

PAYPAL / IZETTLE

RESPONSE TO PROVISIONAL FINDINGS

This is PayPal's response to the CMA's Provisional Findings of 30 April 2019 (the **Provisional Findings**) in respect of the completed acquisition of iZettle by PayPal (the **Merger**).¹

1 Executive summary

- 1.1 PayPal welcomes the overall conclusions set out in the Provisional Findings that the Merger will not result in a substantial lessening of competition in the UK. Indeed, as the Provisional Findings demonstrate, the Merger is pro-competitive, allowing the combined entity to better serve the existing and emerging payment needs of small businesses in the UK and around the world, in particular by accelerating the development of omni-channel services that neither party would have been able to offer as quickly or as effectively alone.
- 1.2 The CMA's engagement with and willingness to acknowledge the dynamic and nascent markets in which the Parties operate is appreciated. In particular, PayPal welcomes the development of the CMA's thinking in a number of areas since the Phase 1 Decision:
- (a) the recognition of the increasing convergence of POS and mPOS devices and services, accepting the competitive constraint that each pose on the other and the increasingly blurred distinction between the two;
 - (b) the use of non-traditional market assessment techniques when investigating this dynamic market – recognising that tools that work for more static markets are not appropriate in this context, and that other measures are a more accurate way of assessing competition and identifying the strength of constraint that is imposed by competitors that can expand rapidly; and
 - (c) the recognition of the difficulties involved in assessing the nascent and wide-ranging omni-channel market, despite which the CMA has reached what we believe to be a sensible conclusion in the Provisional Findings.
- 1.3 There are a few aspects of the Provisional Findings that PayPal wishes to address in further detail. The body of this response:
- (a) welcomes the overall finding in respect of the counterfactual but queries some of the more detailed conclusions identified by the CMA in its counterfactual assessment (**Section 2**);
 - (b) encourages the CMA to ensure that its decision fully acknowledges the fast-moving and dynamic market, as evidenced by existing and pipeline technological developments in this area (**Section 3**);
 - (c) reiterates the important context that should be taken into account when analysing PayPal's internal documents (**Section 4**); and
 - (d) discusses certain specific technical methodological points of law and economics arising from the Provisional Findings (**Annex**).

¹ The response does not seek to address every point raised in the Provisional Findings but instead focusses on key points of factual or methodological disagreement.

2 Counterfactual

- 2.1 PayPal welcomes the CMA's provisional conclusion that there are limitations to what PayPal could have done to incrementally improve its offline payment offering in the short term. PayPal has continued to believe throughout the investigation that the most likely counterfactual is the continuation of pre-Merger conditions of competition.
- 2.2 Notwithstanding PayPal's general agreement with the CMA's conclusion, we set out below some clarifications regarding the likely competitive impact of any incremental improvements made to PayPal Here in the UK and regarding PayPal's submissions during the course of the investigation.

Incremental improvements to PayPal Here

- 2.3 Given the acknowledged [redacted], PayPal believes that it would have been impossible for the PayPal Here product to be improved materially in the short term (measured in years rather than months).
- 2.4 If PayPal could easily have made incremental improvements to PayPal Here to make it a materially more competitive product, it would already have done so. The Provisional Findings give the example of changes to pricing: as explained previously,² any change to pricing would only have a positive impact if [redacted].
- 2.5 As a result, PayPal believes that PayPal Here's relative decline would have continued for a material period of time absent the Merger – after which any subsequent strengthening by virtue of limited and minor changes would have been unlikely to fully stem PayPal Here's decline and would not have had any material competitive impact. This is more pertinent in light of the fast-moving, dynamic market in which PayPal Here competes, where other competitors would have continued to innovate and improve.

PayPal's submissions regarding the counterfactual

- 2.6 The Provisional Findings state that "*the Parties' submissions on the counterfactual changed throughout the course of our investigation*".³ PayPal is concerned that the CMA has received this impression, which was not PayPal's intention. In fact, PayPal believes that closer examination of its submissions on the counterfactual will show that these have been consistent. Throughout the investigation, PayPal's primary submission has been that the "most likely" counterfactual to the Merger is that PayPal Here would have continued its relative decline in the UK (i.e. the continuation of the pre-Merger conditions).
- 2.7 As the investigation progressed, it became clear that the CMA was minded to adopt an alternative counterfactual that was dynamic and global – i.e. more competitive than the pre-Merger conditions. Given the importance of the counterfactual to the CMA's assessment of the competitive effects of the Merger, PayPal considered it necessary to also engage with the question of the relative likelihood of PayPal pursuing alternative options.
- 2.8 For that reason, in later submissions (and after the main document requests and reviews), PayPal expanded its commentary to maintain its primary submission, but against that backdrop also engage in the CMA's exploration of a dynamic counterfactual. For the CMA's ease of reference, and because we think it is important to consider PayPal's submissions on this point in full, we set out below the relevant summary from PayPal's response to the Counterfactual Working Paper (emphasis added):

[redacted]

² PayPal's response to the TOH 1 Working Paper, Annex 1 – pricing structure, paragraph 3.8.

³ Provisional Findings, paragraph 7.5.

- (a) [REDACTED].
- (b) [REDACTED].
- (c) [REDACTED].
- (d) [REDACTED].

- 2.9 We believe that PayPal's submissions have been consistent: that the most likely outcome absent the Merger would have been a continuation of the status quo. These submissions also deal with the situation if the CMA were to disagree with PayPal's submission and find a dynamic counterfactual, and it is only in that context that they consider that the only "plausible" or "credible" alternative (not the "most likely") would have been the acquisition of [REDACTED].
- 2.10 The Provisional Findings also suggest that PayPal's position had changed in that it submitted that it had dismissed alternative [REDACTED].⁵ To clarify, the two positions are not mutually exclusive and are not inconsistent – they describe what happened [REDACTED]. The implications that this has for the counterfactual were explained consistently throughout.

⁴ Paragraphs 2.1(a)-(d) of PayPal's response to the counterfactual working paper, submitted on 28 March 2019.

⁵ Provisional Findings, paragraph 15.

Conclusion on counterfactual

- 2.11 In summary, PayPal agrees that there is uncertainty regarding what would have happened in the foreseeable future absent the Merger, however its ability to make any incremental improvements in that period would have been very limited. It is also unclear what any such improvements might have looked like. For the reasons stated above and in prior submissions, in the context of a dynamic, fast-moving market, any incremental improvements would be unlikely to have had any material impact on the status of competition in the market, meaning the most likely outcome in the absence of the Merger would have been that PayPal Here continued its relative decline.

3 Technological developments

- 3.1 PayPal welcomes the CMA's recognition of the highly competitive, dynamic markets in which the Parties' offline payments services operate now and in the near future. However PayPal considers that the Provisional Findings do not yet fully acknowledge the significant dynamism and upcoming changes in payment services, particularly as regards placing sufficient weight in its analysis on the impact of new technology and the breadth of competition in the market.

New technologies

- 3.2 Some aspects of the Provisional Findings, in contrast to the general acknowledgement of dynamism, take a static view and appear sceptical in assessing the likely disruptive effect of technological and market developments. PayPal understands that, in dynamic markets, the precise details of certain longer term developments are unpredictable, but believes more weight should be placed on the likely effects of current and upcoming developments which are already visible.
- 3.3 For example, while the Provisional Findings correctly note that non-card payments are yet to be adopted at scale in the merchant-consumer relationship, they are already highly relevant for service businesses. In these areas, in-app payments clearly compete directly with offline payment services;⁶ the obvious alternative to in-app payments used in platform apps in Uber, Deliveroo or Just Eat would be payment in person – either with cash (as with more traditional- model taxis or food delivery) or with payment via an offline payments device carried by the driver.
- 3.4 Developments in payment services are frequent and significant; for example in the last couple of weeks Sainsbury's has announced a cashless and cardless trial – instead paying by app – in one of its stores⁷ and Facebook has announced its intention to expand its Indian pilot of payments via WhatsApp into other countries, basing this expansion in the UK.⁸
- 3.5 PayPal believes that it is inevitable that these developments, as well as the entry of new offline card payment technologies (such as PIN on mobile and tap on glass) will have not only a material effect on entry into mPOS provision, but also a material effect on competitive dynamics. For example, to the extent that a POS provider is considering whether to adopt a “pay as you go” flexible pricing model today, the development of PIN on mobile and tap on glass technologies – which do not require any upfront investment in devices by the payment services provider – will encourage them to do so.

Acknowledgement of the role of other mPOS and POS providers

- 3.6 PayPal welcomes the CMA's conclusion that mPOS and POS devices are direct competitors that significantly constrain one another. In line with its prior submissions,⁹ however, PayPal believes that the convergence of POS and mPOS devices is more pronounced than is currently acknowledged in the Provisional Findings.

⁶ Provisional Findings, paragraph 6.44.

⁷ <https://www.ft.com/content/cda260b0-6c0e-11e9-80c7-60ee53e6681d>.

⁸ <https://www.ft.com/content/e371a120-6dc7-11e9-80c7-60ee53e6681d>.

⁹ See for example PayPal's response to the Issues Statement, paragraphs 2.1 - 2.6.

3.7 PayPal believes that more weight could be placed on the real competitive constraint posed by POS providers such as Barclaycard and Worldpay. The Provisional Findings appear to treat these other mPOS providers differently to PayPal Here. For example, it is acknowledged that both WorldPay¹⁰ and Barclaycard¹¹ have concrete plans to improve their offering for smaller merchants, but the conclusion is that these plans are not sufficiently advanced so as to be considered likely to provide a sufficient competitive constraint on the merged entity. This appears inconsistent with the CMA's more optimistic assessment of how PayPal Here might have developed absent the Merger, faced with the same incentives, and also at odds with recent market developments, such as Barclaycard's significant price cut for mPOS services and the relaunch of the Worldpay mPOS offering.

4 Treatment of internal documents

4.1 As noted in prior submissions,¹² PayPal believes that some important context is missing from the assessment of its internal documents in the Provisional Findings which could affect the CMA's interpretation of, and the weight it places on, those documents.

4.2 This is particularly the case for draft documents and internal discussions that did not make it to the decision-making levels of the business. For example, [redacted]. As such, the documents (draft or final) produced by regional or product teams should not be interpreted as reflecting the overall corporate view of PayPal.

4.3 PayPal's internal documents also discuss, in places, [redacted] that are very specific in scope (e.g. relevant only to PayPal in certain non-UK countries). PayPal welcomes the recognition of this point in certain parts of its Provisional Findings, however cautions that documents should not be interpreted as having wider implications than those indicated in the context of the document.

4.4 In addition, at times the Provisional Findings appear to place weight on certain specific points set out in internal documents, while dismissing other aspects of the same document that PayPal believes are equally relevant to the issues that the CMA is considering. PayPal believes that the context in which each document was created, and the full content contained within each document, should be considered in the round in order to attribute the right amount of weight to each document.

4.5 In terms of more detailed examples of this high-level concern, PayPal would ask the CMA to reconsider its prior submissions and the detailed commentary on a document-by-document basis that was provided in the put back process.

5 Conclusion

5.1 PayPal welcomes the overall conclusion expressed in the Provisional Findings and, assuming these Findings are confirmed, looks forward to starting to deliver the benefits to UK merchants that this merger will enable.

5.2 PayPal appreciates the CMA's willingness during its review to acknowledge that this market is dynamic and to consider new methods of assessing competition in that context.

¹⁰ Provisional Findings, paragraph 8.174.

¹¹ Provisional Findings, paragraph 8.182.

¹² See PayPal's prior written and oral submissions, in particular PayPal's response to the PayPal Here Strategy Documents working paper, the covering letter accompanying PayPal's response to putbacks 1 – 11; and PayPal's comments on putbacks 4 and 5. These should be read in conjunction with this response.

¹³ PayPal's response to the PayPal Here Strategy Documents working paper, paragraph 1.1(b).

ANNEX

TECHNICAL POINTS

This Annex sets out PayPal's more technical comments on the CMA's Provisional Findings and is intended as a supplement to the main submissions made in the response above.

1 Updated framework for analysing technology mergers

- 1.1 PayPal appreciates that the assessment of technology mergers, particularly in highly dynamic markets, can present challenges and require use of a wide range of existing tools for assessment, which need to be applied in a flexible way depending on the individual circumstances of the case. There is much to be welcomed in the CMA's developing approach to analysing technology mergers, as shown in the analysis in this case:
- (a) recognition that traditional measures of market shares and diversion ratios, such as they provide historic, static snapshots, are uninformative in a fast-moving and dynamic market such as payments; and
 - (b) preference for – and willingness to accept – evidence on market dynamics to best understand the trajectory of this type of market, taking into account more novel but more accurate (in this context) dynamic evidence such as app download information and switching costs.
- 1.2 However, we do wish to raise some points of caution. While it is important for the CMA to be able to take a flexible approach depending on the facts of each case, it is also necessary to ensure sufficient predictability for merging parties as to how the regime will operate going forwards, and the factors that the CMA will consider in each case. This is a balance that will need to be maintained in future cases, in particular:
- (a) We would be concerned were the CMA to rely too heavily on the case law cited in paragraph 5.10 of the Provisional Findings to justify its general approach to assessment of dynamic competition and counterfactuals. These cases are only support for the CMA not having to elaborate with undue specificity how a particular theory of harm (properly identified and evidenced) may arise in the future. They should not be used to justify a less rigorous approach to assessing competition and the correct counterfactual against which to assess the impact of a merger.
 - (b) As explained in the main body of PayPal's response to the Provisional Findings, when examining internal documents to guide its assessment of competition and the counterfactual, the CMA should take into consideration all aspects of the context in which each internal document is produced, to ensure that it places appropriate weight on internal documents within its analysis.

2 Counterfactual

Application of the legal test

- 2.1 In the introduction to the counterfactual section of the Provisional Findings¹⁴ it is stated that, in line with the Merger Assessment guidelines,¹⁵ where there is more than one possible alternative scenario to the merger, the situation most likely to have existed absent the merger will be selected. Guidance is also referred to that states that it is not generally necessary to make finely balanced judgements about what is and is not in the counterfactual.
- 2.2 While PayPal agrees with these statements, there is a risk that the approach taken in the Provisional Findings goes beyond this.

¹⁴ Provisional Findings, paragraph 7.2.

¹⁵ CC2 Revised, paragraph 4.3.6.

- 2.3 In considering alternative acquisitions, the Provisional Findings note that the CMA's practice is "*not to consider possible counterfactual scenarios that are likely to result in a reference to a phase 2 investigation*".¹⁶ However, this is the CMA's practice when the parties to a merger are arguing that the counterfactual should be something other than the status quo. The practice is used to demonstrate that, as a result of the risk of a phase 2 reference and the uncertainty this introduces, when compared to adoption of the status quo, such a counterfactual cannot be considered "the most likely".
- 2.4 PayPal does not therefore agree that this practice can be applied in the very different circumstances that arise in this case. Here, the CMA is still considering whether the counterfactual should be the status quo or a dynamic one. In doing so, it must decide on what the appropriate dynamic counterfactual is to compare. If the CMA considers that the most likely course of action, absent the merger, is that the acquirer seeks to acquire a different target that might result in a reference to phase 2, to be consistent with its practice to date, the conclusion should be that the most likely counterfactual is therefore the status quo as any other scenario is too uncertain to materialise in the short term – particularly where the alternative transactions were never taken forward. It is not in accordance with the appropriate legal test for the CMA to dismiss a dynamic counterfactual and then adopt an even less likely dynamic counterfactual as being "the most likely".
- 2.5 This is even more the case when the dynamic counterfactual options considered in the Provisional Findings are so unspecific and uncertain. For example:
- (a) [redacted];
 - (b) it is not clear whether some alternative acquisitions would themselves have faced possible in-depth competition investigations;
 - (c) it is not clear what [redacted] any alternative acquisitions – given the competing demands [redacted] within PayPal, conclusions cannot be drawn simply by referring to [redacted]; and
 - (d) it is not clear whether any particular option considered by the CMA would result in positive competitive effects in the UK, particularly given [redacted] and the dynamic nature of competition.
- 2.6 We believe that, even when considering a dynamic counterfactual (perhaps even more so, given the strong presumption towards the pre-merger conditions of competition in the CMA's guidance), the burden of proof remains on the CMA to prove on the balance of probabilities, on the basis of available evidence and with adequate reasoning, that a supra-competitive counterfactual would have been the most likely outcome absent a merger.

3 Economic analysis

- 3.1 In this section we set out additional comments regarding parts of the economic assessment set out in the Provisional Findings.

Customer segmentation and price discrimination

- 3.2 For the reasons we have previously explained,¹⁷ while PayPal agrees with the concept of smaller merchants as a whole, PayPal does not recognise a small/micro/nano level of sub-segmentation, which oversimplifies the wide range of choice factors taken into account by merchants of all such sizes.

¹⁶ Provisional Findings, paragraph 7.35.

¹⁷ PayPal's response to the TOH1 working paper, paragraphs 1.3(a) and 2.4.

- 3.3 Relatedly, the Provisional Findings overstate the ease with which the Parties would be able to price discriminate, particularly as regards any price discrimination targeted at smaller merchants. The examples of price discrimination referred to in the Provisional Findings are all targeted at merchants with larger volumes (in particular, of those iZettle users that have joined since the introduction of iZettle's flat pricing in 2017, [§<] were on a rate other than the standard rate). As such, the cited price discrimination does not impact smaller merchants and cannot be used to justify a market segmentation such as that applied in the Provisional Findings. Indeed, the Provisional Findings also presents new evidence on the importance of flat pricing, such as Square's study finding that merchants wanted a single, flat and consistent transaction price.¹⁸

Email matching analysis

- 3.1 While we welcome the CMA's willingness to engage with novel evidence bases (such as the app download data), PayPal is concerned by the dismissal in the Provisional Findings of the email matching analysis submitted by the Parties in response to the CMA's working papers.
- 3.2 In particular, certain elements of PayPal's dataset and analysis appear to have been disregarded:
- (a) The Provisional Findings suggest that the customer switching rate from PayPal's churn survey is not comparable to the broader pool of the Parties' customers who become inactive (and should not therefore be used),¹⁹ yet the conclusions from the CMA's survey are used to draw inferences about the broader pool of the Parties' customers. PayPal appreciates the difficulties of using data from different sources,²⁰ but submits that the a consistent level of caution should be applied when extrapolating any survey results to a wider population.
 - (b) The Provisional Findings conclude that total switching is likely to be overstated if it is assumed that those customers who are inactive by the end of the dataset have churned, suggesting that customers who did not make a transaction just in the last month of the dataset would be considered as having churned.²¹ We consider this concern to be misplaced – in line with our stated methodology,²² a customer would only be considered to have churned if it had been inactive for at least 12 months.
 - (c) The hypothesis that PayPal customers may be more likely to use personal accounts, and iZettle customers may be more likely to use business accounts,²³ is not borne out in the data which shows [§<]% of users on each platform use consumer email providers such as Gmail and Hotmail.
 - (d) The Provisional Findings query whether a switching event should be defined – per the Parties' submissions – as inactivity in a three-month period, given that seasonal customers may go a longer period between transactions.²⁴ This disregards the transactional data which shows that most of the Parties' customers will [§<].

¹⁸ Provisional Findings, Appendix G, paragraphs 17-18.

¹⁹ Provisional Findings, Appendix F, paragraphs 67-68

²⁰ In this regard, PayPal conducted sensitivity checks which indicate, for any concern to arise, we must assume that less than [§<] of churners switch to another supplier (which is unrealistically low, given the CMA's survey suggests that [§<] of customers no longer using the Parties switched to another supplier).

²¹ Provisional Findings, Appendix F, paragraph 69(a).

²² PayPal's response to the TOH1 working paper, Annex 2 – survey and diversion analysis, Appendix A; the dataset spans from [§<] to [§<], but the data was only used to identify churners in [§<] and [§<].

²³ Provisional Findings, Appendix F, paragraph 69(b).

²⁴ Provisional Findings, Appendix F, paragraph 69(c).