Completed acquisition by Cardtronics plc of DirectCash Payments Inc.

Summary of provisional findings report

Notified: 25 August 2017

Background

1. On 15 May 2017, the Competition and Markets Authority (CMA), in exercise of its duty under section 22(1) of the Enterprise Act 2002 (the Act), referred the completed acquisition by Cardtronics plc (Cardtronics) of DirectCash Payments Inc. (DCP) (the Merger) for further investigation and report by a group of CMA panel members (the Group). Throughout this document, where appropriate, we refer to Cardtronics and DCP collectively as 'the Parties'.

2. In exercise of its duty under section 35(1) of the Act, the CMA must decide:

   (a) whether a relevant merger situation has been created; and

   (b) if so, whether the creation of that situation has resulted, or may be expected to result, in a substantial lessening of competition (SLC) within any market or markets in the United Kingdom (UK) for goods or services.

3. This document, together with its appendices, sets out our provisional findings. The statutory deadline for preparing and publishing our report is 27 October 2017.

Industry background

4. Both Cardtronics and DCP are deployers of automated teller machines (ATMs). Since they are independent from financial institutions such as banks, they are known as independent ATM deployers (IADs).

5. The primary function of ATMs is to dispense cash, although they also may perform a range of other functions, eg maintenance of a customer's bank account, payment of bills, topping up mobile phone credits and making charitable donations.

6. ATMs are either free-to-use (FTU), at which no fee is paid by the user, or pay-to-use (PTU), at which the user is charged a fee to withdraw cash. ATMs may be located inside premises such as a bank or shop (internal ATMs), 'through the wall' (TTW) where they can be used from outside a premises, or in free-standing cash-dispensing kiosks.

7. The owner of a site at which an ATM is installed is the customer of an IAD and this customer generally receives a share of the revenue from the ATM. The cash used in the ATM may be provided, and the ATM filled, by the occupier of the premises (known as 'merchant fill') or by the IAD.

8. Almost every ATM in the UK is connected to the LINK platform, which is an inter-bank payment system that enables banks and building societies (BBSs) to offer their customers access to cash across the whole of the UK. All the UK's main debit and ATM card issuers are LINK members.

9. There are nearly 100 million LINK-enabled cards in circulation. Data from Payments UK indicates that consumers made around 2.1 billion LINK cash withdrawals in 2016, with a value of approximately £129 billion. In that year, 89% of cash machine users withdrew cash from ATMs at least once a month.

10. As at December 2016, there were 70,497 ATMs in use in the UK. 56% of these ATMs were deployed by five major IADs. Of these ATMs, 57% were FTU ATM machines and 43% were PTU machines. In 2015, 98% of cash withdrawals were made from FTU ATMs.

11. Cash remains an important payment method, with a total of around £17.2 billion of cash payments being made in the UK in 2015, equating to 45% of all UK payments. However, payments by debit card have increased fivefold in the past ten years, while contactless payments increased by 26% in the last year. BBSs are developing mobile and online payment channels.

The Parties and their main competitors

12. Cardtronics is a fully integrated IAD, offering all related ATM services (eg maintenance, transaction processing, reporting and settlement). Cardtronics is a UK-listed company with operations in Australia, Canada, Germany, Ireland, Mexico, New Zealand, Poland, Puerto Rico, Spain, the UK and the USA. Cardtronics trades under the brand names Cashzone and Bankmachine in the UK and its UK business is registered under the name of Cardtronics UK Limited. The turnover of Cardtronics in 2016 was around £980 million worldwide and around £[✂] million in the UK.

13. DCP is a Canadian-listed company with operations in Australia, Canada, Mexico, New Zealand and the UK. In the UK, DCP's operations consist primarily of the deployment of ATMs. The bulk of its ATM deployment operations resulted from DCP's acquisition of InfoCash in 2012. DCP trades under the DCP brand name in the UK, although its ATMs are branded DCATM. All marketing is under the name DCPayments. The turnover of DCP in 2016 was around £167 million worldwide and around £27 million in the UK.

The transaction and the relevant merger situation

The transaction

14. On 6 January 2017, Cardtronics acquired the entire issued share capital of DCP.

The rationale for the transaction

15. The Parties told us that the transaction will allow Cardtronics to expand its ATM deployment and related transaction processing business into Australia and New Zealand and increase its presence in Canada and Mexico. The Parties also said that the combination of Cardtronics and DCP will leverage Cardtronics's existing infrastructure and relationships, and drive operating synergies, in particular in Canada and the UK.

Relevant merger situation

16. In respect of the first statutory question that must be decided, we provisionally concluded that a 'relevant merger situation' within the meaning of the Act has been created by the transaction on the basis that the share of supply test is satisfied.

Counterfactual

17. We considered what would have been the competitive situation in the absence of the Merger (the counterfactual). We provisionally concluded that the counterfactual was the continuation of pre-Merger competitive conditions.

Theories of harm

18. Theories of harm describe the possible ways in which an SLC could arise as a result of a merger and provide the framework for the analysis of the competitive effects of a merger.

19. The Parties overlap in:

(a) the supply of ATMs to site owners; and

(b) the supply of ATM services to ATM users/consumers.

20. We considered three theories of harm.

Horizontal unilateral effects in the supply of ATMs to site owners

21. We considered whether a reduction in competition arising from the Merger could allow the merged entity to offer worse contract terms to site owners (eg a lower share of transaction fees and/or lower fixed up-front or monthly payments), to reduce the quality of their offering (eg the maintenance and servicing of ATMs) and/or to reduce innovation.

22. The CMA's phase 1 investigation found that, although the Parties compete, they are not each other's closest competitors and that a sufficient number of competitors would remain post-Merger to constrain the Parties.

23. We therefore indicated in our statement of issues that we were not minded to investigate this theory of harm further, subject to any further evidence submitted. We invited reasoned submissions in relation to the effect of the Merger on the supply of ATMs to site owners. We did not receive any submissions or further evidence. We therefore provisionally concluded that under this theory of harm the Merger has not resulted, and may not be expected to result, in an SLC in relation to the supply of ATMs to site owners.

An increase in interchange fees paid by card issuers

24. We considered whether the Merger could result in higher interchange fees as a result of the Parties having increased bargaining power within the LINK network which might, in turn, lead to an increased commercial strain on the LINK network. In the CMA's phase 1 investigation, the majority of third parties did not foresee the Merger having adverse effects on users of the LINK network.

25. The CMA concluded at phase 1 that there was no realistic prospect of the Merger resulting in a worsening of terms for banks or building societies through an increase in the Parties' ability and/or incentives to negotiate higher interchange fees or inflate the costs that are used as the basis for that negotiation.

26. We therefore indicated in our statement of issues that we were not minded to investigate this theory of harm further, subject to any further evidence

submitted. We invited reasoned submissions in relation to this theory of harm but did not receive any submissions or new evidence. We therefore provisionally concluded that under this theory of harm the Merger has not resulted, and may not be expected to result, in an SLC in relation to interchange fees paid by card issuers.

Horizontal unilateral effects in the supply of ATM services to ATM users on a local basis

27. We examined whether the Merger has resulted, or may be expected to result, in an SLC from unilateral horizontal effects in relation to the supply of ATM services to ATM users on a local basis. In principle, this could occur through:

(a) reduced availability of FTU ATMs through conversion of FTU ATMs into PTU ATMs; and/or

(b) increased surcharge fees on existing PTU ATMs.

28. In relation to the first element of the theory of harm, ie that the Merger has resulted, or may be expected to result, in reduced availability of FTU ATMs through conversion of FTU ATMs into PTU ATMs, the CMA obtained evidence during its phase 1 investigation from third party submissions and interviews with each of Cardtronics's and DCP's business development managers and examined conversion data provided by the Parties. The CMA found in its phase 1 decision that the Parties would have limited ability to convert their FTU ATMs into PTU ATMs at their discretion.

29. In addition, the phase 1 decision found that site owners would be unlikely to agree to such conversion because of the potential reduction in footfall at their sites and that it would be costly, and likely unprofitable, to compensate a site owner sufficiently to agree to a conversion.

30. In our statement of issues, we invited reasoned submissions in relation to the effect of the Merger on the availability of FTU ATMs. We did not receive any submissions or further evidence.

31. We therefore focused our inquiry on the second element of this theory of harm, ie that the Merger has resulted, or may be expected to result, in increased surcharge fees on existing PTU ATMs.

Market definition

32. The purpose of market definition in a merger inquiry is to provide a framework for the analysis of the competitive effects of the merger. The boundaries of the

market do not determine the outcome of the analysis of the competitive effects of the merger.[1]

33. We provisionally concluded that the relevant product market is the supply of ATM services to ATM users. We examined 'out-of-market' constraints (ie alternative methods of cash withdrawal and alternative payment methods) as part of the competitive assessment.

34. In relation to the geographic market, we provisionally concluded, in the light of econometric and survey evidence, that:

(a) the catchment area for a PTU ATM was 100 metres; and

(b) the catchment area for a FTU ATM was 200 metres.

35. We considered whether ATMs at any category of site were 'captive' in that they do not compete with other ATMs. We provisionally concluded that a number of sites were captive and should be excluded from our competitive assessment.

Local analysis to identify areas of potential concern

36. We focused our competitive assessment on the competitive effects of the Merger on surcharges at the Parties' PTU ATMs which were:

(a) not themselves captive; and

(b) within 200 metres of at least one of the other party's non-captive FTU ATMs or within 100 metres of at least one of the other party's non-captive PTU ATMs.

37. We adopted the following filters to identify local areas in which competition concerns were more likely to arise as a result of the Merger:

(a) we removed captive ATMs;

(b) we identified overlaps between the Parties' ATMs and included in the analysis only ATMs inside the applicable geographic catchment areas; and

(c) we filtered out local areas in which, as a result of the Merger, there would be a reduction in fascia count from five to four or more.

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[1] *Merger Assessment Guidelines*, paragraph 5.2.2.

38. After applying those filters, for the remaining local areas we computed critical diversion ratios and expected diversion ratios (using market shares). We excluded areas in which the critical diversion ratios were higher than or equal to the expected diversion ratios.

39. Following the filtering and diversion ratio analysis, 64 ATMs remained. Our provisional view was that any competition concerns were most likely to arise in the local areas of these ATMs.

Competitive assessment of local areas of potential concern

40. We assessed the Parties' ability and incentive to increase surcharges at PTU ATMs as a result of the Merger in the local areas of potential concern.

41. We found differences in the way the Parties' relationships with multi-site owners and independent site owners are managed, including in relation to their contracts, negotiations, relationship management and pricing strategy. We therefore assessed the competitive effects of the Merger separately in relation to ATMs at multi-site and independent site locations.

PTU ATMs at multi-site locations

42. In relation to ATMs at multi-site locations, we found that the Parties' contracts with multi-site owners restricted the Parties' ability unilaterally to increase surcharges at a local level.

43. We also found that the Parties would have very limited incentive to increase surcharges at PTU ATMs which are part of multi-site contracts as surcharges were not set in response to local competitive conditions and the ATMs identified as being of potential concern represented only a very small proportion of the ATMs covered by the contracts concerned.

44. We therefore provisionally concluded that the Merger has not resulted, and may not be expected to result, in an SLC in relation to surcharge fees at existing PTU ATMs at multi-site locations.

PTU ATMs at independent sites

45. We found that the Parties' contracts with independent site owners generally permitted the Parties to increase surcharges unilaterally. The majority of independent site owners that we spoke to told us that they did not play a role in setting the surcharge. However, most site owners told us that they would

oppose a surcharge increase if the Parties proposed to increase the surcharge at their ATM but not also at nearby ATMs.

46. We found limited evidence that a site owner would be likely to switch off an ATM or refuse to re-fill an ATM as a result of a surcharge dispute. However, site owners nearing the end of their contracts or in a rollover period may be able to use the threat of switching to negotiate with the Parties following any proposal by the Parties to increase the surcharge.

47. We therefore provisionally concluded that the Parties may have some ability to increase surcharges at PTU ATMs at independent sites.

48. We considered the Parties' incentive to increase surcharges at PTU ATMs at independent sites as a result of the Merger:

(a) We found that there was limited competition between the Parties' PTU ATMs pre-Merger. The consumer survey found that few customers who used a PTU ATM would switch to another PTU ATM if the ATM they had used was not available, and this was supported by some evidence from the internal documents of one party.

(b) We considered the Parties' pricing strategies and found that surcharges at PTU ATMs are not regularly adjusted. Where surcharges have been adjusted, this has not been in response to changes in local competitive conditions.

(c) We found that footfall and the spending of cash withdrawn from an ATM on-site are key reasons for site owners to have an ATM at their premises. A lower proportion of site owners told us that gaining revenue from an ATM was the most important reason for having an ATM. The majority of site owners told us that they would oppose a surcharge increase proposed by the Parties. In this regard, we note that the Parties had, in many instances, either reversed or not implemented proposed surcharge increases. This was likely to be, in part, because of the importance of maintaining relationships with site owners and a good reputation in the market.

(d) We considered whether the Parties might change their pricing strategy post-Merger by increasing surcharges at PTU ATMs in those local areas identified by filtering and diversion ratio analysis as being of potential concern. We found that the potential gain in revenue from such a strategy was very limited and that it would entail a risk of substantial loss of revenue. Accordingly, we concluded that the Parties were unlikely to pursue such a strategy.

(e) We found that the increasing use of alternative payment methods and the consequent decline in PTU ATMs may further limit the Parties' incentives to increase surcharges at PTU ATMs as a result of the Merger.

49. We provisionally concluded that the Parties would have very limited incentives to increase surcharges at PTU ATMs at independent site locations as a result of the Merger.

50. We therefore provisionally concluded that the Merger has not resulted, and may not be expected to result, in an SLC in relation to surcharge fees at existing PTU ATMs at independent sites.

Provisional conclusion

51. As a result of our assessment, we provisionally concluded that:

(a) the acquisition by Cardtronics of DCP has created a relevant merger situation; and

(b) the creation of that situation has not resulted, and may not be expected to result, in an SLC in any of the markets considered in this inquiry.