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Application for authorisation of  
limited collective negotiation in  
relation to mobile wallet and  
mobile payment systems  
Response to interested party  
submissions

30 September 2016

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## 1 Introduction

Australian consumers are enthusiastic users of technology. They are well ahead of the rest of the world in embracing contactless payments and are enjoying the convenience and security these type of payments offer. Mobile wallets are the next logical step. However, competition and innovation in mobile wallets will not be possible if Apple's decision to deny competitors the ability to offer integrated mobile wallets on the iPhone is left unchallenged.

The applicants are therefore seeking to collectively negotiate with Apple to ensure Apple Pay is introduced into Australia in a way that promotes consumer choice, competition and innovation while maintaining the highest standards of security and allowing for transparency and fairness in fees.

Such collective negotiation is necessary in a context where Apple has the ability and incentive to lock competitors out of the iPhone's near-field communication (**NFC**) technology needed to make integrated mobile payments. Apple claims its lock-out is to make payments more secure – but Samsung and Google already provide access to this technology without detriment to security. The applicants therefore believe it is important to challenge Apple's claims in an effort to increase competition in mobile wallet payments and to benefit consumers.

The applicants also note that Australian card issuers and merchants have already invested heavily in the infrastructure needed to make mobile payments a success. In the United States (**US**), where this investment is yet to be made, the uptake of Apple Pay has been slow. In contrast, the uptake of integrated mobile wallets in Australia could be very fast. The applicants want to avoid a situation where Apple is allowed to free ride on this investment for its own benefit, while blocking others from competing with Apple Pay.

Finally, the applicants also want to ensure Apple Pay operates in an environment that maintains the levels of security and transparency that apply to other payment options. There is no doubt that mobile payments will be enthusiastically adopted by many Australians. However, consumers who do not want to use integrated wallets such as Apple Pay should not be exposed to the cost of inconsistent approaches to security or to hidden costs that benefit Apple but make payments more expensive for everybody else.

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## 2 Executive summary

### **Authorisation will provide real public benefits**

The authorisation sought will give the applicants the best chance to ensure that third-party mobile wallets such as Apple Pay are introduced into Australia in a way that promotes consumer choice, competition and innovation while maintaining the highest standards of security and allowing for transparency and fairness in fees.

The applicants are committed to providing their customers with a choice of mobile payment options, including Apple Pay. Australian card issuers and merchants have invested heavily in the infrastructure needed to make mobile payments a success – in particular the contactless payment network that has been embraced by retailers from the largest to the smallest and overwhelmingly by consumers.

Apple benefits enormously from its access to this established infrastructure, which is far more developed than in Apple's home market of the United States. However, Apple does not allow Australian iPhone users to access this infrastructure except through Apple Pay, denying them the benefits of competition and innovation in mobile payments. Apple seeks to determine every aspect of the security arrangements that apply to Apple Pay, although it is the issuers, and not Apple, who will be liable for any fraud. And Apple seeks to charge issuers for their customers' use of Apple Pay but to deny them the choice of passing through any of those costs, with the result that the cost of Apple Pay will be higher than it should be and will be borne by all of a bank's customers, whether they use Apple Pay or not.

The applicants seek authorisation to collectively negotiate in order to address these issues and ensure that consumers benefit from choice, competition, security, transparency and fairness. They welcome the support of a wide range of industry participants including card issuers, merchants, payments technology companies and industry bodies. They do not consider that the objections raised by or on behalf of Apple detract in any way from the net public benefits that authorisation will provide.

### **These public benefits cannot be achieved without the authorisation**

Apple's submissions make clear that its positions on exclusivity, determining its own security standards and preventing transparency are firmly entrenched. Card issuers around the world, much bigger in size than any of the applicants, have tried to individually negotiate with Apple on these issues and have failed. It is unlikely that any issuer in Australia, negotiating individually, would succeed.

Apple has around a 40% share of the smartphone market in Australia and controls a critical segment of mobile phone users. It is clear that customers are far more likely to change cards in order to use Apple Pay than they are to give up their iPhones in order to use mobile payments, as demonstrated by the increase in card applications reported by ANZ Bank since it launched Apple Pay.

This results in a significant disparity in bargaining power between Apple and any Australian card issuer when it comes to negotiating the terms of Apple Pay, and these are precisely the circumstances in which collective negotiations are recognised to promote fairer and more efficient outcomes, and collective boycotts may be required to

bring a more powerful party to the negotiating table.

Apple has said that it will never negotiate in relation to these issues no matter who sits across that table. That is exactly what Apple would be expected to say. In fact, Apple has never publicly faced a collective negotiation on all of these issues before, and it is not possible to predict the results of such a negotiation. Apple has compromised on other aspects of Apple Pay before, including altering its position on security. It has opened up many hardware and software features to third-party developers over time. A growing number of card issuers and technology companies around the world are asking for access to the iPhone's contactless payment functionality and are taking their concerns to regulators as the applicants have done.

In these circumstances the applicants believe that there is a real chance that authorisation for collective negotiations will lead to improved outcomes for consumers. They are certain that without authorisation or collective negotiation there will be no chance of these public benefits.

**Further, without the authorisation there will be significant public detriments**

However, the inability of issuers to collectively negotiate with Apple would not only prevent the achievement of clear public benefits; it would also be likely to result in significant public detriments.

In particular, it would stifle innovation and investment in mobile wallet technology at a critical time. It would prevent many customers from using their preferred mobile wallets from the providers they trust most, and would result in customers paying more for payments regardless of whether they used Apple Pay or not. It would reduce the utility of the extensive contactless payment infrastructure that Australians have invested in over almost a decade.

Apple suggests that customer choice can be maintained through workarounds such as stickers and wristbands – which are nothing more than smaller contactless cards and have nothing to do with mobile phones – or by new payment infrastructure that would inefficiently duplicate and overbuild the infrastructure that is already there. These solutions have been tried around the world and have invariably led to expensive failures – and unnecessary failures, attempted only because Apple has denied its competitors access through the iPhone to existing technologies and the only contactless payment technology that has been successful.

Even if these efforts were to succeed, they would come at a higher cost than simply using the existing infrastructure – which Apple did not develop but wishes to control – and would lead to ongoing inefficiencies and fragmentation. These are all anti-competitive public detriments that would be very likely to arise if authorisation were not granted.

**Authorisation is about choice and competition leading to better outcomes for Australian consumers, not about preventing Apple's entry into the**

Apple suggests that the applicants wish to “blunt” or delay Apple Pay and its entry into Australia, and to slow innovation and reduce competition. This is exactly backwards. The applicants are under intense pressure to participate in Apple Pay, and risk losing customers to other issuers who offer Apple Pay before them. They wish to commence and conclude collective negotiations and offer Apple Pay to their customers as quickly as possible.

**Australian market**

However, it is clear that the applicants have a very limited opportunity to influence the conditions on which Apple Pay is introduced, and they need to take this opportunity to ensure that choice and competition are available for the benefit of their customers. The applicants are continuing to innovate and compete by developing their own mobile banking and mobile payment apps on other platforms, and participating in other third party mobile wallets that allow choice and competition. They have no desire to prevent their customers from using Apple Pay, and the idea of a collective negotiation is necessarily predicated on the banks' desire to offer Apple Pay. They only wish to offer other alternatives alongside Apple Pay.

**Providing choice and competition will in no way undermine security or user experience**

Apple objects that providing access to the iPhone's contactless payment functionality would undermine security and consumer experience. However, it provides no explanation of how this might occur. Android, Windows and BlackBerry phones all provide access to their NFC contactless payment functionality and there is no evidence that Android Pay, Samsung Pay or any of the mobile payment apps that have been developed for those platforms have affected security.

Any other mobile payment apps developed for the iPhone would use the same security features that Apple Pay uses, including tokenisation, customer verification by PIN or Touch ID, and encryption in the embedded secure element or – depending on how Apple chooses to implement access – securely in the cloud. Those apps would need to comply with the EMVCo security standards and any additional standards mandated by the card schemes – as apps on other platforms that allow access to the NFC contactless payment functionality already do.

The applicants are confident that Apple would implement third party access to this functionality in a way that maintains the highest level of security, and would subject any app that accessed the NFC functionality to intense scrutiny before approving it for distribution through the App Store.

User experience would only be altered if the customer chose to download an additional app and permitted it to access the iPhone's NFC functionality. Apple would need to develop a governance mechanism that would determine which payment card and which payment app would be presented at different times, but this has not proved to be a difficult issue on other platforms. Again, the applicants would expect Apple's solution to be elegant and user-focused.

**Negotiations on security standards will benefit consumers**

Apple has raised some concerns about the development of security guidelines and the scope and effect of collective negotiation on these issues. The applicants wish to ensure that consistent levels of security apply to third party wallets and to their own mobile payment options on all platforms. Apple has indicated that its current proposition for identification and verification (**ID&V**) would meet the applicants' requirements, and if this proves to be accurate then this aspect of the collective negotiation can be dealt with quickly. The applicants have otherwise clarified their concerns and objectives around security and have attached further details to this submission.

**The ability to pass-through Apple's fees**

Through collective negotiation, the applicants seek to secure the ability for each issuer to determine for itself whether and to what

**will promote efficiency and fairness**

extent it will pass on the transaction fees Apple charges for participation in Apple Pay. This will provide a competitive constraint on the fees that Apple charges, and will also subject the determination of the fees the issuers may charge to the competitive process.

There are well-established reasons why rules prohibiting charges for particular payment methods are inefficient and unfair, as they obscure the true costs of different payment methods and require more costly payment methods to be subsidised by consumers who do not use them. These reasons have been recognised by the Reserve Bank of Australia (**RBA**) in their removal of the “no surcharge” rules previously imposed on merchants by card schemes, and they apply equally to the “no fee” rules imposed on issuers by Apple.

**An analysis of all interested party submissions supports the grant of authorisation**

While a number of submissions have criticised the applicants for not simply signing up to Apple Pay on Apple’s terms, these submissions appear to be based on the misapprehension that the applicants wish to promote their own mobile payment solutions to the exclusion of Apple Pay. In fact, the applicants wish to offer customers a real choice of mobile payments whichever mobile platform they choose.

Apple would naturally prefer to deal with card issuers on an individual basis using the “take it or leave it” approach that it has used successfully in other countries. However, its arguments against the collective negotiation are superficial and unconvincing. They ignore real differences between integrated NFC-based mobile wallets and other mobile banking or mobile payment apps and infrastructure. They appeal to security without providing any explanation of how allowing choice and competition in iPhone payments would compromise that security. They conflate a collective negotiation to redress imbalances in bargaining power with a hard-core cartel and use competition law concepts such as exclusive dealing and the national access regime that have no clear relevance to the assessment of benefits and detriments being undertaken.

Finally, they assert that Apple will never compromise – but this is a self-serving assertion which plays up to Apple’s reputation but goes against its conduct in practice, and the ACCC should give it no more credence than it deserves.

Against these arguments, a number of submissions support the application and agree with the applicants on the need for real competition and choice, for security standards and for transparency of fees. Supportive submissions include those from Coles, the Australian Retailers Association, Bluechain, the Australian Payments Clearing Association, Australian Settlements Limited, Indue, Heritage Bank, Tyro Payments, eftpos and MasterCard.

In these circumstances the applicants urge the ACCC to grant the application for authorisation.

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## 3 Public benefits of authorisation

### 3.1 Public benefits case

Irrespective of their choice of mobile phone, Australian consumers should not be restricted from choosing the mobile wallet that best meets their requirements and preferences.

The limited collective negotiation requested by the applicants is directed at achieving the public benefits associated with removing this restriction on consumers, and will also have flow-on benefits in relation to:

- allowing Australian consumers to enjoy the full benefit of investments that have been made in our payment infrastructure. Without collective negotiation, there is a material risk that Apple will be allowed to free ride on that investment;
- enjoying price and quality improvements that result from increased competition and choice in mobile wallet products;
- reducing the potential for inefficient and inequitable fee recovery; and
- greater adoption of mobile payment technology and confidence and stability in Australia's payment system.

### 3.2 Authorisation request

As set out in **Annexure A**, the applicants are seeking authorisation to collectively negotiate with Apple in relation to three issues:

- **exclusivity:** the ability to access or use the iPhone's NFC functionality to provide Australian consumers with integrated NFC-capable mobile wallets that can make NFC payments at point of sale (**POS**) (alongside and in competition with Apple Pay, which will remain the default mobile wallet for iPhone owners unless they wish to choose another mobile wallet);
- **security:** ensuring that all parties to the collective negotiation can rely on Apple Pay at least meeting the same security standards as those that apply to Australian credit card issuers (in relation to card payments and their own mobile wallets); and
- **pass-through of fees:** the ability of the applicants to make independent decisions as to whether to charge their cardholders for the additional costs incurred by their use of the Apple Pay mobile wallet.

As part of the authorised conduct, participants will agree not to introduce Apple Pay during the period of collective negotiation. However, participants are free to negotiate individually with Apple on all issues other than the three issues above at any time, including during the period of collective negotiation.

Further information on the proposed collective negotiation framework is provided at **Annexure A**.

### 3.3 The applicants' commercial rationale and incentives support the public benefits case

The Australian payments landscape is rapidly evolving. New transaction types, payment methods, channels and technologies are providing Australian consumers and businesses, with the potential for more payment options than ever before. As payment

technology and customer preferences evolve, customers' expectations of what their banks should provide are shifting. It is not clear yet which payment models will succeed.

What is clear is that in order to remain competitive in attracting and retaining customers, banks and payment providers need to be able to offer a suite of products and services that will provide the security and flexibility to best meet customers' payment preferences and capture the benefits of alternative payment methods.

To this end, Australian banks and payment providers have embraced innovation in technology, services and platforms and invested heavily in delivering various new payments technologies to customers – striving to continually improve the customer experience to make payments safer, easier, more convenient and ultimately more competitive.

In particular, Australia has led the world in the adoption of advanced payment technologies such as EMV chip-and-pin security and has invested heavily in the infrastructure needed to make contactless payments ubiquitous. Australian banks and retailers have made substantial investments in NFC terminals at POS and corresponding consumer education. Without this investment, the world-leading fast and widespread acceptance of “tap and go” NFC payments (and consequently of Apple Pay) would not be possible.<sup>1</sup>

Given the investment already made, and the importance of interoperability of payment methods (for example, cards on the American Express, Visa and MasterCard networks all being able to use the same contactless NFC terminal, and consequently Apple Pay being able to use those same existing terminals), it would be highly inefficient for Australian businesses to be forced to deploy an entire network of diverse connectivity options simply to satisfy Apple's commercial desire to avoid competition on NFC integrated mobile wallets. A proliferation of diverse connectivity options at the POS, with multiple terminal or reader options coupled with varying payment routines or behaviours presented at once, also potentially opens up substantial customer confusion and loss of efficiency. It is in the interest of not only Australian banks and retailers, but all Australians, to ensure that this investment in the existing, and still technologically relevant and up to date, NFC terminal infrastructure is utilised efficiently to its full potential.

This widespread consumer and merchant acceptance of NFC contactless payment transactions, and the related investment in terminals, combined with Australia's high levels of smartphone ownership and enthusiasm for new technology, means that payment card issuers need to be able to offer customers the next logical step in interface format – integrated mobile payments.

It is difficult to predict the full potential of mobile payment and mobile wallet services and the shape or form that innovation may take. In the applicants' view, mobile payments will only succeed if they offer customers, merchants and financial institutions the right combination of convenience, security and cost. In all likelihood, consumers will also need to be offered more than a simple “like for like” replacement of an existing contactless physical card, with additional enhanced features or functionality driven by the smart phone capabilities in order to drive widespread take-up. These attributes will only be

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<sup>1</sup> In contrast, the adoption of Apple Pay in the US has been slow. At the time Apple Pay launched, only about 2% of the country's 12 million POS terminals were NFC-enabled. In February 2016, it was announced that the number of merchants accepting Apple Pay had increased to 2 million, however this still represents less than 20% of POS terminals in the US. See Smart Payment Association, *An Overview of Contactless Payment Benefits and Worldwide Deployments*, April 2016, available at: <http://www.smartpaymentassociation.com/images/news/16-04-26-SPA-Contactless-Payment-Benefits-WP-Final.pdf> (accessed 29 September 2016).

developed in an environment in which vigorous competition drives innovation, efficiency and continuing investment.

Conversely, the introduction of mobile payment or mobile wallet services on a basis that limits or prevents competition is likely to result in fragmentation, under-investment and a reduction in innovation and customer choice. The decisions made now have long term implications not only for the banks and wallet providers, but also for consumers and the future of the Australian payments system.

### 3.4 There is no basis for Apple’s claim of detriments and delay

Apple has claimed that the applicants are using the application for authorisation as a means of delaying or blunting Apple Pay’s entry into the Australian market, but evidence in this submission shows that the applicants have strong incentives to complete collective negotiations at the earliest possible time (see section 6). Indeed, with the Sydney mass transit electronic ticketing system (and potentially those of other major Australian cities) soon moving towards the use of “open loop” (eg, MasterCard and Visa) contactless payment cards, alongside the “closed loop” Opal card system, the applicants are keen for all of their cardholders regardless of their choice of mobile phone handset to be able to utilise the mobile wallet of their choice as soon as possible – as using a mobile wallet on the mass transit system can be more convenient than cards, as evidenced overseas in cities such as London.

Consistent with this goal, the applicants have prepared a framework for negotiations which they expect will simplify and facilitate collective negotiations with Apple (see **Annexure A**).

### 3.5 Support for the authorisation

As outlined in Table 1 below, a number of interested parties have shown significant support for the proposed authorisation and the public benefits identified by the applicants.

**Table 1: Summary of interested party submissions supporting the authorisation and its public benefits**

Authorised conduct and public benefit	Interested party	Summary of comments in support
Collective negotiation to gain access to the iPhone’s NFC functionality allowing increased consumer choice and innovation	Coles Supermarkets Australia Pty Ltd	Consumer choice should be driven by the ability to tailor solutions rather than technical lockout
	Bluechain Pty Ltd	Locking control to alternate interfaces (such as NFC) causes disruption to market choice
	Australian Retailers Association	For as long as Apple Pay remains the only app that can use the iPhone’s NFC functionality, the potential for innovation in mobile wallets and mobile payments will be limited
	Australian Payments Clearing Association (APCA)	Access to payment platforms and competition on open platforms are key enablers of innovation in payment services and products, and deliver tangible benefits to consumers and merchants
	Australian Settlements Limited	Smaller financial service providers do not have the scope to develop mobile wallets for each mobile device, rather, they seek to develop one app that can be used on both Apple’s iOS or Google’s Android OS

Authorised conduct and public benefit	Interested party	Summary of comments in support
	Heritage Bank Limited	Exclusivity reduces competition and successful collective negotiations are likely to result in greater customer choice with regard to the wallet used to make mobile payments
	Tyro Payments Limited	Eliminating third party access to the Apple NFC function stifles innovation and competition
Collective negotiation to ensure Apple Pay meets minimum security standards	APCA	Adoption and use of the APCA Guidelines will promote the safety and security of mobile payments in Australia and mitigate liability for fraud and unauthorised transactions
	MasterCard	Digital payment solutions must comply with internationally accepted standards for security and fraud prevention
Collective negotiation to remove Apple's restriction on the ability to pass through Apple's additional costs allowing more efficiency and transparency and less distributional inequity	Australian Retailers Association	Preventing issuers from charging their customers for use of a mobile wallet may lead to unreasonably high costs and unfair and inefficient cross-subsidies
	Australian Settlements Limited	Price transparency empowers consumers to choose the payment method on their device
	eftpos Payments Australia Ltd	Efficiency and transparency is an important feature in all payment systems as it allows both consumers and merchants to make informed payment choices
	Heritage Bank Limited	Lack of price transparency will mean that the cost of third party wallets will need to be cross-subsidised by the bank's other customers

Of the few submissions that have opposed the application, Apple has presented the strongest opposition. The rest of this document therefore seeks to answer Apple's main claims.

## 4 Facing Apple's bargaining power advantage: why the applicants need to collectively negotiate

### 4.1 Overview

There is a strong disparity in the bargaining position of Apple as compared with the individual applicants – a disparity that the authorisation seeks to address. Indeed, Apple's responding submission has made it clear that without the limited collective negotiation and collective boycott, any adoption of Apple Pay in Australia will be on Apple's terms. Such terms effectively protect Apple from competition in relation to integrated mobile payments using iPhones, unilaterally grant Apple the exclusive use of the existing NFC payments infrastructure built by third parties for integrated mobile payments using iPhone devices, create inefficiencies and are suboptimal for Australian consumers.

However, if authorisation is granted, there is a real likelihood that substantial efficiencies will be achieved and that significantly improved positions in relation to exclusivity, security standards and pass-through of costs will be negotiated for the benefit of Australian consumers.

## 4.2 Apple's significant bargaining power advantage

Apple's share of mobile devices in Australia, as well as the importance and characteristics of iPhone users as a key customer segment for Australian credit and debit card issuers, give Apple a significant bargaining advantage.

- (a) Apple has a high share of smartphone sales in Australia and Apple's customers are particularly valuable for payment card issuers

Almost 80% of Australians have a smartphone, and as a manufacturer Apple has the highest share of smartphone sales in Australia at around 40%. Significantly, this market share is almost exclusively at the premium end of the smartphone market. Apple's share of smartphone sales by operating system is higher in Australia than it is in almost any other country. As a result, iPhone device users represent a key component of the addressable market for mobile wallet developers.

More importantly, iPhone device users are a particularly valuable customer segment for payment card issuers in relation to mobile payment technology. The average iPhone user tends to be wealthier and likely to conduct more and larger transactions than other customers. iPhone users are also more likely than the average customer to value the ability to make mobile payments, as they adopt and consume technology more enthusiastically than other smartphone users.

This is reflected in overseas research regarding the greater revenue opportunity for mobile payments companies provided by iPhone users than Android users and the characteristics of iPhone users in Australia. According to research conducted in the US, Americans who make payments using their iPhones in stores spend nearly double that spent by Android users making the same type of payments.<sup>2</sup> Thus, even though Android accounts for a larger share of smartphones than iPhones do, this does not make up for the shortfall in mobile payment value or frequency. As a result, iPhone customers represent a larger payments revenue opportunity for companies that are interested in developing mobile payment products. However, this opportunity requires access to the currently closed NFC capability on iPhones.

- (b) Apple has the ability to block access to iPhone customers

Apple controls the operating system, the mobile hardware and the software that can be introduced onto an iPhone. In effect, Apple has complete ability to control access to the all-important iPhone customer segment. For so long as Apple restricts access to the iPhone's NFC functionality, Apple will not face any competition from either existing or emerging mobile wallet providers in relation to these customers – Apple Pay will be the only NFC-enabled integrated wallet available to iPhone users.

Apple also knows that it is unlikely to face any consequences if Apple Pay is not available on the iPhone – ie, an iPhone user is unlikely to buy a Samsung phone only to access Samsung's mobile wallet..

According to Apple CEO Tim Cook:

*...our iPhone loyalty rate is almost twice as strong as the next-highest brand. In addition, a growing portion of our revenue is directly driven by our existing install base. Because our*

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<sup>2</sup> John Heggestuen, *Business Insider Australia*, 'iOS users are a much bigger revenue opportunity for mobile payments companies than Android users', 19 June 2014, available at: <http://www.businessinsider.com.au/the-biggest-revenue-opportunity-is-on-ios-for-mobile-payment-companies-2014-6?r=US&IR=T> (accessed 29 September 2016).

*customers are very satisfied and engaged, they spend a lot of time on their devices and purchase apps, content, and other services. They also are very likely to buy other Apple products, or replace the one that they own [with a newer model].<sup>3</sup>*

From the perspective of most iPhone owners, iPhones and non-iPhone devices are not close substitutes and there are high switching costs involved with moving from one ecosystem to another – which might be compared to moving house, in a digital sense. iPhone users tend to keep buying iPhones. This stickiness is also reflected in Australia’s smartphone consumption and adds to Apple’s strong comparative bargaining position. Further, the ability to make integrated mobile payments is only one, and today a relatively minor, potential functionality of a smartphone – a device which is no longer just a means to communicate but has become more of a “personal integrated remote (or digital assistant) for life” being the go-to device for many day-to-day activities. It is unlikely that mobile payment functionality would be a major determinant of switching from iPhones to non-iPhone devices, and this functionality is at best a secondary or tertiary differentiating characteristic in the eyes of consumers.

Additionally, many iPhone purchase decisions are made via “lock in” contracts with mobile phone carriers where the cost of the handset is subsidised by the mobile carrier over the term of the contract, typically two years. For these consumers, the ability to economically switch from an iPhone to a non-iPhone device only comes up every two years as they come out of contract.

(c) Apple has significant bargaining power

In negotiations regarding Apple Pay, the applicants and Apple are in significantly different bargaining positions, because:

- Apple controls the operating system, the mobile hardware and the software that can be placed on the iPhone and ultimately controls access to iPhone customers;
- increasing consumer appetite to use their mobile phones to make payments requires that the banks provide integrated mobile payment solutions or risk losing their customers;
- for as long as Apple restricts access to the iPhone’s NFC functionality, Apple Pay will be the only mobile payment solution for iPhone users wanting to use their phones to make contactless payments; and
- iPhone customers in particular value the ability to make mobile payments and also represent significant value to issuers, which means that in individual negotiations the banks will have no choice but to provide Apple Pay on Apple’s own terms in order to satisfy customer demand for mobile payment solutions. This is an outcome which limits choice and is ultimately suboptimal for Australian consumers.

As reflected in Apple’s responding submissions, Apple has the capacity to offer “take it or leave it” terms to the applicants, knowing that a refusal to accept the terms offered will impact the banks’ ability to compete in card issuing and more broadly in retail banking services. This is especially true now that ANZ Bank has joined Apple Pay and will increasingly be the case as mobile payments become more commonplace (see section 9.8 below). At the same time, Apple is unlikely to lose iPhone customers and, from Apple’s perspective, the cost of negotiation breakdown is low relative to the potential

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<sup>3</sup> Serenity Caldwell, Jason Snell, ‘This is Tim: Apple’s CEO on Q1 2016’, Financial earnings live transcript, 26 January 2016, available at: <http://www.imore.com/tim-apples-ceo-q1-2016> (accessed 29 September 2016).

benefits of exclusivity. Although Apple needs to sign up issuers to expand Apple Pay, Apple is the party with the bargaining power in the negotiation, not the applicants.

Apple's position in relation to the iOS platform not only gives it strong bargaining power in Apple Pay negotiations with issuers, but arguably also allows it to enjoy market power in respect of applications and services for iPhone users.

As noted in the expert report of Dr. Susan Athey:

*... Apple competes to attract a large group of consumers, and then exercises market power over firms that wish to do business with those consumers.*

Further Dr. Susan Athey finds that:

*Even though Apple competes for users of smartphones, it has market power in respect of applications and services for iPhone users. The "competitive bottleneck" occurs because the only way for service providers to access iPhone users is through Apple's platform. The market power held by Apple translates into highly asymmetric bargaining power for Apple when negotiating individually with card providers.<sup>4</sup>*

However, a finding of market power is not necessary for the purposes of this application for authorisation and the applicants do not rely on any such finding in order to demonstrate Apple's bargaining power and the disparity in bargaining power between Apple and individual card issuers.

(d) Apple's submission that the individual applicants have greater bargaining power than Apple is incorrect

Apple's submission claims that the individual applicants have bargaining power against Apple, but this does not reflect the dynamics discussed above or the ability for Apple to (and the fact that Apple has) put "take it or leave it" terms on the table.

Payments are not one-sided markets and Apple's submissions do not provide a proper assessment of the bargaining power of either Apple or the applicants given that fact. For example, Apple dismisses the suggestion of bargaining power by noting:

- it is a new entrant in the banking sector;
- there are numerous existing mobile payment and mobile wallet providers in Australia with which Apple Pay must compete to win over customers; and
- there are other mobile device manufacturers that Apple competes with (and mobile phone shares are highly volatile).

None of these points addresses the bargaining power relevant to the authorisation. Apple controls not just the handset, but the operating system, the hardware and the software available to iPhone users in Australia. As a result, Apple controls (and has the ability to block) access to those customers. The limited collective negotiation sought is concerned with obtaining access to those customers to provide them choice in mobile payment and mobile wallets. Apple's bargaining power in relation to the control of access to those customers is not relevantly constrained by the fact that there are other payment and mobile banking options in Australia (which do not directly compete with Apple Pay in any case).

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<sup>4</sup> Expert report prepared by Dr. Susan Athey.

As noted above, when a consumer chooses a mobile phone handset, the ability of that handset to make different forms of NFC contactless payments is not high on the list of selection criteria, with exterior design, screen size, memory, processing speed, price and other functions being of key importance. Hence, at the time the consumer is purchasing an iPhone handset, there is likely to be no realisation that Apple Pay is the only application able to access the NFC function. This leads to the position of Apple being successful in convincing consumers (who have already made their iPhone purchase decisions) that it is their bank that has chosen not to offer Apple Pay, rather than Apple that has chosen not to provide NFC access to their bank's own mobile wallet.

#### **4.3 Collective negotiation / boycott is necessary in this case**

The purpose of the authorisation is to reduce the significant disparity in bargaining power between the applicants and Apple in order to achieve better market outcomes than would be possible without the authorisation.

Collective negotiation and associated collective boycott conduct can be authorised where there is a net public benefit. As outlined in section 3 above, the ability to collectively negotiate with Apple in relation to NFC access, security and fee pass-through will result in public benefits for consumers. The limited nature of the negotiation also restricts any potential detriment from the collective arrangements.

As noted by the ACCC, where collective bargaining alone is not sufficient to address market failures and improve the efficiency of contracting and associated market outcomes, the threat of collective boycott may be an efficient negotiating tool that facilitates the collective negotiation of more efficient contracts and better market outcomes. In particular, the ACCC has stated that:

*Collective boycotts are more likely to be appropriate where there is a significant disparity in bargaining power between the bargaining group and the target, or where the target is less willing to participate in collective bargaining and the failure to collectively bargain would result in inefficiencies or other public detriments.<sup>5</sup>*

This is a situation in which a collective boycott is appropriate because:

- there is significant disparity in the bargaining position of Apple as compared with the individual applicant banks in relation to negotiations regarding Apple Pay (see section 4.2 above); and
- a failure to collectively negotiate will result in inefficiencies and public detriments (see section 5 below).

The collective boycott is required to give effect to the collective negotiation and meaningfully bring Apple to the negotiating table, thereby facilitating the realisation of the benefits discussed in section 3 above.

#### **4.4 Collective negotiation / boycott will improve the applicants' bargaining position and has a real chance of success**

Apple has said that it will never negotiate in relation to exclusivity, the ability to pass-through fees and minimum security standards. This is clearly the likely outcome in the

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<sup>5</sup> ACCC, Media Release, 'ACCC proposes to revoke immunity for collective bargaining and collective boycott against NRL by betting agencies', 26 February 2014, available at: <https://www.accc.gov.au/media-release/accc-proposes-to-revoke-immunity-for-collective-bargaining-and-collective-boycott-against-nrl-by-betting-agencies> (accessed 29 September 2016).

context of individual negotiations; and is exactly the public position that would be expected from a party with the kind of bargaining power that Apple enjoys.

Submissions that argue that Apple will never reach a commercial arrangement on these issues, including Apple's own submissions, draw on Apple's reputation as intransigent, closed and controlling. However, an examination of Apple's past conduct shows that these qualities – and the differences between Apple and other hardware and software providers – can be exaggerated, as shown below.

(a) Apple is already under pressure to make changes in relation to Apple Pay

When initially launched, Apple negotiated with US banks under conditions of great secrecy, commercial pressure and in a markedly different contactless payment environment (ie, while contactless payments are ubiquitous in Australia, there have been very low take-up rates in the US). The outcome of those negotiations reflects the amount of bargaining power that Apple was able to exercise at that time.

Since then, when trying to launch Apple Pay in other jurisdictions, Apple has needed to make changes and concessions on aspects that were previously presented as “non-negotiable”.

- Canada: in Canada, an industry wide taskforce was established before Apple entered the Canadian market to respond to fraud concerns associated with the use of Apple Pay in the United States and to ensure that the banks could influence the authentication and card provisioning processes associated with Apple Pay. This resulted in the publication of a *Payments Security White Paper* in July 2015 highlighting the need to maintain the highest level of payment security, promote security and support innovation (**Canadian White Paper**).

The Canadian banking industry was concerned with the control that Apple retained over card authentication and provisioning in the US market, where Apple initially employed a ‘red, yellow or green path’ process for handling card provisioning requests by consumers:

- a green path allows the card to be provisioned without referral to the issuer;
- a red path is where the provisioning request is declined without referral to the issuer; and
- a yellow path requires card issuer approval for a card to be provisioned.

This model of card provisioning can be described as a ‘pull model’ and was alleged to result in high levels of card fraud. Following the publication of the Canadian White Paper, cross-industry workshops were held to negotiate and agree upon a standard approach to authentication and provisioning of cards in mobile wallets. The Canadian banks and a number of mobile wallet providers, including Apple, participated in these workshops. Ultimately, the model of card provisioning that was negotiated in Canada is a ‘push model’ whereby the banks retain control over the provisioning of a card into Apple Pay through the introduction of mandatory ‘secondary authentication’ by the banks to verify customer information before a card can be used in Apple Pay.

This change from the US model was assisted by a context where a number of Canadian banks initially approached aspects of the negotiation on a common basis and where it was crucial for Apple to succeed in negotiations with Interac (Canada's domestic debit card scheme, similar to eftpos in Australia).

- China: Apple had difficulty entering the Chinese market and has now partnered with UnionPay in order to facilitate entry and expansion. The applicants understand that the major banks and telecommunications providers in China adopted a collaborative approach in relation to the introduction of Apple Pay by conducting negotiations through UnionPay, which is a unified Chinese bankcard association and all bankcard issuers in mainland China are members.<sup>6</sup> This negotiation is reported to have resulted in significant compromises on the level and timing of fees and other changes, and may have included the use of an NFC-enabled SIM card of the kind used by China Mobile and China Unicom rather than the iPhone's embedded systems.<sup>7</sup>
- Japan: Apple Pay's recent launch in Japan reportedly involved a number of compromises from Apple, including by upgrading the iPhone and Apple Watch hardware for compatibility with the FeliCa variant of NFC,<sup>8</sup> and allowing public transit and small denomination POS payments using a Suica card without requiring a Touch ID fingerprint or PIN.<sup>9</sup> This is an example of Apple making changes not only to its hardware, but also in relation to its 'non-negotiable' security requirements.

The applicants understand that similar concerns to those raised by the applicants in relation to access to the iPhone's NFC functionality are being raised in other jurisdictions:

- in South Korea, it has been reported that financial technology companies have announced an intention to commence an action against Apple over Apple's refusal to open its API for NFC at the Korean Fair Trade Commission;<sup>10</sup> and
- in Switzerland, the consumer protection authority, Stiftung für Konsumentenschutz (**SKS**), filed a complaint with the Swiss competition commission Wettbewerbskommission (**Weko**) in relation to Apple's refusal to grant other mobile payment apps – in particular Twint – access to the iPhone's NFC technology ahead of the Apple Pay launch.<sup>11</sup> Apple reportedly confirmed that it would not open up NFC functionality for third-party payment services, for reasons of "security and convenience".<sup>12</sup> Weko has reportedly said that it is aware of the problem and will watch how the market develops.<sup>13</sup>

This is evidence of increasing pressure on Apple to open up access to the iPhone's NFC functionality – a reasonable request, in line with historical opening up of other features,

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<sup>6</sup> China UnionPay, 'FAQs', available at: [http://en.unionpay.com/merchantService/faqs/file\\_4420480.html](http://en.unionpay.com/merchantService/faqs/file_4420480.html) (accessed 29 September 2016).

<sup>7</sup> Zhang Yuzhe, *Caixin*, 'Chinese banks to pay much smaller fees to Apple Pay than US counterparts', 22 February 2016, available at: <http://english.caixin.com/2016-02-22/100911334.html> (accessed 30 September 2016).

<sup>8</sup> Apple, Press Release, 'Apple Pay coming to Japan with iPhone 7', 7 September 2016, available at: <http://www.apple.com/newsroom/2016/09/apple-pay-coming-to-japan-with-iphone-7.html> (accessed 29 September 2016).

<sup>9</sup> See Apple Japan's promotional video for Apple Pay using iPhone 7 at <https://www.youtube.com/watch?v=2eUlr-sn570&feature=youtu.be> (accessed 29 September 2016).

<sup>10</sup> Cho Jin-young, *Business Korea*, 'Appeal against Apple policy: Local fintech firms will appeal to FTC over Apple's closed policies', 12 September 2016, available at: <http://www.businesskorea.co.kr/english/news/ict/15836-appeal-against-apple-policy-local-fintech-firms-will-appeal-ftc-over-apple%E2%80%99s-closed> (accessed 29 September 2016).

<sup>11</sup> *Telecom Paper*, 'SKS files Apple m-payments complaint with Weko', 6 July 2016, available at: <http://www.telecompaper.com/news/sks-files-apple-m-payments-complaint-with-weko--1152095> (accessed 30 September 2016); Apple, Press Release; Apple, Press Release, 'Apple Pay now available in Switzerland', 7 July 2016, available at: <http://www.apple.com/newsroom/2016/07/apple-pay-now-available-in-switzerland.html> (accessed 30 September 2016).

<sup>12</sup> *Neue Zürcher Zeitung*, 'Apple Pay startet in der Schweiz', 7 July 2016, available at: <http://www.nzz.ch/digital/bezahlsystem-apple-pay-startet-in-der-schweiz-ld.104159> (accessed 30 September 2016).

<sup>13</sup> *Neue Zürcher Zeitung*, 'Konsumentenschutz reicht Klage bei Weko ein', 6 July 2016, available at: <http://www.nzz.ch/digital/einfuehrung-von-apple-pay-in-der-schweiz-konsumentenschutz-reicht-klage-bei-weko-ein-ld.104173> (accessed 30 September 2016).

that will drive competition for mobile payment solutions, speed up adoption and deliver benefits for consumers worldwide.

- (b) The ability to engage in a collective boycott will strengthen the applicants' bargaining position

The experience in Canada and the other overseas examples set out in section 4.4(a) above demonstrate that where there is a decrease in the disparity of bargaining power between Apple and issuers (eg, as a result of industry pressure from either particularly significant participants or collective negotiation), Apple is prepared to respond and adjust its "non-negotiable" terms and conditions.

However, as has also been reflected in the overseas experience, such response can be easily neutralised with a "divide and conquer" strategy in which Apple persuades each issuer to accept its terms by playing each issuer off against the others with the prospect that unless an issuer agrees, it will find itself at a competitive disadvantage, as its competitors will be able to offer customers the ability to use Apple Pay while it will not. This dynamic is already in motion in Australia with ANZ Bank noting the following on its website:

**Not with ANZ?**

*You won't find Apple Pay at the other big banks, so make sure you're ready with an eligible ANZ card.<sup>14</sup>*

In this case, the ability to engage in collective negotiation with an associated collective boycott will afford the applicants some protection against a "divide and conquer" strategy and address the market failure that is likely to occur in the counterfactual. As noted in the CRA report:

*In this particular case, access to the NFC chips in iOS devices, which is essential for the provision of integrated mobile wallets on iOS devices, is a scarce resource that is controlled by a player that is also competing downstream with its own integrated mobile wallet on iOS devices. Vertically integrated firms that control upstream inputs that are important for downstream competition often have incentives to refuse access to those inputs in order to favour their own downstream product. In this particular case, Apple's policy is not to provide access to its NFC chips, and for the reasons explained in Section 4 of the first CRA report, in individual negotiations the respective bargaining positions of Apple and the applicant issuers are such that the likely counterfactual is one in which the applicant issuers will agree to join Apple Pay, Apple will maintain its policy of exclusivity, and Apple Pay will be the only integrated mobile wallet on iOS devices. As a result, there will be limited competition downstream in the supply of mobile wallets on iOS devices. This is the market failure that is the subject of the application for authorisation of collective negotiations. This limited competition will likely result in:<sup>15</sup>*

- a. *limited choice of integrated mobile wallets for iOS device users (Apple Pay will be the only option);*
- b. *higher prices for mobile wallets;*
- c. *lower quality mobile wallets;*

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<sup>14</sup> ANZ, 'ANZ with Apple Pay', available at: <http://www.anz.com/personal/ways-bank/mobile-banking/apple-pay/> (accessed 29 September 2016).

<sup>15</sup> See generally section 6 of the first CRA report, which considers, in reverse, the benefits of a waiver or relaxation of exclusivity and hence the rectification of the market failure.

- d. *less investment and innovation in mobile wallets; and*
- e. *high fees charged by Apple for the use of Apple Pay.*

Further, as noted in the report of Dr. Susan Athey:

*In contrast, if card issuers can collectively bargain and boycott in relation to Apple Pay, the value created by card issuers as a group will be reflected in negotiations, which increases the probability of negotiating to eliminate or improve the restrictive terms and conditions surrounding exclusivity, security, and transparency of fees. Modifying or eliminating Apple's restrictive conditions will promote competition, transparency, and innovation in mobile payments, which in turn increase adoption and producer and consumer surplus in Australia.<sup>16</sup>*

#### **4.5 Apple's submissions on boycotts do not negate the case for authorisation**

Under the *Competition and Consumer Act 2010 (CCA)*, collective bargaining and boycott behaviour can be authorised in appropriate circumstances. Apple's assertion that collective boycotts will almost always have too high a degree of anti-competitive detriment to ever pass the public benefit test is incorrect as a matter of law and contradicts the plain intention of the Australian Parliament. If Apple were correct, the Australian Parliament would have restricted the benefit of collective bargaining to the potential for increased cooperation and information exchange but not extend it to correcting an imbalance in bargaining power through the ability to collectively refuse a bad deal.

As noted above and in the applicants' original submission, the ACCC has identified the public benefits that can arise when a collective negotiation process is supported by a collective boycott. As the ACCC said in its submission to the recent Competition Policy Review:

*In some circumstances, attempts by small businesses to collectively bargain with a large supplier or acquirer without the ability to threaten and/or engage in a collective boycott, may render the bargaining process ineffective. The counterparty business will refuse to negotiate with the collective bargaining group or only agree to similar terms to those that would have been agreed without the collective bargaining process. Whether the ability to collectively boycott will bring the counterparty to the table to negotiate, and result in better contractual arrangements, will depend on the particular circumstances of the negotiations.<sup>17</sup>*

In relation to Apple Pay, collective bargaining will not be effective, and the public benefits derived from the ability to collectively negotiate will not be possible, without the collective boycott. Individual negotiation in circumstances where one party knows that the other cannot walk away from the negotiation is unlikely to be successful, and in most circumstances the same will apply to collective negotiation. As Trindade, Smith and Merrett have pointed out:

*The debate about collective negotiation versus collective bargaining in the Chicken Meat Growers authorisation brought this starkly into focus by suggesting that collective bargaining alone can result in public benefit without any need for a collective boycott. But, in reality, being allowed to ask for the same price and terms without being able to say no at any given*

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<sup>16</sup> Expert report prepared by Dr. Susan Athey.

<sup>17</sup> ACCC, 'Submission to the Competition Policy Review – Response on Draft Report', 26 November 2014.

*point is not negotiating. Indeed, any collective bound by such a restriction is in a position not dissimilar to a vendor undertaking a fire sale.*<sup>18</sup>

The implication in Apple's submission that a collective boycott should not be available to the applicants due to their size or profitability in the retail banking sector reflects a misapplication of the test for authorisation. The legal question is whether there would be a net public benefit from the proposed conduct. It is not the size of the applicants that is relevant but the disparity in bargaining power between Apple and the applicants resulting in the potential for inefficient outcomes in Apple Pay negotiations.

Apple's submission relies on the outcome of the 2006 Tribunal decision *Re VFF Boycott Application* (2006) ATPR 42-0120 (***Re VFF Boycott Application***) to infer that because a collective boycott was not authorised in that fact scenario it should not be authorised in relation to Apple Pay.

As noted in Apple's submission:

*But even in the VFF Chicken Growers matter, while the Tribunal accepted there was some evidence that the large processors had acted opportunistically to impose terms and conditions of supply on growers which were economically inefficient and a public detriment, the Tribunal found this detriment was short term and likely to be overcome by the processors' own demands for supply. Consequently, the Tribunal found the detriment raised by the Applicants was transient.*

The scope of the collective arrangements sought in relation to Apple Pay and the factual circumstances surrounding the nature of the inefficiencies and public detriments that will result absent the authorisation are quite distinct from those in *Re VFF Boycott Application*.

In *Re VFF Boycott Application*, the Tribunal found that:

*While collective boycotts will enable Growers to overcome, to some extent, opportunistic behaviour by Processors, we believe demand growth would, over time, be likely to achieve this in the absence of authorisation.*<sup>19</sup>

In other words, as reflected in the extract from Apple's submission set out above, the inefficiencies or public detriment that would arise without the collective boycott were considered by the Tribunal as "transitory". This is not the case here.

The public detriments and inefficiencies that the applicants seek to avoid:

- Apple Pay being the only choice available to iPhone users;
- Apple Pay being the only integrated wallet app that can access this key component of the addressable market;
- the inability to exert competitive pricing pressure on Apple in relation to its fees for Apple Pay (and Apple's ability to increase those fees in future);

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<sup>18</sup> Rachel Trindade, Rhonda Smith and Alexandra Merrett, 'The Australian difference: has the public benefit test been eroded?' *The State of Competition*, Issue 12 (May 2013).

<sup>19</sup> *Re VFF Boycott Application* (2006) ATPR 42-0120, [454].

- the potential for inequitable cross-subsidisation of Apple Pay users by other Australians; and
- not being able to collectively negotiate in relation to security,

will not be able to be overcome without authorisation.

The other reason the Tribunal decided that the net public benefits test was not met in *Re VFF Boycott Application* was a concern that:

*... Growers might use their enhanced bargaining power to achieve market outcomes that more than offset any gains that may result from more rapidly overcoming opportunistic behaviour by Processors.<sup>20</sup>*

As noted by the Tribunal:

*However, just how Growers would seek to exercise the power to boycott in their negotiations with Processors is highly uncertain. While we are confident they will be able to use the power to overcome opportunistic behaviour by their Processors, we are not confident they will have the incentive to use it only in ways that will lead to more efficient market outcomes.<sup>21</sup>*

The scope of the collective negotiation and boycott in *Re VFF Boycott Application* was much broader than is the case here, and the detriments that the Tribunal considered would have a real chance of arising are also distinct from this application. As such the fact that the net public benefits test was found not to be met in that fact scenario does not mean it is not met in this application.

The ACCC appears to consider that the consequence of *Re VFF Boycott Application* in discouraging applications for collective bargaining supported by a collective boycott is an unfortunate one:

*Currently, however the ACCC receives very few collective bargaining proposals that involve collective boycott activity, even when it could be efficiency-enhancing. A reason for this may be a decision by the Tribunal in 2006 to overturn the ACCC's determination granting authorisation to allow chicken growers in Victoria to collectively withhold their services where negotiations broke down with chicken meat processors.<sup>22</sup>*

In this case the applicants submit that the limited collective boycott accompanying the proposed collective negotiation would be efficiency-enhancing and the Tribunal's decision in *Re VFF Boycott Application* should not raise a presumption against authorisation or prevent a proper consideration of these benefits.

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## 5 Without authorisation there will be public detriments

### 5.1 Overview

Without authorisation, individual banks will not have the bargaining power required for there to be any meaningful chance of Apple genuinely negotiating in relation to

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<sup>20</sup> *Re VFF Boycott Application* (2006) ATPR 42-0120, [454].

<sup>21</sup> *Re VFF Boycott Application* (2006) ATPR 42-0120, [451].

<sup>22</sup> ACCC, 'Submission to the Competition Policy Review – Response on Draft Report', 26 November 2014.

exclusivity, pass through and security standards. This has been made clear by Apple's responding submission. This section addresses these public detriments in more detail.

## **5.2 No choice, no flexibility and no competition**

Without authorisation, Australian users of iPhone devices will have no choice between integrated mobile wallets. When making integrated mobile payments, Australian users of iPhone devices will have one choice and one choice only – Apple Pay.

Different mobile wallets have the capacity to offer different functionality, features and services to entice consumer take-up (including loyalty points or other incentives to encourage use of particular wallets). Customers benefit from having the ability to choose between integrated mobile wallets to best meet their preferences and needs:

- Some customers may value the ability to manage payments within the same application they use to manage their accounts, manage personal budgets, check balances and credit limits, and make transfers between accounts. Apple Pay does not currently offer its customers this functionality. However, these functions are available to Android device users through issuers' proprietary mobile wallets integrated with a general mobile banking app and could be made available to Apple customers if Apple allowed access to the NFC functionality.
- Other customers may value the flexibility to choose between different mobile wallets on a transaction by transaction basis. From a consumer perspective, it may be important to be able to simultaneously access the consumer's account balance or credit limit to ensure the transaction can go ahead without penalty or in line with a personal budget, or there may be savings or benefits available to the consumer for using particular mobile wallets at particular retailers (eg, loyalty points or discounts).

With only one choice of integrated mobile wallet available on iPhone devices, consumers are stripped of the benefits described above, benefits which may increase in value as technology develops on other platforms.

Competition and choice between different integrated mobile wallets also drives innovation and better price/quality outcomes for consumers. However, without the authorisation, there will be no competition between integrated mobile wallets on iPhone devices – an outcome which ultimately will affect the investment in mobile wallet technology and limit the full potential of mobile payment adoption in Australia (see section 5.4 below).

Apple's submissions on choice and competition do not deny this counterfactual outcome. In fact, Apple confirms that in the counterfactual, the only integrated mobile wallet available to Australian iPhone users will be Apple Pay.

## **5.3 No competition from other contactless payment options**

Apple's submissions on choice and competition in the counterfactual fail to acknowledge the important differences between integrated mobile wallets and other contactless payment methods, in particular the limitations of other contactless payment methods as competitive alternatives to NFC-enabled integrated mobile wallets.

In Australia, the industry has made substantial investment in payments technologies and in particular in the deployment of NFC technology. Merchant terminals accepting contactless payments via NFC technology are ubiquitous. There is already a widespread consumer acceptance of contactless technology and contactless payments, so much so that per capita contactless payments in Australia are among the highest in the world. There has been a 42% growth in contactless card accounts between 2014 and 2015 and

contactless penetration has grown to the point where 74% of all MasterCard in-store transactions are now contactless.<sup>23</sup> In this environment, any new mobile payment technology has to be seamless and integrated enough for it to make sense for customers to choose to “tap and go” with their mobile instead of a physical card.

Apple’s submission notes that Apple does not restrict its partners from developing iPhone apps and that in the counterfactual there are a wide range of contactless payment options available in Australia (including QR code based wallets, mobile banking apps that in some cases complete POS transactions, and non-mobile options such as NFC-enabled credit cards and debit cards). However, the “options” put forward by Apple will not directly compete with Apple Pay and will not provide an adequate solution to iPhone users seeking to make contactless payments with their mobile phones:

- NFC-enabled credit and debit card: NFC-enabled credit and debit cards, although widely used and providing the convenience of “tap and go” payments, do not provide consumers with the benefits derived from integration in a mobile payments wallet, including additional customer verification, immediate feedback on successful completion, the potential for greater convenience and integration of loyalty programs, and many other potential consumer-benefiting future uses of the “smart” capabilities inherent in a location-aware, internet-connected smartphone. Furthermore, the NFC function on a mobile phone will be easier to use than a card in a physical wallet as and when the mass transit electronic ticketing systems go “open loop”, as “antenna clash” does not occur on the phone.
- Mobile banking apps: mobile banking apps can provide integrated NFC functionality on compatible Android phones where access to the NFC functionality is not restricted. However, for as long as Apple restricts access to the iPhone’s NFC functionality, mobile banking apps for iPhones cannot provide a directly competitive integrated mobile wallet that iPhone users could use instead of Apple Pay. They require an NFC sticker or tag (containing a separate and discrete NFC chip and antenna) to allow iPhone users to complete POS transactions by tapping the mobile near the POS NFC terminal. This lack of integration of NFC payment functionality is a significant limitation on the benefits that can be derived by consumers from a mobile bank application as compared to integrated wallets such as Apple Pay. These limitations were explored in detail in CRA’s Report which was submitted in support of the application for authorisation.<sup>24</sup> Apple has elsewhere recognised that currently Apple Pay complements, rather than competes with, the applicant banks’ mobile offerings.<sup>25</sup>
- QR code based wallets: mobile applications that rely on QR codes are not a suitable alternative to integrated NFC for the following reasons:
  - *Australia’s payments infrastructure*: the situation in Australia, where NFC-enabled POS terminals are ubiquitous and there is already widespread consumer acceptance of, and preference for, NFC-enabled contactless payments, is very different to other countries such as China, where QR code based mobile wallets such as Alibaba’s Alipay and Tencent’s Tenpay are very popular and offer an alternative to Apple Pay for iPhone users because of the existing payments system infrastructure and consumer familiarity.

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<sup>23</sup> Centre for Internet Safety, ‘The Truth About Contactless Payments’, March 2016, p 4.

<sup>24</sup> Charles River Associates, ‘Collective Negotiations by Issuers with Mobile Wallet Providers’, 12 May 2016, pp 5-6.

<sup>25</sup> Authorisation applications A91546 & A91547, Submission by Apple, 26 August 2016, section 4.2.

- *convenience and functionality*: because there is already widespread use of NFC-enabled contactless payments in Australia, in order to be viable, mobile payment technology has to be seamless and integrated enough for it to make sense for customers to choose to “tap and go” with their mobile instead of a physical card. Mobile wallets that rely on QR codes cannot provide the convenient and seamless experience for consumers that NFC-enabled mobile wallets can (or NFC-enabled credit and debit cards for that matter). To use a QR code to make a payment a user must unlock their smartphone, open a specific QR code reader application, scan the QR code displayed on the QR code enabled terminal with the iPhone camera and typically enter a passcode before receiving confirmation of payment. Using an NFC-enabled mobile wallet to make a payment is much faster and more convenient: the payment will be triggered when your phone is near a contactless payment reader. Depending on the mobile wallet, a passcode may be needed. In the case of Apple Pay, a user just needs to have their finger on the Touch ID button.
  
- *POS confusion*: in Australia, POS transaction “behaviour” and the series of steps required to make a contactless payment is well understood by consumers. That is, there is no confusion about the process necessary to pay for goods or services at POS via a contactless payment, which generates efficiency and reduces POS transaction times for both consumers and merchants. This level of understanding is a direct result of education initiatives undertaken by the industry in general, such as the PIN@POS campaign.<sup>26</sup> This is a direct contrast to the current situation in the US, where there is widespread consumer dissatisfaction and confusion about the series of steps necessary to make an electronic payment with a potential mixture of signing, “chip dipping” and swiping and no clear standard – to the extent that some POS terminals have elements disabled or taped over by the merchant,<sup>27</sup> and every POS transaction is “a horrible guessing game”.<sup>28</sup> The introduction of an alternative to the already ubiquitous NFC standard is likely to lead to similar confusion (and the resulting inefficiencies) around the correct POS transaction process for consumers in Australia.

Without authorisation, there will be less choice and competition in relation to mobile payments and mobile wallets because Australian iPhone users will have no choice in integrated mobile wallet other than Apple Pay, and there will be no competition between integrated mobile wallets on iPhone devices.

#### **5.4 Lost opportunity for investment and innovation**

The applicants agree with Apple that there will be a certain amount of investment and innovation in mobile wallet technology with or without the authorisation. The applicants have already individually invested significantly in various competing mobile based apps and technologies. However, absent the authorisation, the potential extent, speed and quality of investment and innovation will be much lower, as the inability to access the iPhone’s NFC functionality reduces the impetus for investment and innovation. This will

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<sup>26</sup> ANZ, ‘The PIN is mightier than the word’, 28 May 2014, available at: <https://bluenotes.anz.com/posts/2014/05/the-pin-is-mightier-than-the-word/> (accessed 29 September 2016).

<sup>27</sup> Karen Workman, *The New York Times*, ‘Confused by Chip Credit Cards? Get in Line’, available at: [http://www.nytimes.com/2016/08/06/business/chip-credit-cards-for-dummies.html?\\_r=0](http://www.nytimes.com/2016/08/06/business/chip-credit-cards-for-dummies.html?_r=0) (accessed 29 September 2016).

<sup>28</sup> Dieter Bohn, *The Verge*, ‘Credit card companies are blowing it with chip payments’, 26 July 2016, available at: <http://www.theverge.com/circuitbreaker/2016/7/26/12287360/credit-card-companies-blowing-emv-chip-payments> (accessed 29 September 2016).

lead to less choice and competition not only for iPhone users but in relation to mobile wallet technology more generally.

- (a) No access to a significant segment of the addressable market diminishes investment incentives which in turn reduces innovation and competition

As outlined in sections 4.2(a) and 4.2(b) above, iPhone customers represent a significant premium segment of the addressable market for mobile payment solutions and Apple controls access to that segment of the market.

The costs of investments in mobile wallets by payment card issuers and third parties are largely fixed and common across customers and across platforms, leading to economies of scale and scope. Once an integrated mobile wallet had been developed for Android, there would be only a small incremental cost to making a similar wallet available on iPhones (assuming access to the NFC function was permitted).

Without the ability to offer competing integrated mobile wallets to iPhone users, the addressable market for developers will be significantly reduced in terms of both size and value. Without the ability to generate returns from iPhone users as well as other users, investments that would be commercially justified if iPhone device users were part of the addressable market may not occur.

Apple's submission does not deny the impact of the smaller addressable market on investment and innovation for integrated mobile wallet functionality. It simply restricts the discussion of innovation to Apple Pay, non-integrated complementary solutions on iPhone platforms (or solutions using non-NFC technology such as QR codes) and innovation on Android platforms. The treatment of innovation on Android platforms implicitly acknowledges the value of the iPhone user segment without discussing or taking into account the impact of the loss of that segment on mobile technology development as a whole (ie, the reduced incentives to develop on the Android platform as well).

- (b) Mobile payment solutions without integrated NFC access tend to fail

While Apple argues that other contactless payment systems are an alternative to NFC, it is a fact that in Australia, as in many countries, the only realistic option for contactless payments is based on NFC standards (see section 5.3). NFC offers a simple, convenient and secure mobile payment experience that other technologies cannot match. That is why Australian banks and merchants have invested heavily in NFC technology and why Apple has chosen NFC for Apple Pay. Apple knows as well as the applicants that in Australia, as in many countries, a mobile payment system that does not use NFC is unlikely to succeed.

The lack of access to the iPhone's NFC capability has contributed to the failure of many mobile wallet and mobile payment systems. Most recently:

- In the United States, CurrentC, a QR-code wallet developed by some of the largest retailers such as Walmart, BestBuy and CVS, closed in June 2016.
- In New Zealand, Semble, a joint venture between two banks, three mobile carriers and a payments network operator, closed in July 2016. It had offered NFC payments and public transport payments but was not available on iPhones.
- In Canada, SureTap, a wallet provided by five mobile carriers and CIBC bank on Android and BlackBerry mobile phones, closed in August 2016. Its chief operating officer attributed the failure to a lack of access to the iPhone's payment functionality:

*If we'd been able to deploy a wallet on Apple and non-Apple handsets, we would have more access for issuers and it would still be in existence today," Ledas says. "We went to Apple and talked about getting access to the secure element. The answer was clear – no."*<sup>29</sup>

- In Switzerland, Paymit, a peer-to-peer and QR-code based mobile payment system backed by UBS, Zürcher Kantonalbank and the SIX Swiss stock exchange, announced that it was merging with rival Twint, a Bluetooth Low Energy and QR-code based payment mobile system backed by Credit Suisse and PostFinance, in May 2016. Twint chose Bluetooth instead of the more widely accepted NFC because of lack of access to the iPhone's NFC functionality:

*Twint wants to offer a payment solution that can be used with both iOS and Android smartphones. NFC cannot currently be used with iPhones (iOS).*<sup>30</sup>

A new Twint will be launched in 2017, again combining Bluetooth and QR-code payments. Swiss media reports that, apart from now being later to market than Apple Pay:

*Twint faces another significant disadvantage against Apple Pay: Apple blocks NFC (Near Field Communication) technology in its smartphones for other payment operators. With a 50 per cent share of the smartphone market [in Switzerland], that is a serious obstacle. It was already enough to cause the Swisscom payment app Tapit to fail.*

*In the meantime, Apple Pay can connect with the payment terminals of most Swiss retailers. The Bluetooth technology, which Twint relies on, is not yet widely used in stores.*<sup>31</sup>

As outlined in section 4.4(a) above, the Swiss consumer protection authority has filed a complaint with the Swiss competition commission in relation to Apple's refusal to grant Twint access to the iPhone's NFC technology.<sup>32</sup>

## **5.5 Investments in NFC-enabled technology may not be fully or efficiently realised**

Australian banks and large retailers have played a key role in the implementation and acceptance of NFC payment technologies in Australia. They have invested millions of dollars not just in the underlying technology (ie, NFC-enabled terminals), but also in consumer education and marketing. Without the authorisation, Apple's entry into the Australian market with Apple Pay will be effectively free-riding on this investment in NFC infrastructure, which has been made on an open and inclusive basis to improve the payments experience for all Australian consumers. Many competitors to the banks have equally benefited from this open and inclusive system, with companies such as Tyro Payments describing NFC technology as "the only available and highly secure connectivity option that is ubiquitously available across the entire card payment

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<sup>29</sup> Gary Ng, *iPhone in Canada*, 'Suretap Wallet to Shut Down in August, Lays Partial Blame on Apple', 14 July 2016, available at: <http://www.iphoneincanada.ca/carriers/suretap-wallet-shut-down/> (accessed 29 September 2016).

<sup>30</sup> Twint, FAQs, 'Why is beacon technology used rather than NFC?', available at: <https://www.twint.ch/en/support/faq/> (accessed 29 September 2016).

<sup>31</sup> *Finews*, 'Apple Pay arrival unseats Swiss competition' July 2016, available at: <http://www.finews.com/news/english-news/23608-apple-pay-arrival-unseats-swiss-competition> (accessed 29 September 2016).

<sup>32</sup> *Telecom Paper*, 'SKS files Apple m-payments complaint with Weko', 6 July 2016, available at: <http://www.telecompaper.com/news/sks-files-apple-m-payments-complaint-with-weko--1152095> (accessed 30 September 2016); Apple, Press Release; Apple, Press Release, 'Apple Pay now available in Switzerland', 7 July 2016, available at: <http://www.apple.com/newsroom/2016/07/apple-pay-now-available-in-switzerland.html> (accessed 30 September 2016).

infrastructure and terminal fleet”.<sup>33</sup> PayPal recently announced that its Android app would be updated to support NFC-based payments.<sup>34</sup>

There is public benefit in the efficient use of the existing payments infrastructure that supports NFC payments, particularly given the significant investment that has been made. In particular, the move to mobile payments and wallets away from plastic cards and physical wallets could result in significant efficiencies in the payments system and for the Australian economy. However, in order to ensure the success of mobile payments, merchants and financial institutions need the right combination of convenience, security and cost. These attributes will only be developed in an environment in which vigorous competition drives innovation, efficiency and continuing investment.

Without authorisation, because of the technical lockout of the iPhone’s NFC functionality, the banks and other mobile wallet providers will be unable to develop competing integrated NFC-enabled mobile wallets for iPhone devices. This therefore limits the public benefits that can be derived from the NFC payment infrastructure already deployed and paid for by Australian banks and merchants, as it limits the full potential of mobile wallet and mobile payment adoption in Australia.

Apple’s submission states that, instead of using the NFC infrastructure already deployed, banks could invest in alternative payment technologies that Australian customers are less accustomed to, and supportive of, to provide iPhone users “choice” (eg, by investing in QR code based technology which is used in China and the USA and available on iPhone).

Aside from the fact that these alternative technologies do not provide appropriate competition, the suggestion that the banks roll out new POS terminals would lead to inefficiencies as a result of duplication of Australia’s payments system infrastructure. The inefficient use of resources is a public detriment that leads to higher-cost payment systems overall (see further discussion in section 5.6 below). It should not be necessary to duplicate this infrastructure, and this investment, in order to give customers a choice in mobile payments regardless of the mobile phone platform they use.

## **5.6 No opportunity for price visibility or constraint**

Without authorisation, the applicant banks (and any other issuer that signs up to Apple Pay) will not be permitted to charge their customers for using Apple Pay, despite the cost of Apple Pay as compared to other payment methods. This means that there will be no opportunity for price visibility to act as a constraint on Apple’s ability to charge excessive and uncompetitive fees for Apple Pay. This creates uncertainty and risk in relation to future costs as, once a bank agrees to offer Apple Pay, it is powerless in the face of Apple (a non-regulated entity within the four-party payment system) changing its per transaction pricing, as it has done in the past with iTunes.

The inability to pass-through fees also has implications of inequitable and inefficient cost recovery from the rest of the system, as the applicant banks will only be able to recover the costs of Apple Pay through cross-subsidisation. This means that Australians who do not use Apple Pay will end up subsidising those who do, which will increase the costs of the Australian payment system overall.

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<sup>33</sup> Tyro, ‘Choice and innovation stopped without free NFC’, 8 August 2016, available at: <https://tyro.com/blog/business-choice-and-innovation-stopped-without-free-nfc/> (accessed 29 September 2016).

<sup>34</sup> Mobile Payments Today, ‘PayPal embraces NFC’, 23 February 2016, available at: <http://www.mobilepaymentstoday.com/news/paypal-embraces-nfc/> (accessed 29 September 2016).

Therefore, absent the ability for the issuer banks to pass-through the costs of using Apple Pay, all Australians will end up paying for the higher price of the Australian payments system.

Further discussion of the implications of the lack of fee transparency is provided in section 9 below.

### **5.7 Uncertainty as to the applicability of security and fraud protection standards**

Without authorisation, there is also a risk that security standards that otherwise apply to cards and card payments offered by Australian banks will not be available to all customers using Apple Pay. This is addressed in detail in section 8 below.

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## **6 Authorisation is not about “blunting” or delaying Apple’s entry into the Australian market**

### **6.1 Overview of Apple’s contentions**

Apple’s submission suggests that the purpose of the authorisation is to delay Apple Pay’s entry into the Australian market:

*Apple is concerned that the applicant banks may attempt to use collective bargaining/boycott to blunt Apple Pay precisely because they want to control the direction and pace of innovation and advantage their own mobile wallets. Obtaining authorisation for the present application may make it easier for the applicant banks to slow this innovation and disruption by delaying the introduction of Apple Pay to a large proportion of Australian cardholders, to the detriment of the applicant banks’ own customers...*

*The proposed collective bargaining/boycott would slow innovation and reduce choices by protecting the applicant banks from competition with each other and from Apple for the next three years. The applicant banks would have little incentive to compete amongst themselves to develop the best and most innovative presentment methods for their customers.<sup>35</sup>*

These assertions do not withstand any scrutiny. The applicants wish to offer their customers a choice of mobile wallet and mobile payment apps that would necessarily include Apple Pay. There is intense customer demand for Apple Pay, and the international experience has shown that few issuers find it commercially viable not to participate in Apple Pay for long. However, the applicants recognise that the opportunity they have to promote NFC-based competition in mobile payments will be lost as soon as they sign up to Apple Pay on Apple’s current terms. The applicants wish to offer their customers a choice between various mobile wallets that they could load onto their mobile phone (regardless of the handset manufacturer), so that the customer can select the mobile wallet that best meets their needs.

### **6.2 The applicants have every incentive to introduce Apple Pay as soon as possible**

The applicants are seeking to collectively negotiate with Apple so that they can provide their customers with a meaningful choice in mobile wallets and mobile payments, and can continue to innovate and compete with each other and with third party wallet providers. They are not seeking to gain an unfair advantage for their own mobile wallets, only to give those wallets a chance to compete on their own merits.

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<sup>35</sup> Authorisation applications A91546 & A91547, Submission by Apple, 26 August 2016, section 2.3.

Apple's economist has also raised the possibility that the banks' preferred positions may be insufficiently aligned to reach a speedy conclusion to the negotiation:

*[I]f the strategic interests of the cartel members are not sufficiently aligned, the combination of cooperative negotiation and a collective boycott could prevent any agreement between the Applicants and Apple (assuming that any agreement was even possible under the circumstances) or might result in an agreement that some of the cartel members would view as suboptimal. In other words, the collective boycott element of the conduct proposed to be authorised would, all else equal, promote holdup behaviour among the cartel members.<sup>36</sup>*

However, the limited scope of the collective negotiation, combined with the commercial pressures on the banks to conclude the process and participate in Apple Pay – and the risk of any of the applicants moving to sign up with Apple Pay ahead of the others, like ANZ Bank did – make this hold-up unlikely.

The applicants know that their customers will choose which mobile wallets and mobile payments they prefer. Each applicant is aware that a number of its customers have signed up for payment cards with American Express and ANZ Bank in order to use Apple Pay, and will continue to do so unless and until it offers Apple Pay. The overseas experience confirms that banks who are seen to delay their participation in Apple Pay have been the subject of complaints through social media and in the press – for example in relation to HSBC and Barclays in the UK.<sup>37</sup>

As a result of these pressures, it is clearly not in the applicants' commercial interests to delay their participation in Apple Pay, and they have every incentive to ensure that the collective negotiation process is resolved as soon as possible.

### **6.3 The applicants propose an expedited negotiation process**

There is no basis for Apple to argue that authorisation would delay competition or innovation for three years. While the authorisation is sought for that period, the active phase of collective negotiation is likely to be limited (and the collective boycott is only in place while the relevant collective negotiation is ongoing). In practical terms, this period is likely to take months (not years). Further, given the pressures on all of the banks to offer Apple Pay to their customers, the applicants have a strong incentive to ensure that the negotiation period is as short as possible.

The collective negotiation and boycott sought are limited to three issues. All other aspects of an agreement with Apple will be individually negotiated. Whether a bank decides to introduce Apple Pay and the timing of that introduction will not be in "lockstep", but will depend on each bank's individual negotiations. In addition, while all participants in a collective negotiation are expected to remain within the negotiating group for the period of negotiation, in practice there is no penalty for leaving the negotiating group and there is little to prevent one or more banks signing up with Apple Pay before the negotiation period is over. This is an additional incentive for the applicants to conclude negotiations within the shortest possible time.

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<sup>36</sup> Pleatsikas Report, 24 August 2016, [24].

<sup>37</sup> Mary-Ann Russon, *International Business Times*, 'Apple Pay UK: No mobile payments for HSBC customers until late July but Barclays is on board', 14 July 2015, available at: <http://www.ibtimes.co.uk/apple-pay-uk-no-mobile-payments-hsbc-customers-until-late-july-barclays-board-1510750> (accessed 29 September 2016).

The applicants therefore expect that the collective negotiation process will proceed expeditiously and be resolved in a timely manner. Further details on the applicant's proposed negotiation framework are set out in **Annexure A**.

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## 7 Providing access to the NFC functionality will not undermine the security of Apple Pay

### 7.1 Overview of Apple's contentions

The applicants submit that collective negotiation with a view to allowing competing apps to access the NFC payment functionality on mobile devices has the potential to increase competition and innovation for the benefit of consumers. In its submission before interim authorisation, Apple argued that the applicants wished to:

*force Apple to undermine the security of its mobile payment service by opening access to the NFC antenna, placing at risk the consumer experience of a simple, secure, and private way to make payments in store, within applications, or on the web.*<sup>38</sup>

Apple's initial submission further said that:

*Providing simple access to the NFC antenna by banking applications would fundamentally diminish the high level of security Apple aims to have on our devices.*<sup>39</sup>

In its lengthier submission before draft determination, Apple expands on its position as follows:

*Much of the applicant banks' application relates to their desire to have direct access to the NFC antenna contained in Apple devices. This is not open to negotiation with any bank... Apple does not provide banks access to the NFC radio because doing so would undermine the security our customers expect when using Apple devices to make payments.*<sup>40</sup>

Apple's claim that access to NFC functionality would somehow undermine security fits well with Apple's marketing strategy and its commercial objectives of blocking access to competitors to Apple Pay, but is not supported by any facts and it is questionable for a number of reasons as discussed below.

### 7.2 Other technology companies offer access to NFC without compromising security

Apple's "evidence" is limited to the following references to Android Pay and Samsung Pay:

*Indeed, Android devices, which provide open access to their NFC radios to banks, have been shown to be susceptible to third party attacks that can compromise the customer's card information. There have also been reports of non-NFC security issues related to Samsung Pay, which is why it is so important to Apple to maintain the tight integration of our hardware, software, and services such as in Apple Pay.*<sup>41</sup>

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<sup>38</sup> Authorisation applications A91546 & A91547, Submission by Apple, 4 August 2016, p 2.

<sup>39</sup> Authorisation applications A91546 & A91547, Submission by Apple, 4 August 2016, p 3.

<sup>40</sup> Authorisation applications A91546 & A91547, Submission by Apple, 26 August 2016, section 4.2.

<sup>41</sup> Authorisation applications A91546 & A91547, Submission by Apple, 26 August 2016, section 4.2. Apple's submissions reference the following websites: <http://www.digitaltimes.com/new-android-nfc-attack-could-steal-money-credit-cards-anytime->

While Apple does not go so far as to say that Android devices are susceptible to these attacks *because* they provide access to their NFC antennas, it invites the ACCC to draw such a conclusion. While such a potential vulnerability does appear to have been demonstrated in highly controlled conditions, it is not at all clear that the vulnerability Apple is referring to has anything to do with the provision of third party access to Android's NFC functionality.

Indeed, Apple acknowledges that reported security issues related to Samsung Pay have nothing to do with NFC functionality, but arise from the emulation of older magnetic stripe technology provided by some Samsung phones. It is not clear how this demonstrates that it is important that Apple exclude competitors from the iPhone's NFC functionality. Again, this is a theoretical vulnerability and there has been no report of mobile NFC payments actually being compromised in everyday use.

Issuers and card networks throughout the world have signed onto Android solutions and certified the devices that employ them without expressing any concern about the access that Android provides to its NFC functionality. While all mobile platforms are subject to attacks and vulnerability,<sup>42</sup> this does not mean that any of them are insecure in a practical sense, whether or not they provide third party access to their NFC functionality.

### 7.3 Level of access

Apple appears to be concerned that the potential for "simple access" or "direct access" to NFC functionality would compromise security on the iPhone. While the level and nature of any access to NFC functionality are intended to be the subject of collective negotiation, the applicants expect that the access provided would not – and should not – be "simple" or "direct" in the sense of low-level access to the underlying hardware.

Rather, the applicants would expect a level of access comparable to the access Apple already provides to a myriad of iPhone hardware and software features such as the accelerometer, Keychain (stored passwords), Touch ID (fingerprint sensor) functionality and perhaps most relevantly the iPhone's Bluetooth functionality. The most recent iOS update extended access to one of the most basic features of calling functionality.

Apple implements the Bluetooth Low Energy specification through a framework that allows apps to connect and communicate directly with Bluetooth-enabled devices. These apps can already be used for mobile payments (provided compatible devices have been installed by merchants) and it is not clear that NFC functionality is inherently more vulnerable than Bluetooth when it comes to providing third party access. If anything it should be less vulnerable, as NFC only operates across a field of around 4 centimetres, while Bluetooth has a theoretical range of up to 100 metres.

Again, the applicants would expect that, if Apple were to provide access to its NFC functionality, it would do so in a way that would meet its own security standards. For example, the potential vulnerability Apple has identified with open access to the NFC functionality on Android appears to rely on:

- the ability to use the Android device as an NFC payment card reader; and

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[your-phone-near-445497](http://www.informationweek.com/wireless/nfc-phone-hacking-and-other-mobile-attacks/d/d-id/1105508?); <http://www.informationweek.com/wireless/nfc-phone-hacking-and-other-mobile-attacks/d/d-id/1105508?>

<sup>42</sup> Including for example Apple with the recent three high-severity iOS vulnerabilities that were being actively exploited to infect iPhone. See: Dan Goodin, 'Actively exploited iOS flaws that hijack iPhones patched by Apple', 26 August 2016, available at: <http://arstechnica.com/security/2016/08/actively-exploited-ios-flaws-that-hijack-iphones-likely-spread-for-years/> (accessed 29 September 2016).

- a user downloading and installing a “poisoned app” on their device.

To reduce this vulnerability, Apple may wish to limit the use of the NFC functionality to making payments only (as opposed to using the iPhone for *reading* contactless cards). Apple already prevents customers from installing apps from sources other than its App Store and reviews all apps thoroughly before making them available for download. It is difficult to imagine that Apple would approve an app that used the iPhone’s NFC functionality to compromise card details.

#### 7.4 Multiple cards and wallets

The applicants understand that, on any mobile device, only one tokenised payment credential can be nominated as the “live” or current payment credential, so that when a mobile device is tapped against an NFC terminal, only that payment credential (ie, the selected or “default” card) is presented and digital “card clash” is avoided.

“Card clash” occurs in the real world when multiple contactless plastic cards are presented to a contactless reader at once, for example in the same physical wallet, and the reader may either “choose” a card on an unpredictable basis or refuse to process the payment. Mobile NFC systems avoid this issue by only presenting one payment credential at any time (and the mobile phone only has one NFC antenna). However, the clash issue would still arise in the case of an NFC-enabled mobile device that also had an external NFC sticker attached to it.

This is one reason why external NFC stickers are not an effective alternative to integrated NFC functionality: it would not be possible for a customer to use both Apple Pay (through the iPhone’s integrated NFC functionality) and a banking app that relied on an external NFC sticker attached to the iPhone, because of card clash.

Of course, Apple Pay allows users to register multiple cards and provides users with a simple and intuitive mechanism for choosing both:

- which of those cards will be the default card; and
- which of those cards will be used for the current payment transaction.

That is, Apple provides a governance mechanism for selecting which payment credential token will be transmitted the next time a payment is initiated. Whenever an iPhone is brought within range of an NFC payment terminal, Apple’s Wallet app will launch (if it has not already been launched by the user) and the user is able to pay immediately using their default payment credential or to select another credential before paying.

The applicants appreciate that allowing third party access to NFC functionality would require an expansion of the governance mechanism to identify first which app or wallet would be launched, and then which payment credential would be presented by the chosen app.

This is the governance mechanism used successfully by Android. On an Android device, any number of payment and other apps may access the NFC functionality to communicate with other NFC devices. Payment apps may be secured using an embedded secure element, a SIM-based secure element or a cloud-based secure solution such as host card emulation (**HCE**).

These apps can all coexist on a single Android device and make use of the same NFC functionality due to a simple governance mechanism. A similar governance mechanism could be developed for the iPhone.

## **7.5 Granting access will not compromise the user experience**

If Apple were to grant access to the iPhone's NFC capability, Apple Pay would remain the only mobile wallet or payment app installed by default on the iPhone, and the user experience for customers who did not choose to download a competing app would remain entirely unchanged. Users who preferred Apple Pay to other alternatives would be free to use it – and to load cards issued by any participating issuer, including all the banks who participated in a successful collective negotiation – and to take advantage of the simplicity of a single mobile wallet.

Only those users who chose to download one or more banking or other payment apps would find their experience altered. These users could continue to use Apple Pay, and would be able to load the same or different payment credentials into both Apple Pay and into another mobile payment app, where the same credential would be represented by different tokens in the different wallets. Additional consumer-benefiting features, utilising smart phone features such as location based card preferences, are also potentially possible.

It is likely that many customers will continue to use Apple Pay either exclusively or as their primary NFC payment app – particularly as the latest version of Apple's operating system repeatedly prompts customers to load a payment credential into Apple Pay when they upgrade or set up an iPhone and at regular intervals afterwards – just as most customers use Apple's default mail, camera and browser apps.

However, to assume that no other developer could make use of the iPhone's NFC functionality in a way that provides additional value to customers, even within the consistent look and feel outlined in Apple's Human Interface Guidelines, is to ignore the thousands of apps that have done exactly that.

There are successful apps that compete directly with every one of Apple's default apps, covering e-mail, calendar, notes, contacts, messaging, videoconferencing, recording, web browsing, music, document creation, camera, maps, compass, fitness, stocks, weather, voice assistance and other functions. These apps use the iPhone's hardware and operating system in ways that challenge Apple's own apps and inspire them to improve. There is no reason to think that competition and customer choice would not have the same impact in mobile payments.

## **7.6 Apple has the ability to grant access to the NFC hardware/API**

It has been reported that the hardware Apple uses to provide NFC functionality is based on standard hardware manufactured by NXP Semiconductors (the co-inventor of NFC technology along with Sony) and made available to all mobile device manufacturers. There is no technical reason why this hardware would prevent access to the NFC functionality on Apple devices, given that identical hardware demonstrably allows that access on Android devices.

While this hardware is subject to the standards and limitations inherent in NFC technology – for example being limited to one active card token at any one time – there is absolutely no evidence that providing access to the iPhone's NFC functionality would

require Apple to “completely overhaul the architecture of its hardware and operating system”.<sup>43</sup>

As discussed above, Apple would need to create a governance system to determine which app would be the default NFC payment app, and each app would need its own mechanism to decide which card to present within the app – always determined according to the user’s preference. However, it is difficult to see how this would be a significant overhaul compared to the other changes to iOS that are made every year, which frequently provide access or increased access to a range of hardware features, and given that a functional governance system for NFC has already been successfully achieved on the Android operating system.

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## 8 Negotiation on security will benefit consumers

### 8.1 Overview of Apple’s contentions

Apple has listed a number of concerns in respect of the applicants’ proposal to collectively negotiate in relation to security issues. Broadly, these concerns fall into two categories:

- concerns associated with the concept of a collective negotiation; and
- concerns associated with some of the specific requirements that Apple believes it will be subject to if collective negotiation is allowed.

Each of these areas is addressed in more detail below.

### 8.2 Why the applicants are seeking to collectively negotiate with Apple on security

Apple alleges that the applicants are attempting to use fraud and security as a rationale for creating obstacles for third party wallet providers to enter and expand in Australia. However, Apple’s allegations conveniently ignore the history of security issues that have arisen in relation to Apple Pay, and the efforts that have been made to address those issues in other jurisdictions.

In particular, there were a number of reports of high rates of fraud associated with Apple Pay soon after its launch in the US (which, according to one report, was as high as 6%, compared to 0.1% for swipe card transactions).<sup>44</sup> According to these accounts, the problems experienced with Apple Pay in the US stemmed from inadequate customer ID&V processes at the time of “on-boarding” card details into the wallet. This in turn stemmed from the incentives of Apple (and perhaps some payment card issuers) to make “on-boarding” as simple as possible for iPhone device users in a context in which issuers were “desperate to become their customers’ default card on Apple Pay” and consequently “did little to build their own defences or to push Apple to provide more detailed information about its customers”.

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<sup>43</sup> David Glance, *The Conversation*, ‘Why the ACCC siding with the banks against Apple will not be in consumers’ interests’, 22 August 2016, available at: <http://theconversation.com/why-the-accsiding-with-the-banks-against-apple-will-not-be-in-consumers-interests-64220> (accessed 30 September 2016).

<sup>44</sup> Daisuke Wakabayashi and Robin Sidel, *Wall Street Journal*, ‘Fraud Comes to Apple Pay’, 3 March 2015, available at: <http://blogs.wsj.com/digits/2015/03/03/fraud-comes-to-apple-pay/> (accessed 30 September 2016); pymnts.com, ‘Spike in Fraud has Experts Doubting Apple Pay’, 25 March 2015, available at: <http://www.pymnts.com/news/2015/spike-in-fraud-has-experts-doubting-apple-pay/> (accessed 30 September 2016); and Andrew Ross Sorkin, *New York Times*, ‘Pointing Fingers in Apple Pay Fraud’, 16 March 2015, available at: <http://www.nytimes.com/2015/03/17/business/banks-find-fraud-abounds-in-apple-pay.html> (accessed 30 September 2016).

These concerns lead to the Canadian banking industry making a concerted effort to put up a coordinated front against Apple in an attempt to ensure that, when Apple Pay was launched in Canada, 'secondary authentication' would be available.<sup>45</sup> As outlined in section 4.4(a) above, the Canadian banks formed a consortium and, together with consultancy firm McKinsey & Co, published the Canadian White Paper that was concerned with security risks associated with the introduction of open mobile wallets that hold credentials from multiple issuers.<sup>46</sup> In particular, the Canadian White Paper identified the following concerns associated with customer ID&V in open wallets where the issuer relinquishes control to the wallet provider (as was the case for Apple Pay in the US):

- an open wallet that provides the highest level of transaction security can still present fraud risk if the identity of the customer requesting the initial provisioning of the card into the wallet is not confirmed;
- card issuers are best positioned to undertake customer ID&V and determine where to approve a request to provision a card into a mobile wallet because of their relationship with the customer and because they are liable in the case of account takeover fraud; and
- weak ID&V at a single issuer could potentially undermine consumer and merchant confidence in, and the integrity of, the overall payment system.<sup>47</sup>

In Australia, APCA undertook a similar effort which resulted in the publication of the "Third Party Digital Wallet Security: Card Issuer Guidelines" (**Guidelines**). The Guidelines were published in May 2016.

In this context, it is disingenuous to present the applicants' concerns around security as motivated by a desire to block Apple Pay's entrance into the Australian market. Rather, these concerns arose from broader (and widespread) concerns around weaknesses in the way Apple Pay had been implemented in the US, which weaknesses were feared would be replicated in other jurisdictions (given Apple's reputation for inflexibility and for imposing "take it or leave it" commercial terms when negotiating).

### 8.3 Concerns associated with specific security requirements

- (a) Collective negotiation will not impose on Apple security obligations that do not already apply to the applicants

Apple has also raised some specific concerns around the fact that the Guidelines would only apply to third party wallets (but not to the applicants' own wallets), and the fact that collective negotiation would not be effective in bringing the best solutions to fraud and security concerns in the Australian market.

While the Guidelines themselves provide an explanation as to why they were designed to only apply to third party wallets,<sup>48</sup> the applicants have also sought to address this concern

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<sup>45</sup> Secondary identification is a form of verification whereby customer information is required by the issuing bank before a card can be provisioned into Apple Pay.

<sup>46</sup> Payments Security White Paper, 13 July 2015, p 1.

<sup>47</sup> Payments Security White Paper, 13 July 2015, pp 24-5.

<sup>48</sup> See Section B: "The Guidelines have not been drafted to apply to Card Issuers' proprietary mobile banking applications or proprietary wallet services, being those provided by a Card Issuer solely for its own customers. The responsibility for managing fraud and security of proprietary wallet services, and the liability for, and reputational risk associated with, losses resulting from use of proprietary products, rests entirely with the Card Issuer. A Card Issuer may choose to apply aspects of these Guidelines to its proprietary mobile banking applications and wallet services where appropriate".

by clarifying that collective negotiation in relation to security requirements for Apple Pay would be on the basis of achieving (as a minimum) the same level of security that the applicants offer their customers in respect of their own payment products (mobile or not) – see **Annexure A**.

Apple has also noted that Apple Pay already allows the banks to control decisions in relation to ID&V and card provisioning. If this is correct, then it would be expected that the scope of collective negotiations in relation to security issues will be greatly simplified (and it would be expected to proceed quickly as a result).

(b) Collective negotiation will not stifle innovation

Apple also alleges that collective negotiation will be a “one-size-fits-all” approach that will remove the incentive for wallet providers to develop more innovative solutions to distinguish themselves from other wallet providers.

The proposed framework for negotiation in **Annexure A** does not limit Apple (or the applicants) if there is a desire to offer additional security features to differentiate particular products from competitors – it simply seeks to ensure that all cards loaded into Apple Pay (and the associated payments) enjoy a minimum level of security that has proven effective in controlling fraud rates in the Australian environment.

However, fraud prevention measures are constantly evolving (as is fraud itself), and it is expected that Apple, the applicants and the payments industry will continue having to evolve in order to anticipate and respond to new types of fraud as they arise. The proposed framework for collective negotiation will not prevent that evolution.

(c) Collective negotiation will not prevent the use of tokenisation

Apple has claimed that the proposed Guidelines would allow the banks to decide whether to use tokenisation. This is a misrepresentation of the facts.

Tokenisation is not a security feature unique to Apple Pay payments. Rather, tokenisation is a security mechanism that has been implemented as part of a world wide effort to minimise fraud. The approach is widely used by card schemes around the world and the applicants have been using it in Australia for years (alongside other security measures such as EMV cards).

In this context, the applicants wish to collectively negotiate so as to ensure any tokenisation requirements imposed by Apple are consistent with obligations already agreed by the applicants with card schemes. The negotiation framework set out in **Annexure A** is consistent with this aim.

(d) Collective negotiation will not require Apple to store information it does not currently store

Apple has also claimed that the Guidelines would require Apple to store certain user and transactional data (and that compliance with these requirements would compromise security in Apple Pay payments).

The source of this concern is unclear, but in order to provide clarity, the proposed negotiation framework in **Annexure A** sets out a very narrow set of circumstances where Apple may be asked to provide information to the applicants (on the assumption that such information would be available). Nothing in the negotiation framework would require Apple to collect information that it does not collect now, or would impose an obligation to provide information it does not hold.

#### 8.4 No delay expected in respect of collective negotiations on security issues

Both the applicants and Apple agree that security, fraud prevention and privacy are critical to customers adopting mobile wallets. To the extent there has been uncertainty as to what the applicants are seeking to achieve in this regard, the proposed negotiation framework in **Annexure A** is expected to provide clarity, prevent delay and avoid the risk of any holdup on negotiations. To the extent that collective negotiation will ensure that common security will be available to all applicants on a standardised basis, the process will provide public benefits with minimum risk of detriment.

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## 9 Restriction on pass-through prevents price visibility and Apple Pay fee constraint

### 9.1 Overview of Apple's contentions

In its submission, Apple states that it is not in the public interest to allow banks to "collude for the purpose of charging customers for using Apple Pay" because:

- Apple's fees reflect the investment made by Apple in offering Apple Pay and the benefit to be derived by the banks;
- customers are not currently charged transactions fees for making purchases using other "mobile wallets", nor are they told about or charged other fees for credit card use;
- banks are free to not agree to pay fees to Apple Pay and develop their own mobile wallets;
- the arguments put forward by the applicants in support of passing on of fees to consumers misconstrue prior analysis of these issues by the RBA; and
- banks have an incentive to favour their own mobile wallet services by charging higher fees if consumers choose Apple Pay.

These arguments reflect a number of misunderstandings, as set out below.

### 9.2 The applicants are not trying to collude on fees

Apple alleges that the applicants are trying to "collude" for the purposes of charging customers for using Apple Pay. This is plainly incorrect.

To be clear, the purpose of the collective negotiation is *not*:

- to agree on the level of any fees that any applicant may wish to charge its customers for using Apple Pay; or
- to agree on the decision to charge any such fees.

The purpose and scope of the proposed collective negotiation is much narrower. The applicants want to collectively negotiate so that each bank can make its own individual decisions as to whether any fees should be charged at all (and, if so, the level of any such fees).

The need for such collective negotiation arises in a context where, as Apple's own submission states, Apple "requests" that the banks do not pass on to consumers any fee if they offer Apple Pay. Apple states it wants zero fees for Apple Pay because it "is trying

to attract new users and does not wish to be competitively disadvantaged". In a practical sense, while it would be difficult for Apple to be competitively disadvantaged where it can stop competition by enforcing a technical lockout on NFC functionality, Apple's zero fee policy reinforces its position of dominance in mobile wallets and makes it even harder for others to compete even with complementary products. While Apple wants to make sure there is no price competition between each applicant and Apple, in effect its zero fee policy also eliminates price competition for the supply of Apple Pay between banks.

Therefore, in this particular context, the collective negotiation operates as the exact opposite to an attempt to collude on fees.

### **9.3 The existence or otherwise of benefits to issuers from Apple Pay is irrelevant to the assessment of whether the ability to pass-through Apple's fees results in benefit**

Apple submits that the fees it negotiates reflect the investments made by Apple in offering Apple Pay and the benefits that card issuers will derive from participating in Apple Pay.<sup>49</sup> However, Apple has not made clear exactly what the benefits of Apple Pay to issuers are over and above contactless cards and other integrated mobile wallets. For example, many of the claims made by Apple in relation to enhanced security really relate to enhanced security in the US context of a move from payment by cards with mag stripe rather than the Australian context where tokenisation is already in use and movement is from contactless NFC "tap & go" payments to mobile payments via NFC.

Moreover, any such benefits do not remove the benefits of removing the restriction of pass-through. As noted by CRA in their response to Dr Pleatsikas' Report:

*In any event, even if there are positive benefits for issuers of use of Apple Pay instead of alternative payment methods, this does not alter our conclusion that, if Apple maintains exclusivity for Apple Pay on iOS devices, Apple's fees would likely be excessive, as they would likely exceed the level that Apple would be able to sustain if facing competition from other integrated mobile wallets on iOS devices. In this sense, the existence or otherwise of benefits to issuers from Apple Pay is irrelevant to the assessment of whether Apple's fees are likely to be excessive. Moreover, if there are benefits of Apple Pay for issuers, although 100% pass-through may not be efficient, some pass-through (somewhere between 0% and 100%) would be, where the efficient pass-through would reflect the difference between Apple's fees and the benefits to issuers.<sup>50</sup>*

### **9.4 Pressure to avoid large (and increasing) future losses, may lead to issuers agreeing to terms that are inefficient and result commercial detriment**

Apple's submission regarding "benefits" to issuers also ignores the context of the commercial environment in which banks across the world have entered into agreements with Apple in relation to Apple Pay and the potential detriments from bargaining disparity leading to inefficient outcomes.

Apple's dominant position in the Australian smartphone market means that banks which do not agree to Apple's onerous terms of supply are likely to face increasing losses over time as their customers switch services to banks that do support Apple Pay services. In order to avoid these large (and increasing) future losses, banks may agree to terms of supply from Apple even if doing so causes them commercial detriment.

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<sup>49</sup> Authorisation applications A91546 & A91547, Submission by Apple, 26 August 2016, section 4.4.

<sup>50</sup> Response to Dr Pleatsikas' report prepared by CRA.

There are formal economic models of bargaining which are applicable to this situation. These models describe the outcomes in bargaining situations involving a single supplier and multiple potential customers where agreement to the supplier's terms by one customer creates negative outcomes for the customers that are yet to reach agreement.<sup>51</sup> The key result from these models are that bargains reached in such situations result in significant transfer of profits from the customers to the supplier; in fact the customers can be worse off after reaching agreement than they were before doing so, because by entering into the agreement they avoid future losses which are even larger.

The key conditions for these models to apply are present. In particular, customers do not choose their phone based on mobile wallet capabilities (see section 4.2(b) above). This means that a bank which does not support Apple Pay will face increasing losses over time as its customers that use Apple handsets will look to move services to another bank that does offer Apple Pay. Given that iPhone customers make up a very large and particularly valuable segment of the bank's customer base, this creates pressure on each individual bank to not hold out longer than the other banks, which in turn creates an incentive to accept detrimental conditions of supply from Apple.

If the collective negotiation is authorised, the dynamic of the negotiation will change. This is because none of the banks that stay as part of the collective negotiation process will face the prospect of experiencing a negative outcome as a result of another bank participating in the collective negotiation reaching agreement with Apple (although note they will also face the risk of one party leaving the negotiation early – but this in turn creates incentives for the banks to complete negotiations as expeditiously as possible). This will allow for normal commercial negotiations to proceed.

Under the proposed negotiation framework, negotiations about the fees payable by each applicant will still be a matter left to bilateral negotiation between each individual bank and Apple (and a decision to charge any fees and the level of any such fees would also be an individual matter). However, Apple will not be able to force the banks to absorb all of the costs of offering Apple Pay by imposing onerous "take it or leave it" terms that the banks will be compelled to accept in order to avoid the prospects of significant losses over time.

#### **9.5 The authorisation is about the *ability* to pass-through fees given the efficiency, distributional and competitive impacts of a restriction on that ability – other mobile wallets do not restrict pass-through**

Apple contends that the banks should not pass on fees to their customers who elect to use Apple Pay because customers are not currently charged transaction fees for making purchases using other "mobile wallets" or using scheme cards.<sup>52</sup>

In making this argument, Apple has failed to recognise the important distinction between: (a) the banks having the ability to charge a fee and reaching a decision not to; and (b) what Apple is seeking to do in relation to Apple Pay, which is to prohibit the banks from charging any fee to customers for the use of Apple Pay.

As discussed further in section 9.7 below, the ability of banks to threaten to pass-through costs to consumers (as opposed to the question of whether or not they actually choose to

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<sup>51</sup> For example, Segal, I. (1999) 'Contracting with Externalities' *Quarterly Journal of Economics*, 114: 337-388; Segal, I. and Whinston, M. (2003) 'Robust Predictions for Bilateral Contracting with Externalities' *Econometrica*, 71: 757-791; Genicot, G. and D. Ray (2006) 'Contracts and Externalities: How things fall apart' *Journal of Economic Theory*, 131: 71-100.

<sup>52</sup> Authorisation applications A91546 & A91547, Submission by Apple, 26 August 2016, section 4.4.

do so) has important implications for competition and economic efficiency in the Australian payment systems as it acts as a competitive constraint on Apple's ability to extract excessive and uncompetitive fees from the banks for providing Apple Pay. The ability to pass-through costs is also important in a context where mobile payments are a new area and technology and commercialisation models are rapidly evolving.

#### **9.6 The applicants are not “free” to reject Apple Pay and develop their own competitive alternatives because of Apple’s technical lockout of the NFC functionality**

Apple has stated that if the banks are not willing to pay the fees that Apple is prepared to negotiate, then the banks are “free” not to do so and to develop “alternative presentment methods” for its customers.

As discussed elsewhere in this submission, this statement is highly disingenuous: without access to the NFC functionality on the mobile phone, the applicants are not in a position to compete for iPhone customers or successfully compete in mobile payments, and there are numerous examples around the world to show precisely that (see sections 5.3 and 5.4(b) above). It is also audacious of Apple to suggest that Apple should freely benefit from the investment that Australian banks and merchants have made in NFC terminals, but the applicant banks themselves should not (and should, instead, invest in new technology). This inefficient use of resources would be a public detriment that leads to higher-cost payment systems overall (see further discussion in section 9.7 below).

#### **9.7 Issues of transparency and RBA policy**

Apple has stated that its desire to make sure customers do not pay fees to use Apple Pay is different from the “no surcharge” rules that were historically imposed by credit card schemes on the basis that:

- the credit card scheme’s no surcharge rules applied to merchants (not to the issuing banks); and
- the banks have not shown that customers would end up paying more if the banks cannot charge customers fees to use Apple Pay.

Both these statements are overly simplistic and misunderstand the nature and intention of the RBA policy on payment systems reform.

##### **(a) RBA’s policy in relation to price transparency and surcharges**

The RBA’s criticism of no surcharge rules was driven by a concern to improve competition and economic efficiency in the Australian payment systems by providing better price signals on the relative costs of different payment methods.<sup>53</sup> The RBA considers that:

*... ‘no surcharge’ rules suppress price signals that guide the efficient allocation of resources. They result in cross-subsidisation of cardholders by consumers who do not use credit cards; they restrict competition between merchants by limiting the range of pricing strategies they can use; and they prevent end-users exerting competitive pressures on merchant service fees and interchange fees.<sup>54</sup>*

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<sup>53</sup> RBA and ACCC, ‘Debit and Credit Card Schemes in Australia: a Study of Interchange Fees and Access’, October 2000, Executive Summary.

<sup>54</sup> RBA and ACCC, ‘Debit and Credit Card Schemes in Australia: a Study of Interchange Fees and Access’, October 2000, p 50.

The RBA is here referring to the fees charged by a *merchants* to the customer, while Apple’s rules apply to fees charged by the *card issuer* to the customer, but the same considerations apply: either the customer contributes to the cost of processing the payment, or all customers will have to contribute, whether they use the payment method or not. Accordingly, the RBA’s criticisms are equally applicable to Apple’s policy on zero Apple Pay fees, as shown on Table 2 below.

**Table 2: No surcharge rules vs Apple’s “zero Apple Pay fee” policy**

Detriments	No surcharge rules	Apple’s “zero Apple Pay fee” policy
Distorted price signals	<p>Masks price signals to cardholders about the relative cost of different payment methods.<sup>55</sup></p> <p>Distortions to price signals may lead to overuse of some payment methods; and relative prices that do not reflect relative resource costs of different payment systems are likely to lead to a higher-cost payments system overall.<sup>56</sup></p>	<p>Masking the cost of Apple Pay similarly distorts price signals about the cost of using it.</p> <p>If customers are led to believe that Apple Pay is “free” then this may lead to overuse of Apple Pay as compared to lower-cost payment methods. This is problematic in circumstances where the more customers who use Apple Pay, the more it will cost the issuing banks who are offering the service and can lead to higher-cost payments system as a result of cross-subsidisation (addressed below).</p>
Cross-subsidisation	<p>No surcharge rules contribute to the subsidisation of credit card users by all other customers, as merchants would build the costs of accepting card payments into the overall prices of their goods and services, which were paid by all customers regardless of the payment method they used.<sup>57</sup></p> <p>The ability of merchants to levy surcharges reduces the extent to which users of lower-cost payment methods subsidise users of higher-cost methods.<sup>58</sup></p>	<p>If banks cannot pass-through fees for using Apple Pay to customers who use that service, the banks’ overall cost base for issuing cards will increase due to the fees Apple charges issuers.</p> <p>Once the cost of Apple Pay is built into the banks’ overall cost base, these costs are typically recovered in the form of higher fees (eg, higher fees for card membership).</p> <p>As a result, customers who do not use Apple Pay end up paying for those who do (even if they are not aware of it).</p>
Negotiation of fees	<p>No surcharge rules limit the ability of merchants to put downward pressure on their merchant service fees and interchange fees by threatening to charge the customers</p>	<p>If Apple Pay fees cannot be passed through to consumers, then Apple will not be constrained by the threat of pass-through of fees to consumers in the negotiation of the</p>

<sup>55</sup> RBA and ACCC, ‘Debit and Credit Card Schemes in Australia: a Study of Interchange Fees and Access’, October 2000, p 55; RBA, ‘Review of Card Surcharging: A Consultation Document’, June 2011 at 2, 5.

<sup>56</sup> RBA, ‘Review of Card Payments Regulation Conclusions Paper’, May 2016, p 6.

<sup>57</sup> RBA, ‘Review of Card Surcharging: A Consultation Document’, June 2011 at 2.

<sup>58</sup> RBA, ‘Review of Card Payments Regulation Conclusions Paper’, May 2016, p 30.

Detriments	No surcharge rules	Apple's "zero Apple Pay fee" policy
	for using credit or scheme debit cards. <sup>59</sup> Removal of no surcharge rules introduces 'normal market disciplines' into negotiations regarding merchant fees. <sup>60</sup>	fee payable. This compounds the impact of distorted price signals and cross-subsidisation as it means that in setting or increasing the fees charged to banks to offer Apple Pay, Apple does not need to consider consumer's willingness to pay fees to use Apple Pay over another payment method.

Collective negotiation will increase the likelihood that banks will have the ability to pass-through costs to consumers. As identified by the RBA in the context of surcharging, the ability to pass-through costs to consumers "promotes efficiency and competition in the Australian payments system" and leads to a "more efficient allocation of resources... which is in the public interest".<sup>61</sup>

(b) Would customers end up paying more?

Apple has also asserted that the banks have not shown that customers would end up paying more if the banks cannot charge customers fees to use Apple Pay. The basis for this assertion is unclear, and suggests a poor understanding of the way in which banks operate. To be clear, banks are corporations which seek to operate profitably for the benefit of customers, shareholders and the stability of the wider banking system. They are not expected to lower their profits for the benefit of competitors such as Apple Pay.

As noted in the expert report of Dr. Susan Athey:

*Apple Pay effectively imposes an extra intermediary transaction cost (the Apple Pay transaction tax) on retail transactions, decreasing consumer welfare through higher prices, as follows:*

- a. *Total fees per transaction are higher using Apple Pay than using credit cards*
- b. *This is equivalent to adding a tax to the system (which accrues to Apple rather than Australian producers)*
- c. *Part of the additional fee will be passed on to consumers in the form of higher prices.*

Dr. Susan Athey also notes that:

*Without collective bargaining and the ability to boycott by the banks, ultimately Apple will likely prevail in its goals of adding an additional "Apple Pay transaction" tax on what may eventually become a large share of all transactions in Australia, as well as in preventing consumers from seeing transparent and accurate signals about the additional tax imposed on this payment mechanism.*

<sup>59</sup> RBA, 'Review of Card Surcharging: A Consultation Document', June 2011, p 2.

<sup>60</sup> RBA, 'Review of Card Surcharging: A Consultation Document', June 2011, p 5.

<sup>61</sup> RBA, 'Review of Card Surcharging: A Consultation Document', June 2011, p 5.

*The “Apple transaction tax” will be transferred from Australian consumers to Apple, and the Australian economy will suffer as a result.<sup>62</sup>*

## **9.8 The Applicants are incentivised and constrained by fierce competition between issuers for card and account holders**

Apple has contended that if the banks were able to pass-through fees to customers then there is a “real possibility” that the banks would use this as a “competitive tool” to favour their own mobile wallet services by charging higher fees if consumers choose Apple Pay.

Aside from the fact that it is difficult to see how banks could do this if they cannot offer a NFC capable mobile wallet due to Apple’s technological lockout, the argument ignores the fact that the banks are subject to competition in both retail banking and in relation to mobile payments.

As outlined in section 9.2 above, the scope of the proposed authorisation does not extend to collective negotiation of the level of fees that any bank may wish to charge to customers for Apple Pay, or to any decision as to whether to charge any such fees at all. Therefore, each bank’s ability to charge fees for the use of Apple Pay will be constrained by the fees charged by other banks, including by ANZ Bank who does not appear to charge any fees for Apple Pay (and, as the applicants understand, is contractually unable to charge any such fees). If a customer is unwilling to pay the fees charged by its bank to use Apple Pay, then it is not hard for them to apply for a card from another issuer bank, such as ANZ Bank, which will allow them to use Apple Pay for a zero fee. Cards are not a particularly sticky payment product and ‘switching’ a card product is all that is necessary in order to access Apple Pay on terms offered by another issuing bank. Therefore, if a bank attempts to extract high fees from its customers for the use of Apple Pay, then it is likely to lose customers to its competitors.

ANZ Bank, in signing up ahead of the applicant banks, was cognisant of the ease with which customers can ‘switch’ and apply for an ANZ Bank card in order to use Apple Pay. In fact, ANZ Bank is making offers intended to facilitate and encourage ‘switching’, including the current offer of 0% interest per annum on balance transfers for the first 18 months.<sup>63</sup> The fact that customers have ‘switched’ to ANZ Bank in order to access Apple Pay<sup>64</sup> is indicative of the ease with which customers could and would switch in circumstances where the banks charged decided to charge its customers too much to use Apple Pay.

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## **10 Apple’s submission that authorisation will result in reduced competition and innovation is not supported by the facts**

Apple’s submission that the level of competition and innovation would be reduced with authorisation is inconsistent with the facts, and in particular with the advanced development of contactless payment options in Australia.

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<sup>62</sup> Expert report prepared by Dr. Susan Athey.

<sup>63</sup> See, ANZ, ‘Personal credit cards’, available at: <https://www.anz.com.au/personal/credit-cards/low-interest-rate/platinum/> (accessed 19 September 2016).

<sup>64</sup> For example, see submissions by Richard Thorek (1 August 2016), Jason Discount (17 August 2016), Trevor Long (26 August 2016), Wayne Pulbrook (27 August 2016) and Dr. Grischa Meyer (31 August 2016).

## 10.1 The authorisation will drive a real competitive response to Apple Pay

According to Apple, if authorisation were granted, consumers would be denied:

*...the benefits that would flow from the further innovation that would be introduced in Australia by other mobile wallet providers and the banks themselves in response to Apple Pay if introduced by at least some banks.*<sup>65</sup>

However, as noted in section 5.3 above, Apple's submissions on the direction of innovation depend on Apple Pay as the key innovation and other providers developing complementary or non-integrated products on top of Apple Pay for iPhone users and products in response to Apple Pay on Android devices. The restricted response to Apple Pay that Apple seems to be referring to here (ie, complementary non-integrated iPhone apps) would not be prevented by the authorisation and according to other parts of Apple's submission is already occurring.

Far from the authorisation "stifling" the incentive for existing players to develop innovative new solutions that build upon and compete against Apple Pay or "denying" competition or innovation in response to Apple Pay for the next three years, the driving force behind the authorisation is to enable a real competitive response to Apple Pay for Australian consumers.

## 10.2 The authorisation will not insulate the banks from competition

Apple contends that the limited collective negotiation and boycott would somehow protect the applicant banks from competition with each other and from Apple and would allow banks to control the direction and pace of innovation and the timing of Apple Pay's introduction. This is a misinterpretation of the authorisation being sought.

Further, Apple's contention that the limited collective negotiation would allow the banks to avoid the competitive dynamic generated by the risk of losing customers who would choose a bank that offered Apple Pay, or switch banks in order to access Apple Pay, is inaccurate and unfounded. Apple Pay is already available in Australia and is offered by ANZ Bank and American Express. With or without authorisation, the applicant banks will have to compete for customers with ANZ Bank, one of the largest banks in Australia.

In relation to the timing of Apple Pay introduction, while the authorisation is for a period of three years to allow the applicants and other participants the ability to prepare for, organise and conduct collective negotiations in relation to relevant third party providers, the collective boycott is only in place while the relevant collective negotiation are ongoing. The collective negotiation and boycott sought are limited to three issues. All other aspects of an agreement with Apple will be individually negotiated. Whether a bank decides to introduce Apple Pay and the timing of that introduction will not be in "lockstep", but will depend on each bank's individual negotiations. This, combined with the fact that Apple Pay is already being offered by ANZ Bank, also refutes the suggestion in Apple's submission that the applicant banks would have little incentive to agree terms with Apple in an efficient manner (which is addressed in more detail in section 6 above).

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<sup>65</sup> Authorisation applications A91546 & A91547, Submission by Apple, 26 August 2016, section 3.1.

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## 11 The authorisation will result in net public benefit

Apple's contentions regarding the effect of negotiation on exclusivity, restriction on pass-through and security standards are misguided, incorrect and do not substantively address or undermine the case for authorisation.

Authorisation will provide real public benefits to Australian consumers and businesses. Without it, Apple's market power in respect of applications and services for iPhone users and the significant bargaining disparity of Apple will result in individual Apple Pay negotiations leading to inefficiencies and public detriments for the Australian economy.

Apple Pay will be the only choice of integrated mobile wallet available to iPhone users which represent a significant proportion of the consumers that will wish to use mobile wallet technology and the lack of effective competition for providing integrated mobile wallet services to these consumers will likely result in:

- higher prices for mobile wallets;
- lower quality mobile wallets;
- less investment and innovation in mobile wallets; and
- high fees charged by Apple for the use of Apple Pay that ultimately place an inefficient tax on the Australian payment system – a tax that accrues to Apple not Australian producers and will likely be borne inequitably by members not using Apple Pay.

Collective negotiation and the associated boycott will reduce the bargaining power disparity between Apple and the applicants in relation to Apple Pay negotiations and result in net public benefits compared to the counterfactual.

Given the confined nature of the collective arrangements proposed, there are limited public detriments that will arise as a result of the proposed conduct, and substantial detriments that will arise without it.

For the reasons set out in this submission, and supported by the reports of CRA and Dr. Susan Athey, the authorisation will result in net public benefits and should be granted.

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## Annexure A

### Collective Negotiation Framework

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#### 1 Scope

Based on the concerns set out in section 2.1 of the applicants' authorisation application, the applicants propose to collectively negotiate with Apple in respect of Apple Pay. At the present time, the applicants do not intend to collectively negotiate with any other third party wallet provider.

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#### 2 Areas subject to collective negotiation

The scope of matters to be collectively negotiated with Apple is limited to the areas listed below.

##### 2.1 Exclusivity

In addition to offering Apple Pay, the applicants want to have the ability for their customers to load their own integrated NFC capable mobile wallets that can communicate with the iPhone's NFC functionality in order to make NFC payments.

##### 2.2 Security

The applicants want to be able to collectively negotiate in relation to the following:

- ID&V methods for the provisioning of cards in Apple Pay should have the same level of security that applies to ID&V methods for the applicants' own cards (including when those cards are provisioned on the applicant's own mobile wallets);
- CVM for transactions on Apple Pay should have the same level of security the applicants' apply to transactions made using the applicants' proprietary wallets and EMV cards;
- tokenisation services in Apple Pay should comply with existing obligations the applicants have agreed to with the card schemes;
- applicants should have the ability to request cardholder information in relation to transactions made using Apple Pay if the following conditions are met: (a) the information is reasonably required for the purposes of dispute resolution, fraud and customer complaints; (b) the cardholder has consented to the request and sharing of such information (for the limited purpose of resolving a dispute or conducting a fraud investigation); and (c) Apple already holds the information requested.

##### 2.3 Fees

Each applicant wants to have the ability to make its own individual decisions as to whether to charge cardholders any fees for the use of Apple Pay.

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## **3 Process**

### **3.1 Who can participate?**

The applicants, other credit and debit card issuers, and loyalty and store card issuers that have agreed to collectively negotiate with a view to achieving the outcomes set out above.

### **3.2 Commencing negotiations**

As soon as possible (but no later than a month after authorisation is granted).

### **3.3 Conduct of negotiations**

Protocols and procedures will be put in place to make sure that the scope of the matters that can be discussed as part of the collective negotiation are appropriate and in compliance with the terms of the authorisation.

### **3.4 Individual negotiations**

Participants are free to negotiate individually with Apple on all issues apart from the three issues set out in the section 2 at any time including during the period while collective negotiations are underway.

### **3.5 Collective boycott**

Participants in the collective negotiation are expected not to conclude any individual negotiation with Apple until the collective negotiation has been concluded.

### **3.6 Joining and withdrawing from the collective negotiation**

Additional parties may elect to participate in the collective negotiation after it has commenced, on the understanding that any decisions made prior to a party joining will not be open to reconsideration solely because a new party has joined the negotiation process.

Parties are expected to notify the group if they wish to withdraw from the collective negotiation process. No penalties will apply for withdrawal.

### **3.7 Concluding the negotiations**

If the collective negotiation is concluded without Apple and the issuers reaching an agreement on the matters the subject of this document, each issuer can revert to one-to-one negotiations with Apple.