Response to Oxera

In relation to the Application to the Australian Competition and Consumer Commission for Authorisation of the Proposed Amalgamation of BPAY Group Pty Limited and BPAY Pty Ltd, eftpos Payments Australia Limited and NPP Australia Limited

NON-CONFIDENTIAL VERSION

Confidential to BPAY

Confidential to eftpos

Confidential to NPPA

Confidential – derived from confidential information of BPAY, eftpos and NPPA

Confidential to others

Prepared for

Sharon Henrick and Christopher Kok
King & Wood Mallesons

Level 61, Governor Philip Tower
1 Farrer Place
Sydney NSW 2000

Prepared by

Dr Geoff Edwards

Suite 2201, Level 22, Tower 2
101 Grafton Street
Bondi Junction NSW 2022

Date: 31 May 2021

CRA Charles River Associates

TABLE OF CONTENTS

1. INTRODUCTION AND SUMMARY

1. I have been engaged by King & Wood Mallesons, acting for Industry Committee Administration (ICA), to prepare a report in response to the Oxera submission on behalf of Mastercard titled "Initial economic assessment of the proposed amalgamation of BPAY, eftpos and NPPA", dated 22 April 2021.

2. I have previously provided an expert economic opinion on the application to the Australian Competition and Consumer Commission (ACCC) for authorisation of the amalgamation of BPAY Group Pty Ltd and BPAY Pty Ltd (together, BPAY), EFTPOS Payments Australia Limited (eftpos) and NPP Australia Limited (NPPA), which was submitted to the ACCC on 2 April 2021.

3. In this report I respond in turn to the Oxera report's introduction and sections on anticompetitive effects and benefits.

2. RESPONSE TO OXERA'S INTRODUCTION

2.1. Counterfactual

4. Regarding the counterfactual, Oxera state that "absent the merger, it is plausible to expect that the three parties would have continued on a converging path, becoming stronger competitors to each other and increasing competition and innovation in the Australian market" (paragraph 1.6 and paragraph 2.2).

5. In my view this statement cannot take the ACCC far in understanding the competitive effects of the proposed transaction.

    a. Oxera does not state how much stronger the parties would become as competitors to each other, nor how much the rivalry between them (distinct from the rivalry between them and third party payment service providers such as the ICS) would increase competition and innovation. Oxera only states that it is "plausible" that they would become (to an undefined extent) stronger competitors.

    b. Moreover, my understanding is that a relevant counterfactual needs to be likely, not merely "plausible". In Section 6 of my report I assessed the likely counterfactual in terms of closeness of competition between the parties in considerable detail, segment by segment and service by service. The Oxera report has not attempted a similar detailed assessment and is therefore unable to support a view on the counterfactual that goes beyond the "plausible".

    c. My conclusion (based on a detailed assessment) was that in the likely counterfactual overlaps between the parties would be limited and not of a nature that would justify a finding that the proposed transaction would be likely to substantially lessen competition. This was summarised in paragraph 116 of my report in the following terms.

> *While there are today a number of overlaps in segments between the services offered by the three entities, and there are likely to be more overlaps in the future, careful consideration of these overlaps and of competition in each segment reveals that any loss of competition would be marginal at worst, and a substantial lessening of competition is not likely.*

2.2. Incentives to innovate

6. Oxera states that "[o]ur assessment of the horizontal overlap finds that the merger has the realistic prospect of reducing competition in the market, by reducing post-merger incentives to innovate" (paragraph 1.9). I was unable to find any assessment by Oxera of the horizontal overlaps between the parties on which this statement might reasonably be founded.

7. Oxera continues: "[the merger] has the potential to affect incentives across all three entities […] as an investment in any one of the three would be likely to cannibalise volumes run on other schemes". The use of qualifying language ("potential") falling short of "likely" is instructive. This is, also, another statement that is not founded on any form of detailed assessment, and in my view it does not survive more considered analysis.

8. As explained in paragraphs 273-275 of my report:

> *It is possible that, in the counterfactual, the amalgamating domestic entities may develop initiatives beyond their current roadmaps that would compete closely if both were widely adopted by financial institutions.*
>
> *However, any such future initiatives of any scheme that would cannibalise volumes of other schemes would require widespread support from financial institutions for successful deployment. The factual statements that I have reviewed reveal a reluctance of financial institutions to support two or more domestic initiatives that will deliver more or less the same functionality. The likelihood is therefore that the best outcome that can be expected in the counterfactual is one in which ultimately only one of the domestic initiatives is widely supported.*
>
> *Since competition between future initiatives of the domestic schemes (beyond the current roadmaps) is unlikely in the counterfactual, a lessening of competition if the proposed amalgamation proceeds taking the form of fewer competing domestic initiatives is also unlikely.*

9. Oxera posits as a "possible" example that "post-merger, the Parties would not have an incentive to invest in developing certain aspects of the eftpos infrastructure, as this would reduce transactions that could be processed on BPAY instead" (paragraph 1.9). Oxera avoids specifics and it is not clear what type or types of transactions Oxera has in mind here. As explained in my report,[1] BPAY Payments is a "push" payment service that

---

1 See paragraph 138(c) of my report, which states:

> *The BPAY Payments service has a relatively specific role with a focus on a service that allows billers to efficiently reconcile bill payments when customers "push" payments to them (i.e. for credit payments). While the main alternatives to the BPAY Payments service for billers and payers include direct credits and direct debits (which are migrating to the NPP) as well as the ICS, the unique characteristic of the BPAY Payments service – providing efficient reconciliation for billers of "push" credit payments – sets it apart from both direct credits (which do not provide similar reconciliation efficiency) and direct debits (which are less attractive for customers that wish to remain in control of their payments and also come with the risk for billers of dishonoured payments) as well as from card-based payment services. Consequently, from the perspective of financial institutions that wish to offer customers (billers and payers) a range of payment options with different features and functionality, the BPAY Payments service, direct credits and direct debits as well as card-based payment services are more in the nature of complements than close substitutes. Further considerations are that the majority of BPAY billers have no particular need for real time processing and settlement or the rich data feature of the NPP, many prefer the batch nature of BPAY*

provides billers with efficient automated reconciliation properties. Due to these characteristics, its volumes are reasonably well-protected from competition from card-based services (and other services) that are of a "pull" nature and do not offer the same reconciliation properties. I am also not aware of initiatives being contemplated by eftpos that might compete directly with BPAY Payments in automatically reconciled bill payments of a "push" nature. Moreover, should eftpos develop an initiative that would cannibalise BPAY Payments volumes in the counterfactual, it is not likely that such an initiative would be supported by the financial institutions that eftpos would need to adopt it in order for it to be successful.

10. Oxera then posits the converse: "[e]qually, investing in BPAY could reduce the debit card transactions on the eftpos scheme, making that investment less profitable for the company overall" (paragraph 1.9). Again, this statement lacks specifics, and it is not clear what kind of investment in BPAY could reduce debit card transactions on the eftpos scheme to any material extent. As a "push" payment infrastructure, and with a considerable time lag between initiation by the payer and confirmation of payment for the payee, the BPAY infrastructure is not well suited to retail payments. Even if BPAY were to somehow develop a compelling service for retail transactions in the counterfactual, incentives to do so would likely remain under the proposed amalgamation: the vast majority of retail payment volumes are conducted over the ICS infrastructures, so NewCo would likely have strong incentives to win these volumes, notwithstanding some cannibalisation of eftpos volumes.

11. Overall, the argument and the examples in paragraph 1.9 of the Oxera report (which are repeated in paragraph 2.20) represent no more than speculation of possible effects, rather than anything grounded in careful analysis that may be of use to the ACCC in its assessment of the likely competitive effects of the proposed transaction. In my view, the proposed transaction is likely to *enhance innovation* compared to the likely counterfactuals. The reasons are explained in Sections 8 and 10 of my report (see Sections 10.1 and 10.2 in particular).

2.3. Vertical links

12. While the proposed amalgamation will increase vertical integration between the NPPA's upstream infrastructure and downstream services, there is no basis for Oxera's assertion that "NewCo would have the ability and incentives to foreclose third-party providers of payment services" (paragraph 1.10). Ability and incentives to foreclose do not follow automatically from increased vertical integration. Whether anticompetitive effects are likely (even if ability and incentives exist) is another important consideration. Oxera's arguments on vertical effects are examined further in Section 3.2 below.

2.4. Public benefits

13. Oxera argue that a number of the stated benefits of the proposed amalgamation "appear to arise only because of a lessening of competition among the three parties" (paragraph 1.11). This fails to appreciate the important distinction between:

---

payments, and a number would need to undertake significant system changes in order to be able to receive NPP payments.

a. The "competition" for adoption of initiatives by financial institutions with scarce IT and other resources, which leads to a coordination market failure (as set out in Section 2.1 of my report and further in Section 10.1); and

b. Competition in a relevant market for payment services.

14. This distinction was explained in paragraph 299 of my report in the following terms.

> *It is important to distinguish between two forms of "competition". First, there is the contest between initiatives to be favoured in the allocation of scarce resources within financial institutions. Second, there is the potential for competition between those initiatives in payment service markets. Importantly, the first contest will occur in the counterfactual regardless of whether the initiatives would ultimately compete in payment service markets. My expectation is that under amalgamation better coordination and planning (including coordinated sequencing of investments by financial institutions) is less likely to result in situations where initiatives have to be abandoned following investment in them by one of the entities, and is likely to result in more successful deployments of domestic payment initiatives and faster speed to market of those initiatives.*

15. While the first form of "competition" would be reduced, I consider this to represent a public benefit, as inefficient conflict across financial institutions over which initiatives to prioritise is likely to be replaced with coordination around a single agreed industry roadmap for the development of initiatives of the three entities, overcoming the coordination market failure in the industry that is evident from the factual statements provided to the ACCC, and thereby enhancing innovation in domestic payment systems.

16. Oxera also states that "[the] balance between the lessening in competition and net public benefits has not been identified or addressed in the Application or by the Applicants". Section 12 of my report addresses the "balance" directly, based on the detailed consideration of the likely effects on competition and the public benefits and detriments in Sections 6-11.

3. RESPONSE TO OXERA ON ANTICOMPETITIVE EFFECTS

3.1. Horizontal effects

17. Regarding Oxera's suggestion of a contradictory picture in the Application regarding the extent of competition between the parties (paragraph 2.5 of the Oxera report), there is no contradiction between observing, on the one hand, that boundaries are increasingly blurring in the provision of payment services, and on the other hand, that the proposed amalgamation will not have the effect or be likely to have the effect of substantially lessening competition because there are no significant overlaps between the entities and they do not offer services that are close substitutes for each other. Sections 6-9 of my report assess the likely effects in considerable detail and, although boundaries are blurring, I conclude no likelihood of a substantial lessening of competition (see Section 5 of my report for a summary).

18. In paragraph 2.6, Oxera asserts that "the proposed amalgamation would bring together three close competitors."[2] This appears to be based on Oxera's interpretation of the eftpos and BPAY submissions, rather than a detailed independent assessment of the current and

2 A similar assertion appears in paragraph 2.19.

future services of the three entities and the nature of the payment segments in which those services are and will be provided. My own detailed assessment (see Section 6 of my report) does not support Oxera's assertion.

19. Moreover, in my view, the statements of eftpos and BPAY do not support Oxera's selective (and rather strained) interpretation of them.

a. The eftpos statement is clear that *Mastercard and Visa* are eftpos' main competitors. For example, in paragraph 40 the eftpos statement states: "For EPAL, Mastercard and Visa are the most significant current competitors for payment systems."

b. Oxera points to eftpos referring to "overlap" in the roadmaps of the three entities, however services may overlap without them being "close competitors". Similarly, Oxera observes "the elimination of competition" arising from the amalgamation. My report also observes the elimination of competition arising from the amalgamation, but on careful consideration concludes that, because the services of the amalgamating entities are not close substitutes, and face more significant competition from other services (in particular from the ICS), it is not likely to represent a *substantial lessening of competition*, which is the relevant test.

c. Oxera misquotes eftpos as stating that "while in the past its main competition has been from the ICS, this will not be the case in the future" (paragraph 2.6 of the Oxera report). Oxera points to paragraph 180 of the eftpos statement as the source of this. What eftpos actually says in paragraph 180 is the following.

Misunderstanding	***Facts***
eftpos competition was and will always be only ICS	*True of the past not of the future, the future competitors include NPP and BPay but most importantly Big Tech in collaboration with our members*

I do not interpret this as saying the ICS will not remain eftpos' most significant and closest competitors in the future, nor that NPP and BPAY will be close competitors in the future. It only says that the ICS will not always be eftpos' *only* competitors, and that future competitors will include NPP and BPAY and also, "more importantly", BigTech. The quality and strength of those competitors is not stated.

d. In paragraph 2.7, Oxera refers to BPAY stating that the overlap between NPPA's business services and BPAY's overlay services is increasing. This does not imply a lessening of competition, and as I explain in my report (see Section 6.3), if anything, the proposed transaction is likely to produce incentives to lower prices for the NPPA SCT service and for Osko overlay services, due to Cournot complementarities.

e. Also in paragraph 2.7, Oxera seems to interpret BPAY's observations of "potential overlaps" between services as evidence of "close competition". Although BPAY refers to "potential overlaps" between (i) BPAY and eftpos "card on file", (ii) BPAY's Osko Service 1 and NPPA's SCT, and (iii) BPAY Payments and NPPA's MPS, references to "potential overlaps" do not imply "close competitors", and for the reasons I have explained in my report, these services are not likely to be "close competitors" (see, respectively, Sections 6.5, 6.3 and 6.6).

3.1.1. Current competition

20. Oxera argues that the Direct Entry (DE) system is a legacy system with payments "expected to migrate over time to NPPA at an increasing pace" and for this reason the DE system "should not be expected to impose a competitive constraint on NewCo" (paragraph 2.11). Oxera also argues that the market shares reported in the Application "are unlikely to provide a good proxy of the market power of the combined entities because of the inclusion of DE volumes in these calculations" (paragraph 2.11).

21. However, as long as the DE system remains in operation it offers financial institutions a very low cost and fit for purpose payment infrastructure that financial institutions continue to favour even today for the vast majority of non-retail payments (including almost all B2P and G2P payments including payroll and government disbursements) as well as direct debit P2B and B2B payments. Both in the counterfactual and in the factual as part of NewCo, the NPP must compete against this incumbent low-cost alternative in order to persuade financial institutions to migrate direct debits and direct credit disbursements to the NPP. This migration will not happen automatically – financial institutions retain the choice of continuing to use the DE system for these payments, rather than migrating to the NPP. The speed of migration will therefore depend on the functionality that the NPP develops (for example, currently the NPP does not offer "pull" functionality and so the NPP is not yet able to migrate direct debit volumes from the DE system) and the prices the NPP charges. Even once the functionality is in place, only if the NPP can credibly persuade financial institutions that it will be able to maintain low prices per payment for use of the NPP will financial institutions be willing to migrate the direct credit and direct debit volumes that remain on the low-cost DE system. In addition, change is likely to be required by businesses and government departments as well as by third parties such as payroll providers, which in many cases will require moving away from bespoke systems developed for the DE system to bespoke systems developed for the NPP. The DE system therefore does act as a significant constraint on the NPP, notwithstanding its legacy nature, and the inclusion of the DE system in market shares is therefore appropriate when assessing the competitive significance of the various payment infrastructures and services.

22. In any event, the market shares presented in the Blockley report and in my report include forecasts to 2025 that take into account projected future migration of payment volumes from the DE system to the NPP. These future shares therefore do not understate the NPP's future significance within NewCo. As can be seen in Figures 2 and 3 of my report, by 2025 NewCo is expected to have a [Confidential to eftpos]% share of low value payments by volume and a [Confidential to eftpos]% share by value.

23. Oxera is also mistaken when it suggests (in paragraph 2.11) that the large share of the *value* of low-value payments represented by the DE system[3] is responsible for the amalgamating entities having only a 16% share of the upstream market, and when it suggests that, for this reason, these market shares "are unlikely to provide a good proxy of the market power of the combined entities". According to the data in the Blockley report, with my own adjustments to reflect eftpos actuals, in 2020 the amalgamating entities had only a [Confidential to eftpos]% share of the upstream market when measured by *volume* (i.e., number) of transactions, with the DE system having a share by volume of only

3 In 2020, the DE system represented [Confidential to the parties]% of low value payments by value, with the ICS representing [Confidential to the parties]% and the amalgamating entities combined representing [Confidential to the parties]%.

[Confidential to eftpos]%, while Mastercard and other international card schemes (ICS) together represented [Confidential to eftpos]%. The main reason for the combined share of the amalgamating entities in the upstream market being only 16% by volume is therefore the large size of *the ICS*, not the DE system. Indeed, if the DE system were removed altogether from the share calculations, the amalgamating entities would have a combined share of only [Confidential to eftpos]% by volume (while the combined share of the ICS would be [Confidential to eftpos]%).

24. In paragraph 2.12, Oxera suggests that a focus on the ICS as strong competitors in payment infrastructure and services markets "does not recognise accurately the strength of NewCo post-merger because *in value terms* "the total *value* of non-cash payments from BPAY and the NPP is larger than the *value* of all card payments, and again includes the DE system which accounts for approximately 80% of the market in terms of the *value* of transactions" (emphasis added). However, when assessing competitive strength in payment markets by examining shares at the infrastructure level, it is misleading to focus on market shares measured by value rather than by volume.

   a. This is because the types of transactions typically conducted over non-card infrastructures that are designed mainly for non-retail transactions (in particular, the DE system, the BPAY Payments infrastructure and the NPP) are by their nature *significantly larger in average value* than the types of transactions typically conducted over the card infrastructures that are designed mainly for retail transactions.[4] It is therefore not surprising that the vast majority of transaction *value* lies with the infrastructures that have been designed mainly for larger value non-retail transactions. But this fact is not very informative of the relative competitive strengths of the various infrastructures and services when they are competing to be the favoured payment solution for particular transactions.[5]

   b. When measured in terms of transaction *volumes*, the market shares in the Blockley report, adjusted for eftpos actuals, suggests an ICS combined share of all low value payment volumes of [Confidential to eftpos]% in 2020, growing to [Confidential to eftpos]% by 2025, compared to the amalgamating entities' combined share of [Confidential to eftpos]% in 2020 growing to [Confidential to eftpos]% by 2025.

25. In paragraph 2.13, Oxera argues that the reported downstream market shares in the Application "are unlikely to be a reliable indicator of market strength, given the differing nature of the solutions and the fact that DE cannot be considered a strong constraint on NewCo".

   a. The reason why the DE system will be a strong constraint on NewCo, in particular in the (non-retail) bill payment and B2P/G2P segments, has been explained above.

   b. As for the argument that the reported downstream market shares are unlikely to reliably indicate market strength "given the differing nature of the solutions", on the contrary the downstream market shares are more likely to reliably indicate market

---

4 According to the data in the Blockley report, the average transaction values (ATV) over the DE system, BPAY and the NPP in 2020 were [Confidential to the parties], respectively. By contrast, the ATV of credit card schemes was an order of magnitude lower at [Confidential to the parties] and the ATV of debit card schemes was lower again at [Confidential to the parties].

5 It is also worth noting that eftpos' charges are per transaction rather than ad valorem, and the NPP is planning to introduce per transaction charges rather than ad valorem charges.

strength because they are focused on particular segments of payments within which the nature of the solutions are *less differentiated* than when looking at the upstream level where all segments are aggregated. For example, the strength of the ICS in retail payment segments is better assessed by examining market shares of the ICS in retail payment segments than by examining market shares of the ICS at the aggregate upstream infrastructure level where retail and non-retail payments are aggregated together.

26. Oxera states that the transaction would "significantly reduce the number of low-value payment schemes in Australia from six main providers to four" and that "[a]s such, the Application's presentation of market shares underestimates the importance of the competitive interactions among BPAY, eftpos and NPPA, given they currently provide important alternative options to customers" (paragraph 2.14).

    a. It is not clear how the second statement is implied by the first.

    b. It is also not clear what the basis is for the assertion that BPAY, eftpos and NPPA "currently provide important alternative options to customers". This was not my conclusion based on a detailed segment by segment and service by service analysis (see Section 6 of my report).

27. In the next paragraph, Oxera correctly states that "a competition assessment of the likely effect of the merger should focus on the closeness of competition between the merging parties" (paragraph 2.15). Section 6 of my report contains such an assessment. The Oxera report does not contain any such assessment. Oxera's view that BPAY, eftpos and NPPA "currently provide important alternative options for customers" appears to be based solely on selective (and strained) interpretations of the statements of eftpos and BPAY.[6]

28. Oxera goes on to assert that "the market shares presented will underestimate the closeness of competition of the parties" (paragraph 2.15). Whether the market shares underestimate, overestimate or reflect well the closeness of competition between the parties, or their significance for competition, requires the sort of assessment contained in Section 6 of my report, which Oxera has not conducted.

3.1.2. Future competition

29. In paragraph 2.17, Oxera suggests that because payments authorised and cleared in the DE system represent over 80% of the total *value* of non-cash payments, they "constitute the main battleground for future competition in this market". Oxera's focus, again, on market shares in value rather than volume terms leads Oxera to a misleading interpretation of the main areas of future competition in payments. Payments authorised and cleared by the DE system represented *only* [Confidential to eftpos]% of low value non-cash payments in 2020 when measured by *volume*. To put this in context, payments authorised and cleared by the ICS (predominantly by Mastercard and Visa) represented [Confidential to eftpos]% of low value non-cash payments in 2020 and are forecast to represent [Confidential to eftpos]% in 2025. Payments authorised and cleared by card schemes (including eftpos together with the ICS) represented [Confidential to eftpos]% of low value non-cash payments in 2020 and are forecast to represent [Confidential to eftpos]% in 2025.

6 See paragraphs 18-19 above.

30. My understanding is also that migration of DE volumes is likely to be largely if not entirely to the NPP, rather than to card schemes, and that the NPP was conceived precisely for this purpose. This appears to be Oxera's understanding as well: Oxera refers to "the migration of payments authorised and cleared in the DE system to NPPA in the next five to ten years, as acknowledged by the Parties" (paragraph 2.17). It is unclear how an anticipated migration of this nature, which seems largely if not entirely to involve just the DE system and the NPP, could be considered to be "the main battleground" for future competition in payments.

31. Despite acknowledging the anticipated migration of payments from the DE system to the NPP, Oxera argues that "the replacement of the legacy DE system for batch payments provides an opportunity for the three merging entities as well as other players in the market to enter or expand their services, in order to capture part of these migrating customers. BPAY and eftpos could also develop downstream services to compete with NPPA for the services currently provided over DE" (paragraph 2.18).

32. Oxera only goes so far here as to argue an "opportunity" for parties other than NPPA and that BPAY and eftpos "could" develop services to compete with NPPA for these payments. Oxera does not appear to have given careful consideration to the likelihood of parties other than NPPA developing such services. I considered future competition in the B2P/G2P segment (which corresponds to the "batch payments" Oxera is referring to) in some detail in Section 6.8 of my report. The following points that I made in that section bear repeating here.

   a. BPAY's Osko services are overlay services over NPP's SCT service and as such are not substitutes for the SCT service. BPAY is therefore not likely to develop services that would compete with NPPA for these payments, but rather only services that would complement NPPA services (see paragraphs 254-256 of my report).

   b. While eftpos has developed a "Deposits and Withdrawals" service that might be used for business and government disbursements, my reading of the eftpos statement is that eftpos is not viewing significant competition with and displacement of the NPP for these payments as a likelihood in the counterfactual (see paragraph 259 of my report).

   c. Even if financial institutions, businesses and governments were to consider card-based solutions as good alternatives for B2P and G2P payments, there would remain significant competition if the proposed amalgamation were to proceed, because equivalent card-based solutions to eftpos' "Deposit and Withdrawals" service would be available from both Mastercard and Visa (see paragraph 260 of my report).

3.2. Vertical effects

3.2.1. Ability to foreclose

33. Oxera does not provide any basis for its assertions that access to the NPP infrastructure is "crucial for third parties that want to develop or expand payment solutions" (paragraph 2.25) and that the card-based infrastructures of the ICS would not represent good alternatives to the NPP for "a wide range of third parties that need access to the NPPA infrastructure to develop their own payment services, such as bill or invoice payment providers or providers of P2P services" (paragraph 2.26).

   a. Oxera does not identify particular third parties or potential future payment services that could only be provided using the NPP, nor give consideration to the potential for third party services in general to make use of alternative infrastructures, including the card-based infrastructures of the ICS (including Mastercard and Visa).

b. Card-based infrastructures are currently used to provide both bill/invoice payment services and P2P payment services, so it is not clear why they would not provide good alternatives for future bill/invoice payment or P2P payment services.

34. Moreover, if there is a third party payment service that could only be provided using the NPP, it is likely that it would compete most closely with the NPP's own downstream services (e.g. the MPS), rather than with BPAY Payments or eftpos. There may then be little or no merger-specific effect on incentives to foreclose.

35. Oxera then suggests that in Europe "open credit transfer processing infrastructure such as NPPA […] has enabled various parties to develop their own new and innovative retail payment service propositions" and that "[c]ard infrastructure is not a substitute for these needs" (paragraph 2.27). It is again not explained why card infrastructure is not a substitute. In any event, if the third party payment service is a retail service, its competitive relevance in retail payment segments is likely to be limited because the NPP infrastructure is not designed for, and for a number of reasons is not well suited to, retail payments (see Sections 6.4 and 6.5 of my report). This is an important consideration as it goes to whether there would be a likelihood of significant anti-competitive effects if such a service were foreclosed. The eftpos statement corroborates this.

> *We do not see that the growth in digital or our POS volumes will be at risk through NPPA activities as eftpos is already low cost, fast and real time (for consumer and same day for most merchants as a matter of practice) and continues to shift to value beyond price, therefore the business case for merchants and the impetus for consumers to change behaviours at scale in the medium term is unlikely. In addition, to play in retail the investments for the market to move to NPPA are high and the business case for banks to invest may not exist. eftpos also accesses the existing network effect of cardholders and merchants accepting eftpos cards whereas NPP needs to spend time and money [to] create this network effect in addition to materially and sustainably differentiating its propositions to make this shift possible.*[7]

36. eftpos also observes that real time account to account platforms "have not as yet been successful, other than in a few instances, in taking share from cards but are taking share from traditional non real time payments globally"[8] and even in Sweden, where Swish is one of the world's leading examples of a successful direct account to account based app for retail payments, Swish's volumes are still relatively small.[9]

37. Oxera expresses its understanding that the open access arrangements for the NPP and proposed changes to those arrangements under NewCo "do not go far enough in ensuring that there would be no ability to foreclose access to infrastructure" (paragraph 2.29). I am not an expert in relation to the details of the access arrangements or their sufficiency for

7 eftpos statement, paragraph 162.

8 eftpos statement, paragraph 79(b)(iv).

9 eftpos statement, paragraph 150. See also the Expert Industry Opinion of Lance Sinclair Blockley, 18 March 2021, paragraph 309.

third party access needs. I do, however, consider that it is important that access arrangements for the NPP under NewCo be truly open and non-discriminatory, subject to the reasonable limits of ensuring the security of the NPP and Australia's domestic payments system. And I am instructed that NPPA already offers open and non-discriminatory access and the proposed transaction will not change this. In particular, I understand that NPPA provides direct access not only to NPP Participants, but also to any corporate entity that wishes to connect to the NPP as a Connected Institution using payment gateway hardware, and that this is an option open to Mastercard and Visa. I also understand there is an option for ADIs and non ADIs including Mastercard and Visa to connect indirectly to the NPP infrastructure via an NPP Participant or a Connected Institution.

38. Oxera suggests a contradiction in my report between my observation that the fragmented governance structure of NewCo would make it difficult to engage in a foreclosure strategy and the benefit I anticipate from the amalgamation of more effective coordination of investments in domestic payment initiatives (Oxera report, paragraph 2.31). There is not in fact any contradiction. The fragmented governance structure of NewCo – which includes representation for major retailers and for major and smaller financial institutions as well as independent directors – is likely to make it difficult for agreement to be reached on a foreclosure strategy (where the interests of these different institutions would tend to diverge), but it is not likely to preclude NewCo from settling on a single coordinated roadmap for domestic payment initiatives to be developed by the financial institutions (where the interests of the parties are largely aligned to solve a coordination problem – which I consider to be a benefit compared to the counterfactual in which there would be no such roadmap, and differences in investment priorities and sequencing across financial institutions would be likely to result in confusion, splintering and "wait and see" strategies).

39. Oxera finally suggests that "ability to foreclose could also arise from the fact that most new third party development would need to obtain agreement from a critical mass of the Australian banks to develop a new service offering" and that this provides "another illustration of NewCo's ability to foreclose third parties and weaken their competitive position" (paragraph 2.32). This concerns decisions by Australian financial institutions, not NewCo nor NPPA. The abilities and incentives of *financial institutions* and how these abilities and incentives *might change* due to the proposed amalgamation, are therefore what need to be considered. However, Oxera does not explain how the proposed amalgamation would give Australian financial institutions greater ability or greater incentives to not support a new third party development. My understanding is that while the major financial institutions will have ownership interests in NewCo, those interests will be *diluted* compared to their respective interests in eftpos, BPAY and NPPA in the counterfactual. Therefore, if anything, the proposed amalgamation should *reduce the incentives* of the major financial institutions to favour NewCo over third parties and not support a new third party development.

40. Returning to the issue of whether any foreclosure strategy would be likely to have anti-competitive effects, the fact that most new third party developments would need the support of the major financial institutions is one reason why anti-competitive effects of third party foreclosure are unlikely (even if ability and incentives existed). This is because any third party service over the NPP that would compete closely with eftpos, BPAY or the NPP would be likely to struggle to gain the necessary support from financial institutions in the counterfactual. In other words, there may not be any such third party service for NewCo to foreclose.

41. Indeed, as observed in paragraph 265 of my report, there seems to be little interest from third parties in developing overlay services over the NPP, with the main reason for this appearing to be the challenges of achieving the necessary coordination for sufficiently ubiquitous development of an overlay service by financial institutions.[10] If third party services over the NPP are unlikely to develop in the counterfactual, there can be no merger-specific harm, even if ability and incentives to foreclose were to exist.

3.2.2. Incentives to foreclose

General observations

42. In principle the merger may change NPPA's incentives regarding access to the NPP for third parties that would compete with BPAY and/or eftpos in the counterfactual. This is because, pre-merger, when considering a foreclosure strategy, NPPA will compare the losses to the NPP of foregone upstream infrastructure fees only against the gains *to the NPP* of increased use of the NPP's downstream services if the third party does not compete or competes less effectively. Post-merger, as part of an amalgamated entity, NPPA may *also* consider gains *to BPAY and/or eftpos* of increased use of BPAY and/or eftpos downstream services if the third party does not compete or competes less effectively. The potential for larger downstream gains from a foreclosure strategy brings the potential for greater incentives to foreclose third parties from access to the NPP.

43. However, for a number of reasons it is not safe to conclude that the merger will generate incentives to foreclose third parties from the NPP. First, NPPA is either already competing or has plans to compete in downstream services in all segments. It is therefore possible that NPPA would have incentives in the counterfactual to foreclose third parties. In that event, there would be no merger-specific effect on incentives to foreclose.

44. Second, if NPPA would not have incentives to foreclose third parties in the counterfactual, this means that the upstream losses that NPPA would experience would outweigh the downstream gains to NPPA of a foreclosure strategy. It does not automatically follow that by bringing BPAY and eftpos services into the calculus, the downstream gains will increase so much as to outweigh the upstream losses. In this regard it is important to recognise the following.

   a. It is not likely that any third party would seek to access the NPP to provide a new **in-store retail payment** service because the NPP infrastructure is not well suited to in-store retail payments (as explained in Section 6.4 of my report).[11] In any event, eftpos' share of in-store retail payments was only [Confidential to eftpos]% in FY20 and is forecast to fall to [Confidential to eftpos]% by FY25. Assuming diversion ratios that reflect market shares, this means that the downstream margin for eftpos would need to be more than [Confidential to eftpos] times larger than the upstream margin for the NPP in order for the downstream gains from a foreclosure strategy to outweigh the upstream losses in relation to a third party competitor in in-store retail payments.

10 See NPPA statement, paragraphs 42-55.

11 Reflecting this, as explained in paragraph 179 of my report, card-based payment schemes represented more than 99.9% of in-store retail payment volumes excluding cash and cheques in FY20 and even by FY25 they are forecast to represent more than 96%.

b. In **online retail payments**, the ICS dominate with a share of [Confidential to eftpos]% by volume in FY20 and a forecast share of [Confidential to eftpos]% in FY25 even on the basis of eftpos' own volume forecasts. BPAY and eftpos are barely present today and their future shares are likely to remain limited (for the reasons given in Section 6.5 of my report). Even by FY25, and based on eftpos' own volume forecasts, eftpos is only forecast to have a [Confidential to eftpos]% share of online retail payments. Therefore, since the ICS (in particular Mastercard and Visa) dominate online retail payments, a foreclosure strategy in relation to a third party competitor in online retail payments would mainly benefit the ICS, not NewCo.[12] To put this a different way, if there were a third party online retail payment service seeking to make use of the NPP infrastructure, it would be likely to win most of its volume from the ICS, rather than from BPAY and eftpos, meaning that the upstream volume increase for the NPP would be large relative to the downstream volume decrease for BPAY and eftpos. This tends to suggest that the amalgamated entity will have incentives to provide access to the NPP for third party online retail payment services. Again, assuming diversion ratios that reflect market shares, the downstream margin for eftpos would need to be at least [Confidential to eftpos] times larger than the upstream margin for the NPP in order for the downstream gains from a foreclosure strategy to outweigh the upstream losses in relation to a third party competitor in online retail payments.

c. In B2P / G2P disbursements, the DE system currently dominates, but its volumes are expected to largely migrate to the NPP (specifically to various SCT category purpose codes). eftpos and BPAY are unlikely to realise a material share in this segment of payments, for the reasons given in Section 6.8 of my report. Therefore, the incremental downstream gains to NewCo from a foreclosure strategy in relation to a third party competitor in B2P / G2P disbursements (compared to the downstream gains to NPPA in the counterfactual) are likely to be limited and unlikely to be sufficient to "tip" the incentives calculus so far as to generate incentives to foreclose.

45. This leaves only bill payments and P2P payments, where BPAY operates the BPAY Payments service (with an 11% share of bill payments) and Osko Service 1 (with an estimated 40% share of P2P payments and an estimated 22% share of bill payments in FY25). However, it is difficult to see financial institutions in the counterfactual supporting a third party payment service that would compete directly with BPAY Payments for automatically reconciled bill payments or with Osko Service 1. Not only do the four major financial institutions own 100% of BPAY (and Osko), but their appetite for further investments in their own systems to support a third party service that would add little in functionality to the functionality already provided by BPAY and Osko is likely to be limited. Therefore, whether or not incentives to foreclose would be created by the proposed

12 It is conceivable that the ICS may wish to access the NPP in order to provide an online retail payment service similar to the NPP's MPS. The ICS would only be likely to do this if the new service did not cannibalise the ICS's card-based online retail payment volumes to any significant extent. Given this, the new service would also not be likely to significantly cannibalise eftpos' online retail payment volumes (as eftpos' online retail payment services are also card-based and similar to the ICS's card-based online retail payment services). It follows that the new service would likely mostly threaten the NPP's MPS volumes, and so incentives to foreclose the ICS from access to the NPP for such a service are likely to be very similar in the counterfactual to under the proposed amalgamation. In other words, the proposed amalgamation is not likely to generate vertical effects in relation to access to the NPP for such a service, compared to the counterfactual.

amalgamation, there is unlikely to be any anti-competitive foreclosure by NewCo of third parties seeking to provide services in these segments.

Paragraph by paragraph rebuttal

46. Oxera posits for specific consideration “a third party that develops an overlay service to compete with Osko” (paragraph 2.34). As explained earlier, there seems to be little interest from third parties in developing overlay services over the NPP.[13] The difficulties that BPAY itself has encountered in seeking adoption of Osko Service 2 and Osko Service 3 by financial institutions further suggests that overlay services that compete with these Osko services are unlikely to be adopted by financial institutions. The question of whether the proposed amalgamation would generate incentives to foreclose such a third party service is a moot question if no such third party service would be likely to develop even in the counterfactual.

47. Moreover, if we do consider incentives to foreclose a third party that wishes to develop overlay services in competition with the Osko services, we must take into account that, as explained in Section 4.1 of my report, the future of the Osko services is not promising. If the Osko services do not realise or maintain a significant presence in any downstream segment, then there will be no significant change in incentives due to the proposed amalgamation combining the Osko downstream services with the upstream NPP infrastructure. There can only be a significant change in incentives due to the proposed amalgamation if the Osko services are successful.

48. Oxera states that it understands that “the characteristics of these markets are such that the profits made upstream tend to be smaller in comparison to the profits that could be made in the retail payments markets” (paragraph 2.34). The basis for this understanding is not provided, let alone any evidence in relation to the margins of eftpos, BPAY and the NPP. In any event, even if this were true, it is not sufficient to conclude that the proposed amalgamation would generate incentives to foreclose, because downstream diversion ratios must also be taken into account. As explained above, diversion ratios are likely to be small in most segments.

49. Oxera observes that, even if NewCo were not a profit-maximizing entity, it would still have incentives to foreclose, as it would make use of the additional funds from the foreclosure strategy to fund future investment in NewCo services and offer lower prices for NewCo services (paragraph 2.35). This argument assumes that foreclosure would be profitable (i.e. increase the funds available to NewCo), but this has not been established. In any event, Oxera appears to be raising for consideration whether, even if the proposed amalgamation were to generate incentives to foreclose and result in some foreclosure of third parties, the harm from this might be countered by *benefits* in the form of greater investment in and lower prices for domestic payment services.

50. I do not understand the last sentence in paragraph 2.35. In particular, I do not understand why financial institutions would want to “avoid paying for third party services” if those services provide added value for them. I can only understand financial institutions wanting to “avoid paying for third party services” if those services do not add value for them. I also do not understand why avoiding higher cost services and making use of lower cost services should not be viewed as a public benefit.

---

13 See paragraph 41 above.

51. Paragraph 2.37 concerns the incentives of *financial institutions* rather than incentives of NewCo. It is unclear how the amalgamation "could remove the incentives for banks to invest in solutions designed by third-party providers, when these solutions compete with one of the services offered by NewCo". As explained above,[14] the major financial institutions' ownership interests in the three amalgamating entities will be diluted under the proposed amalgamation compared to the counterfactual, and so if anything they will have *greater* incentives to invest in solutions designed by third-party providers.

3.2.3. Information protocols

52. In relation to the concern raised by Oxera that NPPA could exploit information provided by third parties to direct its own downstream investments, and that the scope for exploiting that information would increase under amalgamation, I am in agreement with Oxera, and consider it important that there be robust information protocols within NewCo to ensure such information transfer does not occur. I am instructed that information provided by third parties to each of the schemes is currently subject to obligations to keep that information confidential and use it only for specified purposes, and that these obligations will continue under NewCo.

4. RESPONSE TO OXERA ON BENEFITS

4.1. Merger-specificity?

53. Oxera asserts that "[c]ollaboration between the entities is possible in the absence of the merger and is therefore not merger-specific" (paragraph 3.8). Oxera goes on to observe BPAY via BeemIt as an example of this, and also the ability of the ACCC to authorise specific, discrete types of collaboration.

54. Certainly collaboration is possible without the merger, and the example of BPAY over BeemIt is an example of this. However, as I explain in Section 10.2 of my report:

    a. By lowering the information barriers that typically exist between separately owned and governed firms, amalgamation is likely to result in additional innovations compared to the counterfactual (including additional hybrids) and innovations that are better targeted to Australian user needs and that differentiate better domestic services from the services of the ICS; and

    b. Amalgamation will remove contractual "hold-up" concerns, which is also likely to open and/or speed up paths to the development of hybrid products.

55. The factual evidence is consistent with this. Both the Blockley report and a number of the factual statements from industry participants reveal an expectation by industry participants and observers that amalgamation is likely to result in more effective collaboration and the development of hybrid products that would not develop, or would not develop as quickly, in the counterfactual.

4.2. Benefits would only arise due to a lessening of competition?

56. Regarding the asserted "reduction in competition" (paragraph 3.7) and the claim that "some of the stated benefits are in fact predicated on a lessening of competition" (paragraph 3.13

---

14 See paragraph 39.

and see also paragraph 3.15), see section 2.4 above, where I explain the important distinction between the contest for adoption of payment initiatives (i.e. the contest to be prioritised by financial institutions that have scarce IT and other resources) and competition in relevant payment service markets. Greater coordination in relation to prioritisation of initiatives of the three entities (including initiatives that will not compete with each other in any relevant service market) will address a market failure, rather than represent a loss of competition in any relevant payment service market. This was explained in detail in Sections 2.1 and 10.1 of my report (see in particular paragraph 299).

57. Oxera conflates these two forms of “competition” without appreciating the distinction, and consequently fails to recognise the market failure. Yes, competition between substitutable services within relevant service markets generally encourages innovation, but a lack of coordination of scarce IT and other resources of institutions that need to adopt innovations in order for those innovations to be successful will discourage innovation.

58. For the same reason, Oxera is incorrect when it states that “’reducing uncertainty’ as a benefit implies that […] information sharing will lead to a reduction in competition, since the uncertainty is around whether the other entities will bring other services forward that will compete with each other’s offering” (paragraph 3.16). As explained in Sections 2.1 (see in particular, paragraphs 18-25) and 10.1 of my report, the uncertainty is around which initiatives each other *financial institution* will prioritise and whether any particular initiative will realise the necessary network effects to be successful. The uncertainty is not around whether the other merging entities will develop competing initiatives.

59. In paragraph 3.17, Oxera repeats its interpretation of the statements of BPAY and eftpos that the merging entities view each other as their “closest competitors” rather than the ICS. As explained above, this is not well-founded.[15] Indeed, given that the ICS represent more than [Confidential to eftpos]% of in-store non-cash retail payments and close to [Confidential to eftpos]% of online payments, and are forecast to continue to dominate these segments for the foreseeable future, I consider it indisputable that *the ICS* represent by far the most significant competitive constraint and spur to innovation for eftpos in the counterfactual.

60. Regarding the issue of scarce resources within financial institutions (paragraph 3.19), while capital constraints are likely to play some part, my understanding is that *scarce IT resources* are the main limiting factor precluding rapid simultaneous adoption of initiatives of the amalgamating entities and leading to the coordination market failures I have discussed in my report (see paragraph 18 of my report, in particular). Those scarce IT resources must first ensure that the financial institutions meet their evolving regulatory compliance requirements, before discretionary developments (including initiatives of the three amalgamating entities) can even be considered. The limited resources that remain for discretionary development must then be rationed by each financial institution, as they are in demand from a much larger number of initiatives than they can simultaneously adopt (not just initiatives of the three amalgamating entities, but also initiatives of other payment schemes including the ICS, and non-payment initiatives).

61. Oxera asserts that “[a]n innovation that fails due to limited customer uptake (i.e. limited network effects) is the result of a poor commercial offer or a more competitive offer available” (paragraph 3.20). This is an incomplete analysis. It overlooks that an innovation

15 See paragraphs 18-19 above.

may also fail due to limited customer uptake as a result of the resource constraints within each financial institution just described, which will result in different financial institutions prioritising different innovations, with the consequence that some innovations will fail to realise the necessary network effects to be successful. A coordinated roadmap for innovations produced within NewCo will address this by ensuring a sequenced development of innovations in domestic payment services simultaneously across all financial institutions.

62. Oxera continues: “[t]herefore, by seeking to protect itself from this threat, NewCo is seeking to protect itself from competitive pressures that would otherwise give each entity the incentives to enhance its offering to increase the chance of success” (paragraph 3.20). My reading of the factual material is that the Applicants (who are by and large the *main customers* of the amalgamating entities, not the entities themselves) are not seeking to protect the amalgamating entities from competition between services in relevant markets, but rather to overcome the investment coordination issues that limit innovation in domestic payment services, for the benefit of themselves as customers of those services, and ultimately also for the benefit of their own customers (including merchants and consumers).