
Anticipated merger between LINK Interchange Network Limited and Voca Limited

The OFT's decision on reference under section 33(1) given on 3 May 2007. Full text of decision published 11 May 2007.

Please note that square brackets indicate figures or text which have been deleted or replaced with a range at the request of the parties for reasons of commercial confidentiality.

PARTIES

1. **LINK Interchange Network Limited** (LINK) is a private company limited by shares and is wholly owned by 22 banks and building societies. LINK's main activity is the provision of ATM switching services to members of the LINK ATM Scheme¹, just under half of which are also shareholders in LINK. LINK's total UK turnover for the year ended 30 June 2006 was £38.5 million.
2. **Voca Limited** (Voca) is a private company limited by shares and is wholly owned by 13 banks and building societies.² Voca's principal activity is to provide electronic payment processing services for the BACS payments scheme - that is, the processing and clearing of inter-account payments and processing of direct debits, direct credits and standing orders. Voca's total UK turnover for the year ended 30 November 2006 was £89 million.

TRANSACTION

3. LINK and Voca have agreed to combine the two companies in a merger of equals pursuant to a Memorandum of Understanding [Note 1]. Upon completion of the merger, LINK and Voca will come under common control

¹ []

² All of whom are also shareholders of LINK.

by virtue of becoming wholly owned subsidiaries of a newly established UK holding company, 'VocaLINK'. It is likely that most of the existing shareholders in LINK and Voca will become shareholders in VocaLINK.

4. The parties notified the OFT of the proposed merger on 6 March 2007. The OFT's administrative deadline is 3 May 2007.

JURISDICTION

5. As a result of the transaction, LINK and Voca will cease to be distinct for the purposes of section 26 of the Enterprise Act 2002 (the Act).
6. The parties overlap in the supply of payment processing and clearing services for electronic payment transactions in the UK, for which their combined share of supply exceeds 25 per cent. The share of supply test in section 23(2)(b) of the Act is met. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

BACKGROUND

Relationship between LINK and LINK ATM Scheme

7. LINK operates the LINK cash machine (ATM) network, connecting over 59,000 cash machines in the UK. Approximately 64 per cent of all cash withdrawals in the UK are processed under the auspices of the LINK ATM Scheme.
8. The LINK ATM Scheme is an unincorporated association, established by a body of rules to which its members adhere. Although not legally separate from LINK, there are distinct governing bodies for each entity. The rules of the LINK ATM Scheme allow members (either individually or as a sub-group) to use an alternative processing provider to LINK.³ Members of the LINK ATM Scheme may also individually or in groups decide to leave the LINK ATM Scheme with a minimum of [] notice.

³ Allowing the routing of any transactions involving other members through a different processor over the LINK switch. For example, some members currently use Transaction Network Services (UK) Limited (TNS) in this way.

9. LINK and members of the LINK ATM Scheme have entered into a Service Level Agreement, which ensures that LINK is contractually committed to providing switching and settlement services to agreed service standards and a 'rate card' sets out the agreed tariffs that members are required to pay for the services provided.

Relationship between BPSL and Voca

10. Following publication of a report for HM Treasury on Competition in UK Banking in 2000 (the Cruickshank Report)⁴, the system relating to the automated clearing and settlement of inter-account payments (the BACS payment system) was restructured so that the scheme administrator BACS Payment Schemes Limited, (BPSL) became a separate legal entity from the infrastructure operator Voca, (then called BACS Limited) [Note 2].
11. BPSL is a membership-based company limited by guarantee that administers the BACS Scheme. Voca is currently under contract to supply BPSL with automated clearing and processing services required for the BACS Direct Credit and Direct Debit schemes operated by BPSL.⁵

FRAME OF REFERENCE

12. The OFT considered whether LINK and Voca compete in the provision of their core services: the clearing and processing of ATM transactions and the clearing and processing of inter-account payments respectively. The parties claim that the only area in which their activities overlap is in relation to mobile phone top-up services.

Product scope

13. The OFT considered each of the services provided by LINK⁶ and Voca⁷ in detail. From a demand perspective, evidence obtained from the parties and third parties makes clear that services offered by LINK and Voca are not

⁴ Competition in UK Banking: A Report to the Chancellor of the Exchequer, 20 March 2000.

⁵ The contract can be terminated on [] months' notice; the earliest point at which such notice can be served is [].

⁶ Including clearing and processing of ATM transactions, various payment processing solutions and other services provided by LINK.

⁷ Including clearing and processing services, back office payment processing and other services provided by Voca.

substitutes for final consumers⁸ or upstream customers (who are scheme members and mostly banks or building societies).

14. From a supply perspective, evidence obtained by the OFT was mixed. Although the services provided by LINK and Voca have similarities in that both entail the clearing and settlement of transactions between banking customers, the parties submitted that the differences between processing these two types of payment are fundamental, with processing of ATM transactions utilising real-time processing capability and processing of inter-account transfers (such as BACS payments) based on batch processing technology. Evidence from third parties and international comparisons suggest that such a distinction may be largely artificial and attributable to the particular development of payment systems in the UK.
15. Moreover, the implementation of the Faster Payments Service⁹ in 2007 is designed to enable certain types of inter-account payment to be cleared on a (near) real-time basis. In addition, third party evidence obtained by the OFT revealed a trend in preferences towards a single supplier to meet all payment processing needs.
16. In the OFT's exemption decision on the LINK Interchange Network in 2001,¹⁰ the OFT found the relevant frame of reference to be the provision of switching, transmission transaction and clearing network functionality for ATM services. In the OFT's decision on the LINK-TNS joint venture¹¹ three separate frames of reference were defined – card issuing services, ATM acquirer services and gateway services (access for card issuers to alternative payment system networks) - with potentially even narrower individual frames of reference based on the individual overlaps between the two operators.
17. In this case, however, it is not necessary to conclude on the precise scope of the product frame of reference in relation to payment processing services, as the degree of overlap between ownership of the parties and membership of the schemes they serve seems likely to preclude the

⁸ However there may be limited substitution by customers between the downstream products offered by banks that derive from the services offered by Voca and LINK.

⁹ See OFT Payment Systems Task Force's BPSL Innovation Working Group report, May 2005. Available via www.ofg.gov.uk/news/press/2006/93-06.

¹⁰ OFT decision on LINK Interchange Network, 16 October 2001 (Case CP/0642/00/S).

¹¹ OFT decision on anticipated joint venture between LINK Interchange Network Limited and Transaction Network Services (UK) Limited, 27 January 2005.

possibility of competitive harm being exercised as a result of the merger, which is explored further below.

18. In this case, it is not necessary to conclude on the precise scope of the product frame of reference in relation to mobile phone top-up services in light of the smaller increment in shares of supply as explained in the competitive assessment below.

Geographic scope

19. In previous cases, the OFT and the European Commission have considered the relevant frame of reference to be national in scope.¹² Neither of the parties currently offer payment processing services outside the UK, although both have made efforts to expand their product offerings to other European countries.
20. Recent cross-border consolidation activity suggests that the relevant geographic scope may extend beyond a single country.¹³ However, this may be true for countries already in the Euro - and therefore more heavily impacted by arrangements for the Single Euro Payments Area (SEPA)¹⁴ - and not for the UK. Therefore, the OFT has adopted a cautious approach in this case and considered the relevant frame of reference to cover the UK only.

HORIZONTAL ISSUES

21. Although the parties cannot be considered competitors in terms of their core payment processing services, both LINK and Voca hold a strong competitive position in relation to the payment clearing, settlement and authorisation services provided to the LINK ATM Scheme and BPSL schemes respectively.

¹² OFT decision on LINK Interchange Network, 16 October 2001 (Case CP/0642/00/S); OFT decision on the anticipated joint venture between LINK Interchange Network Limited and Transaction Network Services (UK) Limited, 27 January 2005; ATOS Origin/Banksy/BCC (COMP/M.4316); and Nordbanken/Postgirot (COMP/M.2567).

¹³ Including mergers between Interpay-Transaktionsinstitut [Netherlands-Germany] and SSB-GIRO Bankcard [Italy-Hungary].

¹⁴ SEPA involves the phasing out of national payment instruments and infrastructures in two phases such that by 2010 the standards for clearing all retail payments across the Euro area will be the same.

22. Indeed, it was highlighted in the Cruickshank report that the nature of payment systems means that the supply structure for providers of infrastructure services tends towards a natural monopoly, with a single processor serving the vast majority (if not all) customers.¹⁵
23. The OFT considered whether any horizontal theories of harm might arise in relation to the merger of LINK and Voca.

LINK

24. The parties submitted that LINK currently authorises and clears all but around two per cent of ATM transactions that take place under the auspices of the LINK ATM Scheme, with TNS the only other provider of such services currently used by scheme members. As set out above, the LINK ATM Scheme rules allow for members to use alternative processors for their ATM transactions and some already do so, using both Visa and Mastercard's network for some or all of their ATM transactions.
25. Although the parties submitted that LINK faces competition from other operators this was not corroborated by the OFT's investigation. Some third parties have expanded service offerings in this area but not such as to amount to a sizeable competitive constraint on the parties.
26. As Voca is not currently active in the provision of payment processing services for ATM transactions, the merger does not result in any horizontal overlap such that the current situation is altered. The OFT considered that any theoretical price increase by LINK would not likely be approved by members of the LINK ATM Scheme (who are also the bank and building society customers of LINK) as this would effectively be agreeing to an increase in costs to themselves. As payment processing services are a cost which banks and building societies are currently unable to pass on directly to most banking customers, they have an incentive to minimise these costs as much as possible. Finally, a degradation in service quality is also unlikely due to the Service Level Agreement LINK currently has with the LINK ATM Scheme.

¹⁵ Chapter 3, Competition in UK Banking: A Report to the Chancellor of the Exchequer, 20 March 2000.

27. The OFT also considered whether those members of the LINK ATM Scheme that are not also owners of LINK might suffer a potentially harmful increase in price or worsening of service if they could be identified and discriminated against on either a collective or individual basis; degradation in service quality is unlikely to occur due to the presence of a Service Level Agreement with the LINK ATM Scheme. The setting of switching fees through the negotiation of a 'rate card' common to all members also means that price increases to these customers are unlikely. Even if this were not the case, the parties have provided evidence that a number of smaller members can combine their transactions to achieve a higher volume band and therefore lower switching fees.
28. The OFT also considered the extent to which the parties might potentially compete with one another absent the merger. However, the degree of overlap between ownership of each of the parties is likely to minimise the possibility of any potential competition between them.

Voca

29. Voca is the sole provider of services to BPSL and the parties claim that it is currently the only supplier in the UK that offers such services. [] it is also possible for BPSL members to use alternative processors. However, no member currently exercises this right and a number of third parties told the OFT that they would not switch suppliers, even if prices were to rise. The parties submitted that they expect the number of credible alternative suppliers to increase following the introduction of the European Commission's Single Euro Payments Area (SEPA) initiative in 2010. However the OFT received no evidence to confirm that international competitors were likely to enter in the foreseeable future. Indeed, a number of third party responses suggested that the UK payments market would remain more closed than other European countries, even following full SEPA implementation.
30. The OFT considered whether Voca might increase its price or decrease service levels with BPSL through its annual contract discussions. However, once again the extent of overlaps between ownership of Voca and membership of BPSL (only two of BPSL's 15 members are not also owners of Voca) mitigates any concerns in this area.

31. Finally, the position of smaller members, that are likely to access Voca's services indirectly through a BPSL member, is not altered by the merger as there is no change in the incentive for banks and building societies whether to discriminate against them or not.

Conclusions

32. Overall, the OFT believes that since LINK is not currently active in the supply of clearing and processing of inter-account payments and Voca is not currently active in the provision of payment processing services for ATM transactions, the merger is unlikely to change the current situation or lead to competitive harm.
33. The extent to which the parties might potentially compete with one another is already dampened by the degree of overlap between ownership of the parties and this, combined with the overlap in membership of the schemes they serve, also precludes the possibility of competitive harm resulting from the merger.

Mobile phone top-up services

34. The parties overlap in the provision of mobile phone top-up services. The parties submitted that their combined share of supply based on value is only [zero to ten] per cent. The parties identified numerous other providers with much higher shares of supply and gave an indication of relatively low start-up costs and low barriers to entry. Given the low shares of supply in this developing market the OFT believes that it is unlikely any competition concerns will arise in this regard.

Barriers to entry and expansion

35. Given the specific technical nature of the services provided by the parties and the importance of scale in building a successful payment network, entry by an entirely new supplier of payment processing services in the UK is unlikely in the foreseeable future. Therefore, the most likely constraint from potential competitors is determined by barriers to expansion for existing providers of payment processing services, either in the UK or abroad.

36. Technical specifications for the processing of payment products unique to the UK might represent a barrier to entry for European processors, as might scale or access costs. Estimates from the parties and third parties varied widely on entry costs.
37. Third parties submitted that difficulties in entry would arise mainly from the number of different domestic payment products available in the UK and the perceived low likelihood of compliance with international payment standards, such as SEPA. Third parties also commented that access to infrastructure was a potential issue, with the defensive attitude of UK providers an added complication. However, the parties did provide evidence of increasing standardisation in ATM processing across Europe through the Berlin Group¹⁶ and BPSL informed the OFT that it intended to achieve greater alignment with SEPA scheme features.
38. Some third parties raised concerns that future barriers to entry might arise from the ability of the merged entity to increase the amount of business won through a wider product offering, leading to increased scale and lower prices, which may help it to undercut other suppliers. However, it is unlikely that barriers to entry into the UK payments market for European processors will be raised as a result of the merger, since the merged entity does not gain any benefits of scale immediately.
39. One third party raised concerns in relation to potential barriers to entry arising through cross-subsidisation of the merged entity between the two processing companies that might be used to combat entry in a particular market. To the extent that this might be possible, the retail banks (as both customers and owners of the processors and members of the schemes) would predominantly be interested in reducing costs of payment processing services as much as possible and would therefore be unlikely to engage in such a practice. Cross-subsidisation in this context could reduce profits/raise prices (and hence costs) for processing another type of payment.
40. Although it is likely that banks would seek the lowest cost supplier for their payment processing services, some third party responses indicated a lack of willingness to switch away from LINK and Voca. However, despite the

¹⁶ The Berlin Group (of which LINK is a member) is working towards agreement for a set of non-proprietary message standards to support the authorisation and clearing of card-based financial transactions.

fact that the merging parties' customers are also their owners (which could conceivably incentivise the use of their services in preference to others) it would be expected that the increased profitability in downstream retail banking through reduced costs would ultimately outweigh any profit incentive for paying higher prices for payment processing services through a scheme owned by the bank.

41. Overall, the OFT believes that barriers to entry and expansion into the provision of payment processing services for both inter-account payments and ATM transactions in the UK are not insignificant.

Buyer power

42. The degree of common ownership/membership between processing companies and payment schemes means that customers of LINK and Voca (who are mostly banks and building societies) are likely to have a considerable degree of buyer power. In addition to this power, the degree of concentration in the retail banking market means that, even as individual customers, each large bank generates considerable payment volumes, which could help in negotiating further discounts where possible.
43. Furthermore, retail banks have an incentive to minimise the costs of payment processing as much as possible, given their role as commercial banks and therefore accountable to their own shareholders for creating value.
44. Most small customers of the payment schemes do not have such significant payment volumes and are therefore unlikely to be able to exert much negotiating strength through buyer power. However, the incentives of larger customers referred to above are such as to protect the smaller customers in respect of arrangements negotiated at scheme level.

VERTICAL ISSUES

45. The OFT considered whether any vertical theories of harm might be relevant in this case. For example, potential competition concerns might arise if the parties were to raise prices to the schemes they serve and therefore, their customers. As set out above, the parties' customers (who are mostly banks and building societies) are also members of the LINK and

BACS schemes and therefore it is unlikely they would approve what is effectively a price rise to themselves.

THIRD PARTY VIEWS

46. A number of third parties commented on the merger and any specific competition concerns have been dealt with above. As the majority of the parties' customers are the banks and building societies who are also members of the LINK and BACS schemes, it is not surprising that there were few overall concerns from this group. However, the OFT also received no other concerns from third parties outside the UK.

ASSESSMENT

47. LINK and Voca provide payment processing services, namely, the clearing and processing of ATM transactions and the clearing and processing of inter-account payments respectively.
48. Evidence obtained by the OFT from both the parties and third parties shows that the parties are not considered to be competitors for these core services. However, they each hold a strong competitive position in relation to their respective services provided to the LINK ATM Scheme and BPSL Scheme.
49. The OFT considered whether any horizontal theories of harm might apply in relation to the merger of LINK and Voca. Since LINK is not currently active in the supply of clearing and processing of inter-accounts payments and Voca is not currently active in the provision of payment processing services for ATM transactions, the merger is unlikely to alter the current competitive landscape or lead to competitive harm.
50. In particular, the degree of overlap between ownership of the parties and membership of the schemes they serve precludes the possibility of competitive harm being exercised as a result of the merger. For both parties, an increase in price or reduction in service quality is unlikely to be tolerated by those scheme members that are also owners of parties. It is unlikely that those scheme members that are not also owners of the parties will be harmed as a result of the merger due to scheme-level agreements of both prices and service levels.

51. Evidence regarding technological specifications, required scale and access costs has led the OFT to believe that barriers to entry and expansion into the provision of payment processing services for both inter-account payments and ATM transactions in the UK are not insignificant.
52. The degree of common ownership/membership between processing companies and payment schemes means that customers of LINK and Voca (who are mostly banks and building societies) are likely to have a considerable degree of buyer power.
53. Finally, the parties overlap in the supply of mobile phone top-up services but neither has a significant presence with a combined share of supply of only [zero to ten] per cent post merger. This, combined with the presence of a number of larger, alternative suppliers, has led the OFT to believe that no competition concerns will arise in respect of the supply of mobile phone top-up services.
54. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

55. This merger will therefore not be referred to the Competition Commission under section 33(1) of the Act.

ENDNOTES

1. The merger will be affected by two inter-conditional Court approved schemes of arrangement – rather than a Memorandum of Understanding.
2. The BACS Payment Schemes Limited (BPSL) did not exist prior to the restructuring. In fact, the BACS payment system was altered with the creation of a scheme administrator, BPSL, which was set up as a separate legal entity from Voca.