divert transactions to another switch. As discussed in paragraphs 23 to 37 above, Paymark has the ability to set the parameters within which its rivals can compete, including the switching capability they have access to and how much they pay for that capability – meaning that the banks have no real countervailing power at all.

47. The only real ability that the banks have to constrain Paymark arises from the vendor banks' role as shareholders. The banks could constrain Paymark by changing the composition of Paymark's Board.

The proposed transaction will substantially lessen competition in the switching market: Paymark will have increased ability and incentive to restrict competition

48. Paymark's conduct shows that it already has the ability and the incentive to restrict competition in the switching market. The proposed transaction is likely to further substantially lessen competition in the switching market by:

(a) increasing the ability of Paymark to restrict competition in the switching market. The proposed transaction will remove the only constraint that currently exists, and increase Paymark's ability to restrict competition; and

[6] Paragraphs 152-154 of the clearance application.
[7] Paragraph 135 of the clearance application.

(b) giving Paymark an additional incentive to restrict competition in the switching market, because doing so will facilitate the success of any strategy by the merged entity to foreclose competition in the terminal markets and the digital payments market.

The proposed transaction will increase Paymark's ability to restrict competition in the switching market

49. The proposed transaction will increase Paymark's ability to restrict competition in the switching market by:

    (a) as against Ingenico's proposed counterfactual, removing the ability of the vendor banks to constrain Paymark by using their power as shareholders to change the composition of Paymark's Board (discussed in paragraph 47 above); and

    (b) as against both Ingenico's counterfactual and our proposed counterfactual, giving the vendor banks incentives that they do not currently have (and would not have without the proposed transaction) to encourage their merchants to continue to connect to Paymark's switch. Those incentives will arise by reintroducing volume targets and associated financial incentives to their arrangements with Paymark. We discuss this further below.

50. We have not seen the revised services agreements that Paymark and the vendor banks have negotiated, but we have real concerns that the volume targets that the clearance application confirms they contain are supported by strong financial incentives to meet those targets.

51. We understand that, since Paymark ended its rebate scheme, there have been no financial incentives on the banks to meet any volume targets. As discussed in paragraphs 30 to 34, since the rebate scheme ended, the switching market became more competitive.

52. As we submit in paragraph 16, there is a likely "without" scenario in which no such volume targets and financial incentives (or rebate scheme) exists.

53. We are concerned that the volume targets and financial incentives in the revised services agreements will:

    (a) give the vendor banks incentives to encourage their merchant customers to continue to connect to Paymark's switch, and remove any incentives they might have to constrain Paymark; and

    (b) if the Commission takes the view that the banks do in fact have countervailing power in the switching market, limit the vendor banks' incentives to exercise that countervailing power to constrain Paymark.

The proposed transaction will increase Paymark's incentives to restrict competition in the switching market

54. Currently, any incentives that Paymark has to restrict competition in the switching market are limited to maximising the revenue it can generate from the switching market.

55. The proposed transaction will result in Paymark being part of a vertically integrated merged entity that is also seeking to maximise the revenue it generates from the terminal markets, and the digital payments market.

56. The merged entity will have the ability and incentive to engage in foreclosure strategies in the terminal markets and the digital payments market, as discussed in the sections below. Those

foreclosure strategies would rely on Paymark's market power in the switching market. The merged entity will have incentives to limit the prospect of the foreclosure strategies failing because of its customers choosing to use another switch. Accordingly, the merged entity will have additional incentives to ensure that it limits the competition it faces in the switching market.

The proposed transaction will substantially lessen competition in the terminal markets

57. The clearance application claims that the merged entity would not foreclose competition in the terminal markets by restricting its rivals' access to switching services because:

    (a) the terminal markets are highly competitive, with low barriers to entry and expansion and the option to purchase bundles of terminals services and other services (such as switching services);[8]

    (b) the merged entity would not have the ability to engage in a foreclosure strategy, because it will be constrained by rapid technological change and emerging payment methods;[9]

    (c) the merged entity would not have the ability to foreclose competition, because rival providers of terminals could connect to another switch;[10] and

    (d) the merged entity would not have the incentive to attempt to engage in a foreclosure strategy, because merchants could use terminals and switches provided by the merged entity's rivals, and the merged entity would lose more revenue in the switching market than it would gain in the terminal market.[11]

58. We submit that there is a real chance that the merged entity will restrict other terminal providers' access to Paymark's switch, and foreclose competition in the terminal markets. As we have already outlined, there is no real constraint on Paymark in the switching market – Paymark has the ability to, and does, limit the extent to which its rivals are able to compete with it. By extension, there is nothing to prevent the merged entity from engaging in a foreclosure strategy.

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

60. In the following paragraphs we:

    (a) set out the strategies that the merged entity might use to foreclose competition in the terminal markets, including by foreclosing the market;

    (b) outline why the terminal markets are not as competitive as the clearance application suggests;

[8] Paragraphs 126(a), 135(a), and 137-140 of the clearance application.
[9] Paragraphs 164 and 166-168, and paragraphs 25-29 of Appendix Three of the clearance application.
[10] Paragraph 128 of the clearance application.
[11] Paragraphs 129 and 130 of the clearance application.

(c) outline why any existing competitors in the terminal markets would not be able to effectively respond to a strategy to substantially lessen competition; and

(d) express our doubt about the ability of emerging payment methods to constrain the merged entity.

How the merged entity might foreclose competition in the terminal markets

61. The merged entity may be able to foreclose competition in the terminal markets in at least two different ways:

    (a) by refusing to allow terminals to connect to Paymark's switch in order to process S2I transactions (as occurred with Adyen);

    (b) by raising the price of switching services and using the rents from those increased prices to cross-subsidise the merged entity's terminal offerings at prices with which its competitors cannot compete; or

    (c) by manipulating the requirements that the merged entity, as the only provider of all types of switching services, requires terminals to meet in order to connect to Paymark's switch.

62. Those strategies would be possible because of the limits on competition in the switching market - and, as we have previously outlined, the merged entity could choose to further restrict competition:

    (a) Paymark's switch is the only option for processing S2I transactions; and

    (b) Paymark is the only provider of switching services that is capable of processing all S2A transactions, regardless of the acquiring bank;

    (c) Paymark's competitors in the switching market rely on Paymark agreeing to grant them access to Paymark's switch at a reasonable price to be able to process all of their customers' transactions.

63. In relation to the pricing-based foreclosure strategy, if the merged entity chose to raise the price of its switching services in order to cross-subsidise its terminal offerings, customers could not avoid those price increases by moving to another switch. In our case, as we have already outlined, under the terms of our renewed wholesale switching agreement with Paymark, Paymark will increase its charges for processing any volume that we do not already have, to the point that we will incur losses on that volume.

64. The merged entity will also be able to lessen competition in the terminal markets by manipulating the requirements that terminals must meet. To provide terminals, a terminal provider's terminals must:

    (a) meet terminal specifications set by Payments New Zealand;

    (b) meet terminal specifications set by Paymark in order to connect to Paymark's switch. The specifications in question relate to, for example, the form in which data must be transmitted in order to be processed by Paymark's switch; and

    (c) be certified by Paymark as meeting Paymark's terminal specifications.

65. The merged entity could use the terminals specifications set by Paymark and the control of the terminal certification process to provide an advantage to Ingenico's terminal business, and limit the ability of rival terminal providers to compete. In particular, the merged entity could:

    (a) introduce new, complex requirements for terminals to connect to Paymark's switch, while giving Ingenico's terminal business advance notice of the new requirements, and/or grace periods to comply; and

    (b) prioritise any requests from Ingenico for clarification about Paymark's terminal specifications or for confirmation that a terminal meets Paymark's terminal specifications, over any similar requests from rival terminal providers;

    (c) Prioritise certification of Ingenico devices in preference to those of competitors or enforce a much stricter certification on competitor devices versus Ingenico devices; and

    (d) use the "software sunset" process to waive restrictions or requirements for Ingenico devices. The software sunset process governs when terminal applications and devices need to be removed from Paymark's connectivity network. The merged entity could waive or loosen software sunset requirements for Ingenico terminal applications and devices, while enforcing requirements that its competitors retire their applications and devices. For example, we understand that Paymark recently granted Skyzer, Ingenico's current New Zealand distributor, a grace period to comply with Paymark's software sunset requirements. Meanwhile, Skyzer's competitors had invested millions to comply.

66. Strategies such as those would result in lower quality terminal services, as well as distorted competition.

67. We have an aggregation agreement with Paymark under which we can use an aggregation link to connect Verifone terminals that may not meet Paymark's specifications to Paymark's switch. However, the aggregation agreement will not provide any real constraint on the merged entity's ability to manipulate terminal requirements to lessen competition in the terminal markets:

    (a) the aggregation agreement only relates to Verifone terminals that do not meet Paymark's specifications, and does not extend to terminals provided by any other competitors;

    (b) **[**

    REDACTED

    ]

    (c) terminals we connect under the aggregation agreement must comply with minimum standards set unilaterally by Paymark. The merged entity could manipulate those

requirements in a similar fashion to the terminal specification and certification processes described above.

68. Based on the size of the terminal markets and our understanding of each participant's market share, we estimate that there is potentially $70-$80 million of additional revenue that the merged entity could capture by foreclosing the terminal markets. That, combined with the lack of a competing switch that is fully independent of Paymark's switching infrastructure, means that the merged entity will have both the ability and incentive to substantially lessen competition in the terminal markets.

Terminal markets are not as competitive as the clearance application suggests

69. New Zealand terminal markets offer a relatively small number of options to merchants compared with markets overseas. Over 90% of terminals deployed in New Zealand are produced by three terminal manufacturers (Verifone, Ingenico, and PAX). The other options mentioned in the clearance application, such as Castle and Newland, have failed to achieve any meaningful scale in New Zealand. This is the result of the high costs of entry and of maintaining compliant solutions in market.

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

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

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

    (c) to break even, a new entrant would need to sell at least 15,000 to 20,000 terminals. That accounts for at least 10% of the market, and would take several years to achieve.

71. In addition, number of terminal providers around the world that might enter the New Zealand market is limited:

    (a) Ingenico and Verifone are the only two major global providers of terminals and there are few international providers that could enter the market; and

    (b) smaller providers from international markets would be unlikely to enter the New Zealand market, given the prohibitive cost of entry; and

    (c) terminal markets have become more concentrated. The need for scale to support development has resulting in acquisitions that have concentrated the market. For example, since 2000, Verifone has acquired Dione, Lipman, Way Systems, Hypercom (which itself acquired Thales), and Gemalto NV, and Ingenico has acquired Epos, VIV Checkmate, Landi, and Sagem Monetel.

72. We also disagree that competition in the terminal markets has "intensified":[12]

    (a) we disagree that the entry of Castles and Newland are evidence of increased competition. We understand that Castle and Newland intend to exit the New Zealand terminal markets and are not actively developing and deploying new solutions;

    (b) PayClip and FastPay are not examples of "alternatives" to terminals. Like any other terminal, those products require access to a switch in order to process payments. If the merged entity engaged in a foreclosure strategy, those products would be unlikely to provide a competitive constraint. In addition, such products cannot easily enter the market without financial support – we understand that BNZ subsidises PayClip with acquiring revenue, and we have underwritten the entry of FastPay into the market. Financial support for similar products would be difficult to secure in a market experiencing foreclosure; and

    (c) we disagree that large Chinese manufacturers of terminals are necessarily able to readily enter or scale up in New Zealand. Again, those manufacturers would need to connect their terminals to a New Zealand switch (ie, Paymark's switch) in order to compete in New Zealand. PAX is the most credible potential competitor of this type, but there is no evidence that it would be able to upscale. In fact, its presence in the New Zealand market appears to be in decline. If the merged entity pursued a foreclosure strategy, large Chinese manufacturers would be unlikely to be able to provide a competitive constraint..

Existing competitors in the terminal markets could not effectively respond to a foreclosure strategy

73. In any case, regardless of the current state of competition in the terminal markets, the merged entity's control of the only fully functional switch in New Zealand would prevent any terminal provider from effectively responding to a foreclosure strategy. If terminals providers require access to a switch, and the owner of that switch does not provide access to the switch on terms that allow terminal providers to compete, there is little, if anything, that terminal providers can do to respond.

Emerging payment methods will not constrain the merged entity

74. The clearance application suggests that, even if terminal providers could not secure the necessary access to Paymark's switch, emerging payment methods that bypass the need for a switch would be sufficient to constrain the merged entity.

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

    (a) around 75% of merchants in New Zealand are single site, single terminal operations that rely almost solely on a terminal with basic terminal functionality (limited to debit cards and credit cards) to accept in-store payments;

    (b) the only material innovation that the market has seen in the last five years is a slow increase in acceptance of contactless payments. Even so, less than 50% of payment devices accept contactless payments;

[12] Paragraph 138 of the clearance application.

(c) around 20% of merchants still only accept debit cards, and not credit cards; and

(d) around 20% of merchants use terminals that connect to a switch using legacy dial-up PSTN networks instead of modern IP based protocols (ADSL or 3G/4G).

76. The high proportion of merchants that have been slow to accept change so far are also likely to be slow to accept new technologies following the proposed transaction. Those merchants would be especially vulnerable to any strategy by the merged entity to foreclose competition in the terminal markets.

The proposed transaction will substantially lessen competition in the digital payment market

77. The clearance application contends that the proposed transaction will not substantially lessen competition in the digital payments market because:

(a) the digital payment market is highly competitive, with a number of well-resourced and dynamic competitors and low barriers to entry and expansion;[13]

(b) the digital payment market is being disrupted by "direct access" payment options that bypass the need for a switch;[14] and

(c) the vendor banks will have countervailing power over the merged entity, and, because they will no longer be invested in Paymark, will have incentives to promote alternative payment methods to constrain the merged entity.[15]

78. We submit that the proposed transaction is likely to substantially lessen competition in the digital payment market. The merged entity will have both the ability and the incentive to restrict new entrants' access to processing services. The merged entity could refuse access to Payment's switch altogether, or price access at a level that restricts the ability of other digital payment providers to compete with Bambora **[REDACTED]**.

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

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

(b) uptake of direct access payment options that bypass the need for a switch will not be sufficiently timely or sufficient in extent to constrain the merged entity.

The merged entity could foreclose competition in the digital payment market by restricting access to Paymark's switch

80. The merged entity will have the incentive to restrict rival digital payment providers' access to Paymark's switch to foreclose the digital payment market, in order to maximise the revenue it derives from Bambora.

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[13] Paragraph 141 of the clearance application.
[14] Paragraphs 143 and 155-162 of the clearance application.
[15] Paragraph 163 of the clearance application.

81. The Commission should consider the merged entity's ability to take steps to prevent digital payment providers that could compete with Bambora from entering the New Zealand market, by refusing to provide them with access to switching services on commercially acceptable terms.

Uptake of direct access payment options that bypass the need for a switch will not be sufficient to constrain the merged entity

82. The clearance application recognises that "merchant and consumer behaviour is likely to dictate the uptake" of eCommerce, mCommerce, and direct account-to-account debit payment methods.[16]

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

84. We doubt whether the vendor banks would be willing to exercise any countervailing power (if they have any) to encourage merchants to switch to direct access payment options. In particular, the terms of the revised services agreements will reward the vendor banks for maintaining and growing the volume of payments processed by Paymark. The New Zealand market's history of being slow to take up new technologies suggests that a significant number of the vendor banks' merchant customers will continue to prefer the technologies they currently use, which require access to a switch. This means that the vendor banks will need to continue to pay switching fees to the merged entity. In that context, the revised services agreements are likely to reduce any incentive on the vendor banks to encourage uptake of direct access payment options, because doing so would increase the switching fees the vendor banks are required to pay.

Confidentiality

85. Confidentiality is sought for the information in this submission that is in square brackets and highlighted. We are also providing a public version of this submission, with the confidential information redacted.

86. We request that we be notified of any request made under the Official Information Act for the information, and be given the opportunity to be consulted as to whether the information remains commercially sensitive at the time that the request is made.

87. These requests for confidentiality are made because the information is commercially sensitive and disclosure would be likely to unreasonably prejudice our commercial position.

Concluding remarks

88. Paymark already has the ability to restrict competition in the switching market, the terminal markets, and the digital payment market. To date, it has only taken action to restrict competition in the switching market. However, the proposed transaction will create incentives for Paymark, as part of

[16] Paragraph 156 of the clearance application.

the merged entity, to use its position in the switching market to foreclose competition in the terminal markets and the digital payment market. This will result in higher prices, and lower quality payment services, for merchants and consumers.

89. We submit that the Commission should decline clearance. We are happy to meet with the Commission to discuss any aspect of our submission.

Pete Hansen

General Manager – New Zealand